



Feedback to EFRAG's consultation on LSME ESRS Exposure Draft

WWF European Policy Office

WWF European Policy Office welcomes the opportunity to provide feedback to the ESRS for LSMEs to ensure the reporting requirements are relevant to the objectives, scale, capacities and characteristics of the LSMEs, with a wider view of helping them access finance and ensure resilience to material sustainability matters.

It is critical to maintain the elements of the proposed LSME standard, which are necessary to support LSMEs better benefit from the EU's sustainable finance framework. This primarily includes the need to:

1. Keep the disclosures required by other EU legislations also included in ESRS sector-agnostic standards, notably the SFDR, Benchmarks regulation and CRR-CRD Pillar 3.
2. Preserve the materiality assessment process to identify material impacts and risks in both own operations and the value chain (note that the lower complexity of the LSMEs also means a lower complexity of the materiality assessment).
3. Maintain the disclosure requirements on sustainability due diligence processes, which the reporting LSME can report on only in case they have one.

The proposed LSME standard, however, significantly differs from the sector-agnostic ESRS. The discrepancies are both on the levels of disclosure requirements and specific data points within the disclosure requirements (e.g. for the governance elements of the General Disclosures, or climate and environment-related disclosures, as exemplified below). Such differences hinder investors' and financial institutions' ability to adequately assess and compare LSMEs to other firms reporting under sector-agnostic ESRS, and subsequently increase the risks of:

- Restricting LSMEs' access to credit and investments,
- Increasing LSMEs' reporting burden, as LSMEs would not only have to comply with LSME ESRS reporting requirements, but also face requests for additional information from financial institutions who need the same information as they have for the larger listed companies reporting under ESRS sector-agnostic standards.

Considering the above, the multiple changes that have been made to pursue simplicity actually harm the simplification, standardisation, comparability and hence effectiveness and use of the disclosures for the LSMEs. In addition to complicating access to finance, the differences between LSME ESRS and ESRS Set 1 requirements hinder LSMEs' ability to transition from the former to the latter.

Our main recommendation is therefore to align LSME ESRS with sector-agnostic ESRS as closely as possible, especially in key topics, disclosure requirements and data points.

As one specific example, this relates to the deletion and/or changes to multiple governance-related disclosure requirements and data points in sector-agnostic ESRS 2, a part of disclosures



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that is among the most important to assess — foremost for credit and investment purposes — the LSME’s ability to manage sustainability-related impacts and financial risks.

For the reasons explained above and below, we urge ensuring that LSME ESRS keeps the structure and wording of sector-agnostic ESRS 2 GOV-1, GOV-2, GOV-3, GOV-4 and GOV-5. Among others, this recommendation on governance includes the need to fix the following issues:

- LSME ESRS ED modifies several key data points under its GOV 1 on the role of administrative, management and supervisory bodies, which under the name of simplifying, lowers the comparability of disclosures. For instance, sector-agnostic ESRS 2 wording on “how the administrative, management and supervisory bodies and senior executive management oversee the setting of targets related to material impacts, risks and opportunities, and how they monitor progress towards them” has been reduced to an extent that completely excludes the described bodies’ roles in overseeing setting targets and monitoring the progress towards them.
 - WWF recommendation: ensure the exact comparable wording of several key data points between LSME ESRS and sector-agnostic ESRS, including for the example above. Such changes would not mean an additional reporting burden, given that LSMEs can briefly state if the relevant disclosure requirements or data points are irrelevant to their contexts.
- LSME ESRS ED merges the sector-agnostic ESRS 2 GOV-2 into GOV-1, and thus harms disclosures’ comparability between LSMEs and larger listed entities reporting under sector-agnostic ESRS.
 - Recommendation: keep the original ESRS 2 GOV-2 as a separate disclosure requirement.
- LSME ESRS ED lacks a disclosure requirement critical to assessing if the undertaking’s administrative, management and supervisory bodies addressed any material impacts or risks in the reporting period.
 - Recommendation: include as one of the data points: “a list of the material impacts, risks and opportunities addressed by the administrative, management and supervisory bodies, or their relevant committees during the reporting period.” (reference from Set 1 ESRS 2 GOV-2).
- LSME ESRS ED misses disclosure requirements about whether sustainability-related performance is integrated into incentive schemes. Such a disclosure requirement would not be an additional burden, as LSMEs could simply report on this only if they have such incentive mechanisms, and it would allow those LSMEs that integrate sustainability matters into incentive mechanisms, to report on a matter that investors benefit from.
 - Recommendation: (re-)introduce an incentives-focused disclosure requirement (or at minimum, although not ideal, data point under LSME GOV-1) for LSMEs (reference from Set 1 ESRS 2 GOV-3).
- LSME ESRS ED completely misses disclosure requirements about risk management and internal controls over sustainability reporting, which is necessary to assess the undertaking’s ability to adequately manage sustainability-related impacts and financial risks. Lacking disclosure requirements for risk management and internal controls would fail to provide the certainty to the financial institutions that the undertaking is equipped to address the material sustainability matters, and hence lower the company’s ability to access finance, among other consequences.
 - Recommendation: introduce a disclosure requirement for risk management and internal controls over sustainability reporting (in line with Set 1 ESRS 2 GOV-5).

As importantly, LSME ESRS ED has eliminated many data points on corporate climate transition plans and targets, which are among the key sustainability-related information that financial institutions require from clients and investees. Eliminating these data points hinders LSMEs ability to gain access to finance on equal grounds with larger listed entities, and complicates their process from moving from LSME ESRS to sector-agnostic ESRS. Concrete suggestions to close the gaps:

- LSME ESRS ED E1-1 on climate transition plan deletes some of the key required data points that are essential to ensure the resilience of LSMEs and an integral part of financial institutions' decision-making. Not having a consistent approach with ESRS Set 1 would therefore harm the LSMEs competitiveness and growth prospects.
- Our overarching recommendation is to keep the same disclosure requirements for ESRS E1 as are in ESRS Set 1. But in case this is not possible, it will be important to ensure that at least the following data points are part of the disclosure requirements:
 - "By reference to GHG emission reduction targets and the climate change mitigation actions, an explanation of the decarbonisation levers identified, and key actions planned" (reference to ESRS Set 1 E1 paragraph 16, point b).
 - "By reference to climate change mitigation actions, an explanation and quantification of the undertaking's investments and funding supporting the implementation of its transition plan" (reference to ESRS Set 1 E1 paragraph 16, point c).
 - "A qualitative assessment of the potential locked-in GHG emissions from the undertaking's key assets and products" (reference to ESRS Set 1 E1 paragraph 16, point d)
 - "An explanation of how the transition plan is embedded in and aligned with the undertaking's overall business strategy and financial planning" (reference to ESRS Set 1 E1 paragraph 16, point h)
 - "An explanation of the undertaking's progress in implementing the transition plan" (reference to ESRS Set 1 E1 paragraph 16, point j).

Finally, LSME ESRS ED entirely deletes ESRS E4-1 disclosure requirement on biodiversity transition plans. For LSMEs in many sectors such as agriculture, forestry, fishing and others, other environmental issues such as biodiversity are at least as important as climate change. It is therefore crucial to provide a framework for LSMEs to at least disclose their biodiversity transition plan, if they have one, in order to make them more comparable to other companies in the same sectors.

Concrete recommendations:

- It is critical to ensure that the final LSME ESRS includes the disclosure requirement 4-1 on biodiversity transition plan (which is already very limited in the ESRS Set 1).
- For the sake of standardisation, comparability and simplicity, it will be important to ensure that LSME ESRS will also have the same level of granularity for the disclosure requirements on biodiversity impact metrics (from ESRS E4-5).