

Comment on the DRAFT EFRAG Implementation Guidance – IG 1 Materiality Assessment

General comments on EFRAG ESRS Implementation Guidance

We appreciate that EFRAG is supporting preparer's ESRS application with its non-authoritative implementation guidance. To our understanding the disclaimer that "if anything in this guidance appears to contradict any requirement or explanation in ESRS, ESRS takes precedence." forms an integral part of the guidance paper. For the finalization of the document, it might be worthwhile to make that intention even more clear and to consider the following recommendations to not being understood to go beyond the ESRS requirements. In general, GDV considers that the draft Materiality Assessment Implementation Guidance (MAIG) and draft Value Chain Implementation Guidance (VCIG) do not need any major amendments at this stage. It is reaffirmed that the specificities of the insurance sector need to be taken into account for the development of sector specific guidance.

Differentiation between recommendations and requirements

The implementation guidance papers include a disclaimer saying that "if anything in this guidance appears to contradict any requirement or explanation in ESRS, ESRS takes precedence". However, from our perspective several passages in the documents go beyond the ESRS requirements or do not clearly align.

To ensure consistent application, it would be beneficial to align the use of terms "shall" and "may" with those in the ESRS. For instance, the guidance papers sometimes employ "shall" or "should" in contexts where the ESRS does not mandate such requirements. This could cause confusion for organizations implementing these guidelines. Therefore, we recommend reviewing the documents to ensure they align with the ESRS. Specifically, the wording should be adjusted to more clearly indicate when the Implementation Guidance (IG) is merely providing a recommendation (i.e., avoiding the use of "shall" or "should" in the IG when these are not explicitly mandated in the ESRS).

Examples:

- §30: We would recommend a concretization of how this is meant as well as based on which DR/AR this is deduced. From our perspective, the existence of e.g., voluntary reporting on a topic that is e.g., only relevant only for specific users, or the existence of a policy that covers several sustainability topics should not automatically entail that the reporting undertaking also has material impacts on each of the included topics.

- §67: the requirements of SBM-1 do not apply to the process of the materiality assessment but address general disclosure requirements. Therefore, we suggest to adapt the wording to better reflect this fact. The ESRS do not require an analysis of e.g., the business plan or financial statements as part of the materiality analysis; an understanding of the activities and business relationships however is implicitly necessary for the identification of IROs.
- Chapter 4.2 makes use of references to DR in the ESRS that do not explicitly cover ESRS requirements on the materiality analysis. This could be misleading for implementing undertakings. Therefore, we strongly suggest screening the documents for the alignment with the ESRS and to adapt the wording in a way that more clearly reflects where the IG only states a recommendation as part of the implementation guidance.

Providing contextual information

We recommend reviewing the interpretation guidance for misleading statements which are lacking contextual information. If relevant information is left out or requirements with regards to content, application or disclosures are mixed up, preparers might be misled.

Examples:

- § 135: ESRS 2 requires additional entity-specific disclosures (qualitative and/or quantitative), in the case the undertaking concludes that an impact, risk or opportunity is not covered or not covered with sufficient granularity by an ESRS but is material due to its specific facts and circumstances. While metrics are therefore only to be disclosed, when appropriate and deemed necessary under ESRS, MAIG, § 135 concludes that “While for ESRS preparers the use of SASB standards is optional (as this is a possible source of disclosure, but not the only one), the provision of entity-specific disclosure including sector metrics is a requirement (see ESRS 1 §11, AR 1 to AR 5).” per se.
- FAQ #25 on the Taxonomy: We appreciate the effort to identify similarities between these two pieces of legislation. However, we believe that such comparisons should not be included in the MAIG, except for mentioning the EU Taxonomy as potentially valuable sources of information.

ESRS alignment of definitions and requirements

To serve its purpose it is crucial that the implementation guidance is aligned with the ESRS requirements, esp. with regards to the terms used or the illustrations that are developed. Therefore, the IG should use precise wordings and illustrations in line with ESRS. For instance, the following statements are deemed to being contradictory to the ESRS requirements or do not clearly align.

Examples:

- Figure 1c) green box: The illustration could suggest that the materiality of a matter e.g., triggered only by impact materiality or financial materiality also results in a disclosure obligation vice versa. We suggest adapting the illustration by splitting the green box.

- Figure 2: While we appreciate that it has been added that the figure refers to an example at a granular level, it should be clarified very specifically that the impact could also be identified at topic, sub-topic or sub-sub-topic level, depending on the relevant circumstances (e.g., the more distant in the value chain, the less granular information available). In general, there is a need for full transparency regarding the possibility of identifying material IROs at various levels across sustainability topics.
- Figure 5: According to ESRS, only for Human Rights severity takes precedence over likelihood. Therefore, the matrix illustration from our perspective does not fully align with the ESRS. Moreover, the color-coding in the matrix suggests that a reporting obligation is also triggered for impacts that are very unlikely but highly or even medium severe. The same applies to impacts that are very likely but low in severity. From our perspective, triggering a reporting obligation for such impacts does not align with the principle of materiality of information. We suggest removing the matrix as it raises many open questions rather than providing additional implementation guidance.
- FAQ #19: We suggest to completely delete this question: While we acknowledge that following the segment approach is not generally marked as forbidden by the FAQ, we do not agree with the “negative” wording overall. Segment reporting can form a good starting point where the management approach makes sense also in the sustainability reporting context. This may clearly not always be the case, but it may often lead to better information than following a sector classification (e.g. where the segment view leads to higher granularity than the (draft) ESRS SEC 1 view. Also, the clear benefit would be consistency in the structure in financial and sustainability reporting. This may be beneficial for users also in terms of understandability, as introducing a new approach will also increase overall complexity. As this question goes beyond pure interpretation guidance and contains evaluation elements pertaining to a specific approach – which implementation guidance should generally refrain from – we suggest to completely delete this question.
- FAQ #22: The proposed answer mixes the issues of scope and disaggregation. The fact that topical ESRS partly allow for flexibility on disaggregation can and should not automatically be linked to the likely very common case in which materiality of a matter mainly stems from one subsidiary (or a group of subsidiaries) but not others. In this case, significant additional burden would arise for collecting the information also for subsidiaries that do not significantly contribute to the materiality of the matter. This would cause undue effort esp. where considering the subsidiary as in scope would in substance not change the reported metric (as the incremental increase (or decrease) would be close to nil). Such an argumentation is also in line with the general exemption rule for subsidiaries and the principle of reporting on significant differences – subsidiaries that do not significantly contribute to the materiality of a matter would also not report on this matter from a solo reporting perspective, nor would reporting on significant differences be triggered, as on Group level the respective matter / metric is disclosed. The possibility to use estimates should apply here – e.g., to assume zero for those subsidiaries for which there is robust evidence that the metric would be close to zero and/or to extrapolate for small entities of the Group based on one exemplary subsidiary for which the matter is (also) immaterial. We would therefore strongly suggest to adapt the answer accordingly, or alternatively delete it altogether, as general

materiality considerations on subsidiaries contribution to reported metrics and matters anyway apply (i.e. clarification not necessarily required).

- FAQ #23: We strongly recommend allowing companies to decide whether to report the effects on a gross or net basis. We agree with EFRAG that the identification of impacts should be based on a gross assessment; however, the qualitative characteristics of information as set out in Appendix B of ESRS 1 should guide the decision whether to report on a gross or a net basis. When it comes to reporting, presenting impacts on a gross basis is neither relevant nor faithful if the probability of those impacts is very low. For example, a sustainability report that contains numerous topics that are not actually associated with any risks or impacts after considering avoidance measures might not meet the characteristic of faithful representation because it could obscure relevant information from the users of sustainability reports. Reporting would not provide any additional information for stakeholders if measures already implemented to avoid impacts were not considered when disclosing impacts or potential impacts. In addition, this is likely to lead to a high amount of boilerplate disclosures. For example, many risks (such as political stability, skill shortage or supply chain disruption risks) apply very broadly, across markets, countries and/or sectors. For users, it is decisive how those risks are dealt with in the entity-specific context and what residual risk remains.
- Page 5, point 3: We strongly suggest adding the following clarification: This entity-specific disclosure shall complement the disclosures as required per the ESRS, however, the latter shall not be amended in terms of deviating from the relevant ESRS provisions. For example, if a certain entity deems the scope of scope 1 GHG emissions as inadequate and would deem it more appropriate to include or exclude a category to better reflect the entity-specific context, it shall nevertheless (only) report scope 1 GHG emissions as required under ESRS E1 and the GHG Protocol. In a similar vein, if a metrics only covers own operations, companies shall not include value chain information in this metrics (but consider providing additional information in the entity-specific layer). I.e., to reflect entity specifics, ESRS-defined metrics are not to be changed.

Approach Impact Materiality Analysis

Comments on chapter 3: How is the materiality assessment performed?

- Figure 4: We suggest clarifying the approach stipulated in Figure 4. We suggest to add an example in which only one of the criteria is above the materiality threshold (high or medium-high). Moreover, EFRAG should emphasize more clearly in the MAIG that this representation is only one of many possibilities. We recommend incorporating an additional explanation to paragraph 117, regarding both potential impacts (section 3.6.2, §119) and actual impacts (section 3.6.1, §117). This would involve a suggestion to possibly simplify the depiction by combining the three severity factors.

Comments on chapter 5.3 FAQs on the materiality assessment process

- FAQ 12: Should the materiality assessment be documented/evidenced?
In accordance with the principles of flexibility and proportionality established in the CSRD and ESRS, we propose a wording that reflects these overarching principles. We suggest amending the text in paragraph 176 to indicate that, while the ESRS do not explicitly mandate specific documentation, it may be prudent in certain cases to maintain some documentation for internal purposes.