

## Consultation response

# Draft European Sustainability Reporting Standards



AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €3.4 trillion in 2021, directly supports more than 4.9 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

## Executive summary

The American Chamber of Commerce to the EU (AmCham EU) appreciates the opportunity to provide feedback on the exposure drafts underpinning the development of the European Sustainability Reporting Standards (ESRS). We support the adoption of one harmonised and transparent framework for reporting that ensures interoperability with other reporting frameworks. We call for greater clarity and guidance on definitions of key concepts such as materiality and opportunities, flexibility in reporting on nascent areas, as well as the adoption of a gradual approach where reporting is phased in to reflect data maturity. This is particularly important for reporting on the value chain, which must be aligned with discussions on the Corporate Sustainability Due Diligence Directive (CS3D). We also call for the ESRS to ensure that the management report is balanced and that reporting does not require companies to disclose confidential information.

## Introduction

AmCham EU welcomes the comprehensive work done by the European Financial Regulatory Advisory Group (EFRAG) on the upcoming ESRS. We fully support regulatory efforts to provide a reliable framework for companies to report on sustainability. However, the complexity and detail of such an exercise presents a significant – and for many, new – challenge. To ensure that reporting is accurate, verifiable, auditable, relevant and comparable, our key recommendations for the ESRS are:

- Emphasise the need for harmonisation and international interoperability by aligning with the global baseline under development by the International Sustainability Standards Board (ISSB) where possible.
- Clarify the materiality concept.
- Phase-in implementation of reporting requirements.
- Ensure all reporting metrics do not bear the risk for unintended consequences or excessive legal liability risks.
- Promote a transparent, realistic and initially flexible reporting of Scope 1, 2, 3, and recognise the inherent uncertainty of Scope 3 emissions disclosures.
- Postpone value chain reporting to align with ongoing regulatory discussions (CS3D).
- Protect business critical and confidential information.
- Ensure a balanced management report.
- Provide further guidance on opportunities.

## Emphasise the need for harmonisation and interoperability

While we acknowledge that the ESRS are specific to the EU context and cannot fully align with international standards, international convergence will provide more comparable and therefore more meaningful information to stakeholders like international investors, while significantly reducing costs and lightening the administrative burden for companies. Many AmCham members are simultaneously subject to reporting in the EU, US and under the ISSB. Potentially diverging reporting requirements, in terms of timing and content, would create a significant ‘disproportionate burden’ for companies, an ‘unnecessary regulatory fragmentation’ and a ‘risk of inconsistent reporting requirements’, in contradiction with the wording of the Corporate Sustainability Reporting Directive (CSRD) in article 29b and recital 37.

We call for the ESRS to ensure interoperability with widely used international reporting standards such as the Greenhouse Gas (GHG) Protocol, Global Reporting Initiative and the ISSB's upcoming global baseline. We also recommend seeking alignment on timing of implementation with new disclosure requirements in other jurisdictions such as the US Securities and Exchange Commission. These steps may ultimately be key to facilitate reciprocity and equivalence between jurisdictional approaches to reporting.

The volume, granularity and prescriptive nature of disclosure requirements could dilute the usefulness of the disclosures and conflict with the objectives of understandable and comparable information. The administrative burden is significant and will be exacerbated by a lack of harmonisation with other reporting standards and timelines. We encourage international cooperation on the development of standards that build on robust, well-established and accepted reporting methodologies (including on Scope 3 GHG emissions) that will provide mutual benefit in enhancing transparency on impact on climate change and yield comparable and decision-useful data.

## **Clarify the application of materiality concept**

Additional guidance is needed on the intended application of double materiality in order to allow meaningful and comparable reporting across EU and non-EU companies, in particular on expectations around how to perform the double materiality exercise and on how to effectively use the rebuttable presumption of materiality of each disclosure requirement. The simultaneous extension of double materiality across the value chain and into new areas of sustainability performance with anticipated inclusion in the management report is highly significant and will require a period of significant transition to ensure it is effective and not overly administrative or burdensome in its application.

## **Phase-in implementation of reporting requirements**

Not all reporting areas have reached the same level of maturity in data collection and tracking, and measurement tools are often not sophisticated enough to report with the necessary accuracy in the context of mandatory reporting subject to external assurance. We welcome the ESRS's comprehensive approach but support a phased-in approach for reporting on nascent areas at a later point in time. Rather than reporting approximate data and quantitative metrics – which could lead to inconsistency and incomparability or run a high risk of retrospective restatements or corrections (which is not in the interest of either the preparers or users of this information) – we recommend a flexible approach that allows for qualitative data, where companies can illustrate their progress rather than report against set metrics. An explanatory statement would be more appropriate, as provided for under the CSRD. Alternatively, we recommend an approach where companies report at the highest level of detail possible (or in corporate hierarchy), being able for a transitional period to simply say when data is not available.

## **Ensure all reporting metrics are fully relevant and do not lead to unintended consequences or excessive legal liability risks**

There can be significant variability and little comparability across companies for metrics derived by estimates, even where methods and assumptions are disclosed. Therefore, safe harbour language affording legal protection to preparers of information will be required in implementing legislation that

recognises the implicit risks of such disclosure and thereby protects reporting companies (that use good faith efforts) against sanctions in the event that the estimates turn out to be inaccurate. The standards should also set clear guidance about the level of transparency expected from companies on disclosure of the process they used to derive inputs and any uncertainties that exist due to data constraints.

In addition, across a number of proposed standards (eg ESRS-S1-DR21, ESRS-G2-DR3 [24.c and 24.d], ESRS-G2-DR6 and ESRS-G2-DR7) the required disclosure of a number of grievances, allegations, internal investigations or pending legal proceedings may not be indicative of real issues that may ultimately be substantiated. For instance, high numbers may be interpreted as an indication of poor practices, although in many cases this is a result of a positive culture that encourages employees and other stakeholders to speak up without fear of retaliation. In certain cases, such as pending investigations, details may also be confidential.

Finally, in line with the CSRD, undertakings must remain free to voluntarily implement new policies and strategies or adopt targets if they find it relevant and meaningful to do so. Companies should not be legally liable for information reported in good faith on implemented policies and adopted targets, and progress towards achieving such targets.

## **Promote a transparent, realistic and initially flexible reporting of scope 1, 2, 3 and recognise the inherent uncertainty of Scope 3 emissions disclosures**

AmCham EU supports one harmonised and transparent system of reporting, in line with international standards and initially flexible enough to reflect the existing challenges in Scope 3 emissions reporting. Indeed, Scope 3 emissions disclosures involve estimates and assumptions that result in inherent uncertainty, which runs counter to the principles of comparability and verifiability. Collecting Scope 3 information relies heavily on third-party data (as all value chains' actors start the data-gathering exercise), which can take a significant amount of time to collect and can be costly to confirm its accuracy. Measuring Scope 3 emissions and reporting on them also involves methodologies, processes and industry practices that are evolving and have yet to mature to become fully reliable. Therefore, we recommend allowing initial flexibility to accept proxy data and gaps where data is not available, supported by an explanatory statement, and setting provisions for Scope 3 emissions to the 'best level available' to allow for reporting of what is available to start with.

We also believe that the reporting requirements for Scope 3 emissions should be phased in, eg required, only once all companies have reported their Scope 1 and 2 in the first reporting exercises – making accurate Scope 3 data more readily available, as a three-year phase-in period for Scope 3 emissions reporting for instance, with a provision for voluntary reporting in the interim.

## **Postpone and clarify value chain reporting**

Co-legislators are currently defining the scope of the value chain under the CS3D. We recommend postponing the development of value chain reporting standards pending the finalisation of the CS3D. Social standards generally should be fully aligned with and not extend beyond what is required by the CS3D. Requirements should also be in line with the existing international frameworks such as the United Nations Guiding Principles on Business and Human Rights, the Organisation for Economic Co-operation and Development's Guidelines for Multinational Enterprises and International Labour Organization core conventions.

We consider that the value chain should be restricted, upstream, to tier 1 suppliers and, downstream, should exclude end-users or customers upon which the reporting entity has limited influence.

Similarly, in ESRS-S1, the definition of ‘own workforce’ may include non-employees such as independent contractors, for whom it is difficult to collect employment-related information. In addition, this risks being interpreted as non-employees are treated like own employees, which could represent a co-employment risk to the undertaking. Non-employees should therefore be excluded here and instead be reported under ESRS-S2 on Workers in the Value Chain. If companies must disclose information they cannot accurately retrieve, there should be a safe harbour or other protection from liability. Similarly, many requirements are related to future cash flow impacts, which can be highly speculative and present legal risk.

Sustainability reporting processes and systems are not as developed and sophisticated as financial reporting. For example, software is not globally available, and most of the reporting is done manually and requires significant resources. This is because environmental, social and governance data is derived from a variety of disparate sources and geographies along the value chain. In addition, industry needs time to get a grip on its own performance before being required to extend that reach through highly complex value chains.

## **Protect business critical and confidential information**

Not all information is material. We urge EFRAG to consider that some data may be sensitive to report publicly and allow for exceptions where needed. For example, some required disclosures – such as descriptions of utility grids – could divulge the locations of data centres, which are highly sensitive from a competitive perspective and if public, could result in security risks. Similarly, the broad disclosures required may jeopardise the sensitivity and confidentiality of data that companies often handle – in many cases data disclosure is restricted by contracts. We believe that the standards should be developed in line with the safeguard outlined in the Level 1 text, which specifically references that information should not endanger the commercial position of the undertaking (recital 29).

In addition, ESG-related business opportunities could in some instances be considered competitively sensitive and confidential information, for example under ESRS-E1-DR17 on the financial effects from climate-related opportunities, ESRS-E2-DR1 on details of raw material cost, and ESRS-G2-DR10 on payment practices. Such information should not be a required disclosure because it could significantly harm the reporting company's ability to compete. Such a disclosure exemption is similar to financial reporting, which does not require disclosures on business opportunities related to the market size for product innovations.

## **Ensure a balanced management report**

The ESRS aims to make reported data easily identifiable within the management report. However, we do not believe that the proposed organisation of information would promote clarity and ease of use. Including all disclosures in the management report risks leading to unbalanced reporting, with a management report growing considerably in size, as it would be dominated by the sustainability-related disclosures of a very granular nature.

## Provide further guidance on opportunities

The CSRD requires companies to disclose information on the risks and opportunities for the undertaking related to sustainability matters. We support requirements to disclose material sustainability- and climate-related risks. However, to facilitate more comparable disclosure, we believe that additional guidance and examples are needed to help entities determine what may be considered a significant opportunity, especially for non-climate opportunities where no framework currently exists (such as GHG Protocol, TCFD, etc.).

## Conclusion

We fully support EFRAG's intent and welcome the opportunity to provide feedback on the comprehensive work carried out on the exposure drafts. These recommendations seek to reflect some of the views of users of the future standards, and thus contribute to EFRAG's work by providing insights into challenges we may face and proposals on how to address these challenges. We are convinced that transparency and harmonisation is essential to ensure that companies disclose decision-useful information that is accurate, verifiable, auditable, relevant and comparable.