EU Sustainability framework implementation: remaining data challenges

Introduction by the Chair

The Chair welcomed everyone to the panel dedicated to the EU sustainability reporting framework implementation. This is an important topic given that the available data does not meet the criteria of quality corporate information and the landscape remains fragmented despite the efforts made by many. The risks posed by this situation include an inability to make decisions, communicate properly and greenwashing. The transition towards the different sustainability reporting regimes requires determination and patience.

The EU Corporate Sustainability Reporting Directive (CSRD) establishes a clear and comprehensive path forward. The European Sustainability Reporting Standards (ESRS) were adopted last July. EFRAG is working on implementation guidance, a digital taxonomy, the involvement of small and medium sized enterprises (SMEs) and the sectorial layer of reporting. From a jurisdictional standpoint it is better for global players to be coordinated. EFRAG has made every effort to ensure interoperability is achieved when elaborating the Sustainability Reporting Standards, and the ESRS disclosures embed the International Sustainability Standards Board (ISSB) disclosures, correspond to the Global Reporting Initiative (GRI) and are consistent with the Taskforce on Nature-related Financial Disclosures (TNFD) framework.

1. An unsatisfactory situation but progress is possible and will be helped by the interoperability between ISSB and ESRS

An industry representative stated that a successful transition by 2050 will require that the funding gap is filled, amounting to an investment of €4-6 trillion a year. Good, transparent data is required to enable sensible decisions around financing, investment allocation and risk management. Implementing the regulatory reporting disclosure frameworks will require a collaborative effort by industry players to provide better guidance and an improvement in data quality.

The more that global reporting standards can achieve interoperability the better, because the allocation of capital and impacts of climate change play out on a global level. There is an opportunity to create a broader sense of alignment across fundamental concepts that underpin the framework of EU sustainability regulation and achieve interoperability. Tools can help with digital tagging, classifications and technical mapping, bringing a good opportunity to solve these challenges.

In terms of the current EU landscape, an official agreed that global interoperability is important. The ISSB is working closely with EFRAG to ensure there is interoperability between ESRS and the ISSB standards, which is an important step forward. The ISSB and EFRAG work on digital reporting taxonomies is important to identify common disclosures and disclosures that are EU ESRS specific.

The Chair stated that in establishing a second pillar of standardised corporate reporting this needs to be in a format that is readable to humans, able to be consumed digitally, and interoperable with other frameworks. Every effort is being made to ensure that by complying with the mandatory regime in the EU companies will be reporting in accordance with the ISSB.

A regulator commented that there is a need for high quality, reliable data in relation to sustainability investments, greenwashing risks and climate risks in order to allow the proper supervision of the markets. ESMA has been experimenting with three data sets: ESG controversies, greenwashing-related complaints within the EU and AI technology. There are difficulties in terms of consumers understanding where there are greenwashing risks and no common definition of greenwashing.

This work will be impossible without the development of machine-readable information in regulated documents to extract information and to create greater accessibility. The European Single Access Point (ESAP) will bring all those documents together. ESG disclosures are an EU strategic supervisory priority and there will be a number of common supervisory actions to come.

A regulator commented that it is a huge leap forward that the ISSB and EFRAG are talking positively together, as it is important to ensure interoperability between EU and international standards to help support companies in their reporting. We are currently seeing a challenge around whether there is enough capacity for work on assurance but the International Organization of Securities Commissions (IOSCO) workstream is working hard on this with the help of 97 audit firms.

It is also important to start thinking about how data will be used and how it will be compared. The UK Transition Plan Taskforce (TPT) has published its disclosure framework, which is internationally focused and has credibility globally. It is important to try to use the language and metrics that are already there.

ESG data and ratings providers should be trusted sources of delivering sustainability data and assessments. It is therefore key for these providers to be transparent on the methodology, data sources and objectives of their products – as set out in the IOSCO's recommendations.

A regulator noted that much has been done in a short timeframe and this is promising, but the deadlines are urgent. Sustainability data reporting standards are evolving rapidly and firms are aware that it is relevant in busin ess operations decision-making which leads to increasing interest. The new reporting standards are bringing an enhanced equality, comparability and credibility of the sustainability data. The standardisation of ESG practices will allow easier comparison of sustainability performance across companies and assessing relative strengths and weaknesses, which enables the management of ESG risk more effectively.

The EU has been at the forefront of shaping new corporate sustainability practices and the Centre for Sustainable Delivery (CFSD) and the new ESRS are important steps to enhance the quality, comparability and credibility of sustainability data. The work on assurance and capacity building should proceed in parallel.

2. Challenges posed by the sustainable reporting standards

An industry representative commented that it is pleasing that EFRAG and the ISSB are coming closer together. A comprehensive framework for Europe is welcome, but it is not just ESRS that is being monitored with teams working across different jurisdictions.

First, the key issue is the interoperability and consistency of standards even within the EU. An energy performance certificate (EPC) is required to do loans, but not every country has the same EPC and some do not have a mandatory benchmark, even across the EU.

Second, there is a data gap where smaller companies often do not have comprehensive sustainability reporting available. The data does not exist on Scope 1, 2 and 3 greenhouse gases and so an estimate is prepared, but the method is not consistent across the board.

Third, there is a difference in approach to double materiality between the EU and other jurisdictions, which adds complexity. The Commission can assist by providing practical guidance on how to deal with this from the perspective of several jurisdictions.

It is the case that sometimes the private sector can bridge this data gap by bringing transparency and data comparability into the marketplace. The Net-Zero Data Public Utility has shown encouraging signs in providing a trusted and publicly available centre for company-level climate transition from a data perspective. It is necessary to be pragmatic, minimise the burden on reporting entities and bridge the perceived gap between the different ways of approaching this topic across jurisdictions.

A regulator stated that the new framework has been expanded, strengthened and digitised, which is a move in the right direction. There will be implementation challenges for smaller companies and for regulators. There will be a need for capacity building and infrastructure to properly regulate the market, but the new framework is a step in the right direction in terms of the quality of data.

A regulator stated that two things are needed for endeavours to be successful; first, stewardship is important to ensure people are using data in the right way. The UK does a great deal of work with the stewardship code, supervising asset managers and looking at what they are doing compared to what they are saying, which is important. Second, the FCA's SDR applies later this year. Clear, simple and accessible sustainability data will be key in ensuring the credibility of sustainability-labelled finance instruments and products. Products and stewardship are two areas that will make the transition a success, but a great deal more work is required.

A regulator highlighted several challenges as sustainability becomes more standardised and comprehensive. First, the standards are complex and require a number of indicators and metrics across different areas. Second, there are challenges with collecting, aggregating and verifying data around environmental impacts or social practices, which might undermine the credibility and usefulness of reports.

Third, any gaps in governance or a lack of clear accountability or broad oversight will pose a risk. Finally, competence gaps are linked to data availability. This can be addressed by strong commitment from top management, investment in employee training and collaboration and sharing best practice. There will need to be extra care and attention for SMEs as this is an impossible task for them.

3. What progress can we expect?

The Chair asked the panel when a steady state in terms of sustainability reporting will be achieved. An industry representative stated that all the right steps are being taken to make sense of climate data on a global basis. A more consistent effort is required around guidance and support to issuers and reporters because there are significant disclosure gaps and a lack of capacity and skills in SMEs. Scope 3 in particular is very complex and very volatile and there is a need for participants to lean into the set of recommendations issued by LSEG. It is important to be clear in all discussions that this is reporting with a very clear purpose.

The big hurdle remains with the corporates. In preparing its CSRD report, LSEG is looking at up to 1,100 different data points. This is a prompt that organisations will need a stronger handle on the data around transitioning and building more sustainable businesses.

An official stated that the first challenge is good quality standards and the second challenge is to ensure that those standards are consistently mandated and applied globally. IOSCO's endorsement of the standards last year was a huge step forward and it is important now to engage closely with regulators around the world to understand how those standards will be mandated. Guidance is being developed to assist jurisdictions to understand how to move the standards into a mandatory environment and this is an important step forward.

There will be a further iteration of a jurisdictional adoption guide published this week, with dozens of jurisdictions currently consulting. Moving to a consistent environment will not be perfect from day one, but it will come through pragmatic working across standard-setters, regulatory partners and other stakeholders.

The Chair commented that the EU is in a frontrunning position with the first reports being prepared for publication at the start of next year. It is a very good sign of convergence that the EU is embedding the ISSB disclosures on climate and S1, and that S1 mentions ESRS as a source for other disclosures.

4. Priorities for Progressing

An industry representative stated that pragmatism from the private sector and guidance from the public sector are the way forward.

An industry representative shared that a recent launch for a code of conduct for ESG ratings had almost 1,000 registered participants, a level of interest never before seen, demonstrating that the work across ESRS, disclosures, and labelling regimes is important to broader market participants.

An official emphasised that continued work is still needed. A regulator added that it is a continuous process that requires persistence in order to build capacity in terms of infrastructure and know-how.

A regulator stated that guidance from regulators will be key. We recognise that disclosures might not be complete first time round and companies are on a journey –and we know that learning will be part of the process.

A regulator stated that the key priority is to support companies to adapt to the new framework and embed positive changes within the organisation.

5. Conclusion by the Chair

The Chair summarised the comments made by the panel. First, regulations and reporting requirements are being established for certain parts of the economy while other parts are not submitted to the same rigour. There is now a reasonable basis from which to address the quality of sustainability-related data with the interoperability between the ESRS, ISSB and GRI. In the chain of production data it is necessary to start with the right standards, implement them using management and governance processes, after which comes assurance, the enforcers and market participants.

There remains an element of scepticism in the EU, but implementation has started with the quality of data. This is a test phase and the standards will be refined over time. It is unclear how long it will take to digest this and make it a success. There was scepticism when IFRS was adopted in the EU, but everybody delivered at the end of the day and there is reason for optimism that this delivery will happen in the EU.

One element of the economy that is not taken on board is the world of SMEs. There is a draft voluntary standard for SMEs, providing basic information for their management purposes, but there are 20 million or more SMEs. It is hoped that the data platform will be considered the right one, but if more data is required it should be one or two extra sets. It should not be expanded because the better is the enemy of the good. It is time for those involved to make it happen and the general public to adjust. This pragmatism can bridge the perceived gap between the different ways of approaching this topic across jurisdictions.