

2 February 2024

EBF RESPONSE

EFRAG ESRS IMPLEMENTATION GUIDANCE CONSULTATION

General Comments

The European Banking Federation (EBF) welcomes EFRAG's development of the ESRS implementation guidance considering the significant complexity of the standards and the importance of ensuring the preparation of comparable and qualitative disclosures. The future and timely elaboration of specific guidance for financial institutions would be equally important and necessary given the fundamental role they have in financing the global economy.

Although EFRAG states that it "*plans to work on the development of further draft standards or guidelines for Financial Institutions and on that occasion, specific solutions will be consulted on for comments*"¹, it is currently unclear when such clarification will be developed and available. The lack of specific guidance leaves a series of questions on key concepts introduced by the ESRS unanswered, although the implementation phase has already been initiated. While a 3-year phase-in is foreseen for value chain reporting, we expect that a specific standard for banks that provides clarification will be published by EFRAG in the future.

Furthermore, it would be appreciated that EFRAG continue its work with the ISSB in the development of guidelines to ensure alignment to the level that the ISSB standards can be applied by internationally operating financial institutions as a global baseline for sustainability reporting.

Specific Comments

1) Materiality assessment implementation guidance IG 1

- As there are no practical examples regarding the implementation of the Double Materiality Assessment (DMA). We would suggest the inclusion of practical examples for various industries regarding the implementation of the DMA. Amongst the examples on how the materiality assessment should be performed and how IROs should be reported it would be appreciated if there could be concrete examples on how to:
 - Identify material IROs;
 - Complete the list of sustainability matters indicated in ESRS 1 paragraph AR 16;
 - Connect materiality sustainability matters to the corresponding IROs, as indicated in paragraph 77 of IG 1;

¹ FAQ 2, paragraph 78, *EFRAG Draft IG 2: Value Chain Implementation Guidance*

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- Apply criteria “to determine the material actual and potential impacts, and material risks and opportunities”, as indicated by paragraph 80 of IG 1.

Moreover, comprehensive examples would be appreciated regarding how to consult stakeholders, how to collect and analyze their answers and ultimately, how to use their answers to inform the due diligence process.

All stakeholders would benefit from an EFRAG document providing a comprehensive example that would illustrate all steps (definition of material topics, materiality assessment, consultation of parties, reporting) that a company should follow in order to produce a qualitative report.

- Matters versus material information requires further clarification.
- Materiality is relevant not only at topic level but also with reference to the single data point/information requested. However, in IG 1 it is not clear when a single data point within a material topic can be considered non-material. EFRAG is asked to provide examples/indications on the materiality/non-materiality of a single data point within material topics in order to guarantee greater homogeneity and objectivity in the approaches adopted by preparers and therefore comparability between disclosures, especially between companies belonging to the same sector. This is especially needed in the short-term in the absence of sector-specific standards.
- Materiality is assessed from the point of view of the affected stakeholder(s) (see FAQ 1 IG 1). EFRAG states that decision usefulness is related to the primary users of financial statements and for other users whose “interest” is in the undertakings impact. “Interest” needs further analysis and further clarification as it could otherwise be potentially interpreted very broadly. For primary users of general financial information decision usefulness is clearly defined as the decision making on whether or not to invest in an entity, but a clear definition of “interest” is also needed.
- Paragraph 30 (IG 1) explains that the “MA process (including criteria and thresholds applied and conclusions) should be consistent with internal and other external reporting. Consistency with sustainability management policies and actions is also required, including those fulfilling sustainability-related laws and regulations”.
 - a. Can EFRAG explain what “other external reporting” are targeted in paragraph 30 (IG 1)? We understand that financial statements and reporting are not targeted, because paragraph 124 (IG 1) explains that “the materiality assessment cannot be limited to the scope of financial effects that affect (or will affect in the future) items recognized in the financial statements”. FAQ 3 (IG 1) further specifies that the material information for financial statements is not the same as for the sustainability statement. Could this be confirmed?
 - b. Similarly, clarification on which “sustainability management policies and actions” are targeted in paragraph 30 (IG 1) is needed.
- Paragraph 54 (IG 1) explains that companies shall apply a “filter of materiality of information” to determine the granularity of the description of the policies, actions and targets. We understand that “filter of materiality” is a new concept that has been introduced in the guidance, but does not exist in the ESRS, and i.e., paragraph 30 of ESRS 1 does not require undertakings to apply a materiality filter when disclosing information on policies, actions and targets:

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“the undertaking shall include the information prescribed by all the Disclosure Requirements and datapoints in the topical and sector specific ESRS related to that matter and in the corresponding Minimum Disclosure Requirement on policies, actions, and targets required under ESRS 2”. We kindly ask that this concept be clarified or deleted if it introduces new requirements.

- FAQ 12 (IG 1) (*“Should the materiality assessment be documented/evidenced?”*) explains that *“the ESRS do not prescribe specific documentation”*. At the same time, the introduction of mandatory assurance for the sustainability statement implies that companies should be able to explain how the materiality assessment is performed. We believe that EFRAG should further clarify what is expected from undertakings.
- With reference to both figure 1a), page 11 (IG 1), where EFRAG illustrates the interaction between impact and financial materiality, and the box on page 14, it is explained that *“**most of the materials** also give rise to financial risks and/or opportunities”*. The latter merits further clarification, and in particular what is meant by *“materials”*. In paragraph 35, it is stated that *“impact materiality and financial materiality are **often** intertwined”*. However, practical examples where impacts do not result in financial effects either over the short term, medium term or long term are not provided. It is argued that impacts (on people and the environment) will always lead to financial effects over a period of time, however these impacts might not be reported in general purpose financial information given that they do not meet the criteria for recognition for the required timeframe of that information. Additionally, in this section it would be useful to include more practical examples of differences between financial materiality for the financial report and that for the sustainability report, for example:
 - How and what are the external reports that are related;
 - Multisectoral materiality assessment;
 - Consistency and definition of thresholds within a group;
 - Aggregation of material impact.
- In FAQ 23 (IG 1) EFRAG clarifies that in the DMA, impacts are assessed on a gross basis. However, it is not made clear how to apply laws in place to mitigate the effects of the impacts. Clarification is needed and we suggest providing a practical example of gross assessment of impacts when a legal structure is in place to prevent impacts (e.g., assessment of impacts on social for countries where labour laws are in place and where labour laws are not in place).
- On stakeholder engagement EFRAG refrains from providing behavioural guidance for the DMA. However, the OECD Guidelines for Multinational Enterprises and OECD Due Diligence Guidance for Responsible Business Conduct are extensively referred to. Such guidance, however, only pertains to tier one of the value chain (direct counterparties), whereas EFRAG states that the value chain goes beyond the first tier (e.g., para 148 IG 1 *“including beyond first tier”*). We kindly ask to provide practical examples on how to assess impacts directly linked to the undertaking’s operations, products, and services caused by other tiers in the value chain of a business relationship.
- In paragraphs 58-59 (IG 1), EFRAG states that the datapoints in ESRS 2, Appendix B, are treated similarly to other datapoints for the purpose of assessing the information to be reported on a material matter, i.e., those related to policies, targets and actions follow ESRS 1 paragraph 33, and those

related to metrics are omitted if not material (ESRS 1 paragraph 34). This statement is factually correct but considered poor guidance for the thousands of entities with significant external investors and/or significant external funding. These entities' investors and lenders will most likely consider material those datapoints stemming from SFDR PAI indicators, CRR Pillar 3, etc. Thus, EFRAG's guidance should reflect the importance of engaging with these users/stakeholders before deciding to omit any of the datapoints in ESRS 2, Appendix B.

- Paragraph 218 (IG 1) states that the materiality assessment of potential impacts can consider the effect of technical or other measures for avoiding or (otherwise) mitigating impact in the future, under the assumptions stated. However:
 - Example (a) states that if a treatment technique is available and the undertaking plans to install it may disclose this as part of its management of the material impacts but cannot take it into account in the materiality assessment. Does this mean that even under the assumptions stated (treatment technique is technically feasible, economically viable and accurately described in the report, appropriate management decisions are already taken and effective implementation does not depend on third party decisions) the materiality assessment should be done on a gross basis? Is our understanding correct that "can consider" does mean that mitigating measures cannot be taken into account in the materiality assessment but can only be disclosed as part of the management of potential material impact?
 - Example (b) relates to the case of an ocean oil spill or a failure of an emission treatment facility. Are these potential incidents with a potential impact (as the heading of paragraph 218 relates to potential impacts)? Is our understanding correct that in case of a potential oil spill the existing emergency plans which aim to minimize the potential negative impact also cannot be taken into account in the materiality assessment but can only be disclosed as part of the management of potential material impact?
- FAQ 23 (IG 1) relates to environmental impacts and paragraph 220 (IG 1) refers to similar questions related to social matters, for which guidance may be issued in the future. Such guidance is important for undertakings in performing their materiality assessment.
- FAQ 23 (IG 1) relates to environmental impacts. Do the same principles apply to (environmental or other) risks? If measures to prevent risks (e.g. policies, training, etc.) cannot be taken into account, would this lead to almost every risk being material?

2) Value chain implementation guidance IG2

- In the future, when clarification is provided for financial institutions' value chain, practical examples for financial institutions will be needed as well taking into consideration the specificities given by banks' relation with their counterparties. With respect to the definition of the boundaries of the value chain, which is very complex for a financial institution (particularly if multi-business), it is required to give further indications that further limit the perimeter of the value chain that a company should consider (e.g. only the relevant part of value chain)

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considering the feasibility of data collection, the critical issues regarding the quality and reliability of the same, use of estimates and also data deriving from infoproviders.

- In paragraphs 16-17 (IG 2), EFRAG provides general guidance on the identification of the actors in the value chain (VC) and whether they should all be considered. Given the specific nature of the role of financial institutions (e.g., financing of the global economy), they are connected to a wide diversity of actors beyond tier 1 and therefore the material (potential) impacts, risks and opportunities related to them. Financial institutions, by means of financing direct business relations, have an opportunity to leverage this business relationship to pursue sustainability objectives. However, financial entities do not have any legal rights or contractual arrangements to use as influence to obtain information from the extended value chains of their direct counterparties regarding their IRO's. Please provide guidance on the application of these paragraphs for financial institutions. Also, we would find it helpful to have more clarity and a clearer definition with examples of indirect business relationships.
- Scope of "own operations" ("the reporting group"): does this include subsidiaries excluded from the financial reporting consolidation on the basis of materiality? The answer is not clear considering the differing information provided as illustrated below.

Paragraph 34 (IG 2) refers to ESRS 1 paragraph 62 which states: "*The sustainability statement shall be for the same reporting undertaking as the financial statements*". In the Accounting Directive, a group is defined as "*a parent undertaking and all its subsidiary undertakings*". ESRS 1 par. 62 continues: "*For example, if the reporting undertaking is a parent company required to prepare consolidated financial statements, the sustainability statement will be for the group*".

ESRS 2, BP-1, par. 5 (b) (i) states: "The undertaking shall disclose (...) a confirmation that the scope of consolidation is the same as for the financial statements (...)".

Paragraph 36 (IG 2) states: "*Sometimes subsidiaries are excluded from the financial reporting consolidation on the basis of materiality, for practical reasons. Please refer to the MAIG chapter 5.2 FAQs on financial materiality for considerations of these for the sustainability statement*". It is not clear to us to which paragraph or sentence of MAIG chapter 5.2 is referred to.

In the table in paragraph 52 (IG 2) is stated that (for the treatment of impacts arising from investments) subsidiaries are "*fully included (scope of consolidation is the same as financial reporting)*". The table does not mention the subsidiaries excluded from the financial reporting consolidation on the basis of materiality.

Therefore, considering the above, it is not clear whether or not subsidiaries which are excluded from the financial reporting consolidation on the basis of materiality are part of "own operations". The potential answers could be:

- yes, always, as they are a subsidiary and thus part of the group, or
- no, because they are excluded from the financial reporting consolidation on the basis of materiality, and the scope of consolidation for the sustainability statement should be the same as for the financial statements, or
- other

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If these subsidiaries would not be part of “own operations”, should they be treated as a business relationship in the value chain and/or as an actor in the value chain. Please also see the questions below regarding business relationships.

- Clarification is needed regarding the difference between “business relationship”, “business relationship in the upstream/downstream value chain” and “actor in the value chain”.

Paragraph 26 (IG 2) refers to Annex 2 which defines business relationships as “[t]he relationships the undertaking has with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services. Business relationships are not limited to direct contractual relationships. They include indirect business relationships in the undertaking’s value chain beyond the first tier, and shareholding positions in joint ventures or investments”.

Question 1:

The box on page 8 (IG2) states: “However, there are other entities and individuals that are connected to the undertaking’s operations, products and services without being “suppliers”, e.g., local police protecting the undertaking’s assets, as they may cause an impact by e.g., using excessive force on people trespassing. In this case, there is no business relationship, but there is a value chain impact. It may meet the materiality threshold if it is considered severe enough”.

The definition of “business relationship” encompasses “any other non-State or State entity directly linked to its business operations, products or services”. Why is the local police protecting the undertaking’s assets not caught by this definition? If the local police is not a business relationship, how can impacts caused by the local police constitute “value chain information” to be reported, having regard to the definition of “value chain information” (in ESRS 1, 63) which is “information on the material IROs connected with the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain”.

Question 2:

The definition of “business relationship” encompasses “relationships with business partners” but there is no definition of “business partners”. Can this concept be clarified? Does “business partner” include entities only, or also individuals? E.g., does an impact caused by an individual (customer) buying products or receiving services from the undertaking constitute an impact connected with the undertaking through a business relationship?

- Clarification is needed on the difference between “business relationship” and “business relationship in the upstream/downstream value chain”.

The ESRS and the draft IG 2 sometimes refer to “business relationships” and sometimes refer to “business relationships in the upstream/downstream value chain”.

Shareholding positions in joint ventures or investments are business relationships (as per the definition of “business relationships”). ESRS 1 paragraph 67 states “When associates or joint ventures (...) are part of the value chain, for example as suppliers (...)”. This indicates that business relationships are not always part of the value chain.

On the other hand, FAQ 2 (IG 2) seems to contradict ESRS 1, 67 as it appears to imply that (equity) investments (which includes associates as FAQ 2 sub-point 3 refers to paragraph 49) are automatically considered to be business relationships in the value chain:

“FAQ 2: Are financial assets (loans, equity and debt investments) considered business relationships that trigger VC information?”

75. Yes. Business relationships and VC as defined in Annex II of the July 2023 delegated act does not exclude any types of activities and business relationships.

76. ESRS 1 AR 12(b) illustrates that where the reporting undertaking provides financial loans to another enterprise that ultimately results in the contamination of water and land surrounding the operations of such enterprise, this negative impact is connected with the reporting undertaking by way of the relationship created by the loan agreement.

77. Per paragraph 49, for equity investments there is currently only disclosures under Category 15 of GHG emissions where significant under ESRS E1”.

Stating that investments are business relationships that trigger VC information implies that investments are business relationships in the upstream/downstream VC, having regard to the definition of “value chain information” (in ESRS 1, 63) which is “information on the material IROs connected with the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain”.

Is there a difference between both concepts, or are business relationships (including joint ventures, associates and other investments) always deemed to be part of the upstream/downstream value chain?

- Difference between “business relationships in the value chain” and “actors in the value chain”?

The ESRS and the IG 2 sometimes refer to “business relationships in the value chain” and sometimes refer to “actors in the value chain”. “Actors in the value chain” are defined (see paragraph 23 IG 2) as individuals or entities which receive products or services from the undertaking (e.g. distributors, customers) or provide products or services that are used in the production of the undertaking’s own products or services (e.g. suppliers).

The draft IG2 discusses:

- in paragraph 38 (IG 2), the situation where associates and joint ventures are also actors in the value chain, such as when they are customers or suppliers: then they are treated as any other business relationship in the value chain;
- in paragraph 48 (IG 2), the situation where associates and joint ventures are part of the value chain, for example as suppliers or customers: then they are treated as any other business relationship in the value chain; and
- in paragraph 49 (IG 2), the situation where associates and joint arrangements (= joint ventures?) do not form part of the value chain as suppliers or customers: then they are treated as investments.

As paragraphs 38 and 48 (IG 2) seem to discuss the same situation, “actors in the value chain” and “(business relationships) part of the value chain” seem to have the same meaning. Is this correct?

Why is there an asymmetry between on the one hand paragraphs 38 and 48 (IG2) “for example as suppliers or customers”, and on the other hand paragraph 49 (IG 2) “as suppliers or customers (only?)”? How should an associate/joint venture which is a distributor be treated?

Paragraph 50 (IG 2) discusses “other investments, no further transactions”. The table in paragraph 52 (IG 2) does not make a distinction between investments with/without further transactions. Is it required to check whether the investee company is an actor in the value chain of the reporting undertaking, just as for associates and joint ventures?

- When the reporting undertaking has a participation in an associate/joint venture or another type of investment it has a “business relationship” with the associate/joint venture/investee (as per the definition of business relationship). The first question is whether it is always a “business relationship in the value chain”. The second question is whether a “business relationship in the value chain” has the same meaning as an “actor in the value chain”.

Paragraph 38 (IG 2) states that when associates/joint ventures are not actors in the value chain, the reporting shall consider the investment relationship as potential source of material IRO. Paragraphs 49-50 (IG 2) state in the same way that investments form part of the undertaking’s business relationship and that as such, they may give rise to impacts that are connected with the undertaking and that are to be considered in the MA and reported when material.

Can it be clarified how this relates to paragraph 37 (IG 2) which states: “The information about material IROs of the parent and subsidiaries (...) is ‘extended’ to cover VC information. VC information is defined in ESRS 1 paragraph 63 as information on the material IROs connected with the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain”.

Do paragraphs 38, 49 and 50 (IG 2) imply that:

- an investment is always a “business relationship in the upstream/downstream value chain” and therefore always needs to be taken into account in the DMA and thus can lead to the reporting of VC information? ESRS 1, paragraph 63 only requires the reporting of material IROs connected with the undertaking through its “business relationships in the upstream/downstream value chain”;
- as opposed to what we would conclude w.r.t. the question above, “business relationship in the VC” is not the same as “actor in the VC”;
- at this moment the ESRS do not have specific reporting requirements on impact metrics (except for cat 15 of GHG protocol) for investments:
 - Does this mean that no impact metrics need to be reported?
 - Does this mean that (apart from impact metrics), material IRO connected with the undertaking through its investments need to be reported?
- If the subsidiaries excluded from the financial reporting consolidation on the basis of materiality would not be part of “own operations”, and considering that the reporting undertaking has a participation in the subsidiary, which of the following is the correct interpretation:
 - it has a “business relationship” with the subsidiary (as per the definition of business relationship);

- first question is whether it is always a “*business relationship in the value chain*”;
- second question is whether a “*business relationship in the value chain*” has the same meaning as an “*actor in the value chain*”.

Should we then apply to these subsidiaries the same answers to the questions relating to joint ventures/associates/investments (see above)?

- If the subsidiaries excluded from the financial reporting consolidation on the basis of materiality would not be part of “*own operations*”, are they deemed to be under operational control of the parent?
- With reference to FAQ 1, and paragraphs 33 and 53 (IG 2) - EFRAG seems to allude that the identification of the IRO’s in VC goes beyond the first tier only in the supply side (upstream) of the VC. Is this intentional or does EFRAG also extend the VC beyond tier 1 for the downstream side of the VC (based on the answer this should be clarified in IG 2)? Some of the examples provided in under this FAQ and FAQ 7 may set too broad a value chain and fail in defining limits. Also, the examples provided are mainly focused on the upstream value chain and on the climate and environmental dimension, while it would be useful to have examples covering the social and governance dimensions as well. Finally, it would be appreciated if, in the future, EFRAG provide practical examples on how such identification in the downstream side of the VC would apply for financial institutions.
- The guidance on the transitional requirements does not provide sufficient clarification on the requirement in ESRS 1, paragraph 133. What information should an undertaking provide, if it does not have sufficient reliable in-house data for reporting on the full value chain, but nevertheless is expected to report on all datapoints derived from other legislation, as listed in ESRS 2, Appendix B (see ESRS 1 paragraph 133b) during the transitional period. We suggest adding that the undertaking in this situation shall apply the requirements mentioned in paragraph 60 (IG 2)– i.e. give explanations on efforts, plans etc.
- The notes in paragraph 156 (IG 2) that complement the *VC coverage map of Set 1 ESRS* (paragraph 155) include a reference to E5-6 “*Waste treatment may sometimes require information from supplier who treats waste*”. However, there is no reference to E5-6 on the value chain mapping table.
- The *VC coverage map of Set 1 ESRS* (paragraph 155 IG 2) includes in point 7 “*Disclosure of procured materials*” reference to E2-5 and E5-5. However, there is no specific definition of the VC coverage of this disclosure on the mapping table.
- ESRS S1 relates to disclosures on own workforce and we would expect it to be classified as own operations. On that basis we would not expect any VC coverage. However, the *VC coverage map of Set 1 ESRS* (paragraph 155 IG 2) includes on row 4 reference to S1-1 to S1-5 with a requirement for VC coverage and repeated in row 6 as no requirement for VC coverage. This needs to be clarified and/or corrected.

3) Detailed ESRS datapoints implementation guidance and accompanying explanatory note

- EFRAG is kindly invited to provide examples for financial institutions as well taking into consideration the specificities given by banks’ relation with their counterparties. With respect to the definition of the boundaries of the value

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chain, which is very complex for a financial institution (particularly if multi-business), it is required to give further indications that further limit the perimeter of the value chain that a company should consider (e.g. only the relevant part of value chain) considering the feasibility of data collection, the critical issues regarding the quality and reliability of the same, use of estimates and also data deriving from infoproviders.

- EFRAG should consider incorporating explanatory notes and a key for cell colours into the spreadsheet at the appropriate points. This would facilitate the user's reading of the content and understand the purpose of the information in the spreadsheet. It would improve usability by ensuring that each page can be understood on a standalone basis, without the need go back and forth between the spreadsheet, standards and appendices. An example is in Column F which is supposed to indicate the XBRL data type rather than describing what the nature of the disclosure point is/ what data needs to be collected. In the majority of cases, these two things match up but there are examples where it may cause confusion, e.g. ESRS E4-1 point AR 1(e).
- It would be useful that in the excel it is made clear which data points are mandatory, which are subject to materiality assessment, and which are voluntary. Where a phase-in option allows a reporting entity to either: (i) make the full disclosure; (ii) omit disclosure in full in year 1 or (iii) provide qualitative disclosure in year 1, EFRAG appears to have reflected it in the spreadsheet by marking quantitative data points (and related qualitative disclosure points that are linked to the quantitative disclosure points) as subject to phase in but the qualitative disclosures as not subject to phase in. We assume that this is to highlight the points which would need to be disclosed if you were making a qualitative disclosure but, because there is no phase in marked, it appears as though the point is mandatory. See e.g. ESRS E1-9 para AR 69a. In addition, in the phase-in column of the excel, apart from Y / N, the year (1, 2 or 3) could also be included to make the information more complete.
- For the sake of consistency in approach, we would suggest that a new column is introduced in the datapoints spreadsheet to identify whether the datapoint is related to own operations or requires VC coverage.
- Some rows should be clarified. In ESRS E1 items under E1-6 in blue (rows 114-123), it's not clear to which table those requirements refer to. If they refer to the table of AR48, it would be useful that it is specified - see below example with proposed guide in red:

E1	E1-6	51	AR 46	Gross Scope 3 greenhouse gas emissions	Table/GhgEmissions
E1	E1-6	51	AR 46	The undertaking shall disclose its total GHG emission: Gross Scope 3 greenhouse gas emissions based on the GHG protocol categories, Accounting and Reporting Standard or EN ISO 14064-1:2018 Annex H.3.2 in line with table categories 1-15 specified under Application Requirement 48	Table/GhgEmissions

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About EBF

The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from across Europe. The federation is committed to a thriving European economy that is underpinned by a stable, secure, and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere.

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