BRIEFING

ESRS E1

European Sustainability Reporting Standards: Climate Change

Overview:

The European Union's (EU) Corporate Sustainability Reporting Directive (CSRD) entered into force on January 5, 2023. This package of laws requires companies to report environmental, social, and governance risks and opportunities in line with European Sustainability Reporting Standards (ESRS). ESRS E1 is one of ten topic-specific standards covering climate mitigation, adaptation, and energy.

History:

The CSRD is the successor to the EU's existing Non-Financial Reporting Directive (NFRD), which came into force in 2014 with the objective of enhancing European companies' disclosure of environmental and social information.

Modernizing and strengthening these disclosures is one of the aims of the European Green Deal, a bundle of laws and regulations adopted by European policymakers that are intended to turn Europe into a climate-neutral continent by 2050.

The ESRS that underpin the CSRD were initially drafted by EFRAG, formerly known as the European Financial Reporting Advisory Group. This is an independent advisory body charged with developing and promoting corporate reporting standards. The first set of draft ESRS were submitted to the European Commission in November 2022. In early 2023, the Commission consulted with other EU stakeholders on the standards and produced its own, amended draft for public review on June 9 2023. The final standards were adopted by the Commission on July 2023. They are subject to review by the European Parliament and European Council for a two-month period, which can be extended an additional two months. While they have the power to reject the standards, they cannot make any changes to them.

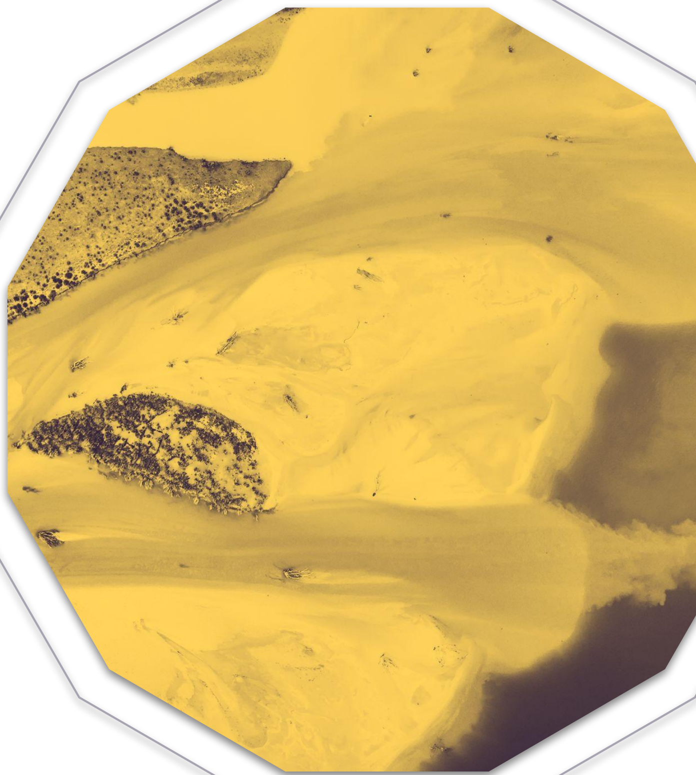
Objectives:

The CSRD aims to ensure that all large companies and listed companies (except listed micro-enterprises) report information on the risks and opportunities arising from social and environmental issues, as well as the impact of their activities on people and the environment. This 'double materiality' approach is intended to help investors and stakeholders evaluate the sustainability performance of companies in line with the European Green Deal.

Scope:

The CSRD applies to around 50,000 European companies, including those with securities listed on a regulated EU market and large companies meeting specific criteria related to employees, balance sheets, and revenues. Over 10,000 foreign companies are also estimated to be subject to the CSRD.

Disclosure of information according to the ten topic-specific ESRS is contingent on a company-wide impact and financial materiality assessment. If the topic is not material, a company can omit the relevant disclosure requirements. However, in the case of ESRS E1, a company must disclose a detailed explanation of why climate change is not material.



Structure:

ESRS E1 requires companies to disclose information on how they affect climate change; information on climate mitigation activities compatible with limiting global warming to 1.5°C; plans to adapt their strategy and business models in line with a low-carbon transition; and the financial effects of climate-related risks and opportunities, among other things.

Many of these disclosures supplement those set out in ESRS 2, which covers general sustainability-related reporting requirements.

ESRS E1 is structured into four reporting areas, as are the other topic-specific ESRS:

Governance: Information on a company's governance processes, controls, and procedures used to monitor, manage and oversee climate-related impacts, risks and opportunities. For example, ESRS E1 requires a company to disclose whether and how climate issues are incorporated into the remuneration of administrators, managers, and supervisors.

Strategy: Information on a company's strategy and business model as it relates to material climate-related impacts, risks and opportunities, including how they address these impacts, risks and opportunities. This includes disclosure of a company's transition plan for climate change mitigation, including an explanation and quantification of the investments and funding that support its implementation.

Impact, risk and opportunity management: Information on the processes a company uses to identify climate-related impacts, risks, and opportunities and assess their materiality, as well as information on the management of material climate matters through policies and actions. Specifically, a company must describe the climate-related physical and transition risks and opportunities across its value chain. Furthermore, a company shall describe the resilience of its strategy to climate change, how and when this resilience analysis was conducted, and the results of this analysis — which may include the results of dedicated climate scenario analysis.

Metrics and targets: Information on a company's climate-related performance, including targets and progress towards meeting them. ESRS E1 specifically requires a company to disclose its gross Scope 1, 2, and 3 greenhouse gas (GHG) emissions, and total emissions, in metric tonnes of carbon dioxide equivalent. It also requires disclosure of GHG emissions intensity based on net revenue. Additional metric disclosures under ESRS E1 include the amount of GHG emission reductions/removals financed through carbon credits, and the anticipated financial effects from climate risks and opportunities.

Application:

Companies will have to produce ESRS-compliant disclosures in line with the below implementation schedule.

Companies with fewer than 750 employees do not have to produce ESRS E1 disclosures on Scope 3 emissions or total GHG emissions in their first year of reporting. In addition, a company does not have to produce quantitative disclosures on the anticipated financial effects from climate risks and opportunities for the first 3 years of compliance if impracticable.

Significantly, the materiality assessment process used by a company to guide its ESRS disclosures is subject to external assurance, meaning they must maintain a clear audit trail and documentation of processes and controls to support the disclosures provided.

Implementation Schedule:

Financial Year 2024

ESRS-aligned reports covering financial year 2024 must be produced by the following companies, with the first public reports published in 2025:

- Companies previously subject to the Non-Financial Reporting Directive (large listed companies, large banks and large insurers if they have more than 500 employees), as well as large non-EU listed companies with more than 500 employees.

Financial Year 2025

ESRS-aligned reports covering financial year 2025 must be produced by the following companies, with the first public reports published in 2026:

- Other large companies, including other large non-EU listed companies.

Financial Year 2026

ESRS-aligned reports covering financial year 2026 must be produced by the following companies, with the first public reports published in 2027:

- Listed small- and medium-sized enterprises. Listed SMES may opt out of reporting requirements for two years. The latest a listed SME may start reporting is financial year 2028, with reports published in 2029.
- Non-EU companies that make over €150m per year in the EU and that have in the EU either a branch with a turnover exceeding €40m, or a subsidiary that is a large company or a listed SME.

Next Steps:

Companies in scope of CSRD should determine how the ESRS differ from the voluntary and mandatory sustainability-related disclosure requirements they currently use in order to understand what adjustments are needed to their reporting practices.

Next, they should ascertain the extent of their value chains to ensure relevant climate risks and opportunities are understood. A double materiality assessment should then be conducted to determine what disclosure requirements they must follow.

A company would also do well to survey its existing sustainability reporting practices and procedures to see where they may be challenged by ESRS requirements, and respond appropriately.