Looming ESRS to heighten focus on company disclosure

Meeting the European Sustainability Reporting Standards early will come with benefits in terms of quality of information, investor access, and ESG risk awareness.

Europe's sustainability reporting requirements

In 2025, the first group of companies will start disclosing according to the **European Sustainability Reporting Standards** (ESRS) for the financial year 2024. These reporting standards apply to companies subject to the **Corporate Sustainability Reporting Directive** (CSRD). Initially only large public interest companies must disclose information on their ESG related impact, risks, and opportunities. But between 2026 and 2029 the reporting scope will gradually expand to all large companies, listed SMEs and EU branches and subsidiaries of non-EU companies. (See our article "CSRD: preparing for a deluge of sustainability disclosures")

The first set of sector-agnostic ESRS were adopted by the European Commission on 31 July 2023 and came into force on 25 December 2023. The sector-agnostic disclosure requirements apply to all companies, irrespective of the sector in which they operate. These ESRS encompass the two cross-cutting standards (General Requirements and General Disclosures) and ten topical ESRS.

The European Sustainability Reporting Standards (ESRS 2 and topical ESRS)

Source: European Commission, ING

BP = basis for preparation, GOV = governance, SBM = strategy and business model, IRO = impacts, risks and opportunities, MDR = minimum disclosure requirements, P = policies, A = actions, M = metrics, T = targets. The disclosure requirements are also applicable for entity-specific disclosures. In addition to the disclosure requirements, most ESRS also contain application requirements, supporting the application of the disclosure requirements.

The second set of sector-specific standards, applicable to companies within a specific sector, and standards for third country companies have been postponed by two years until June 2026. This is to give companies more time to implement the cross-cutting and topical ESRS and legislators more time to develop the sector-specific standards.

The consequential side effect is that companies will, in the early stages of their ESRS reporting, remain more reliant on entity-specific disclosures. These entity-specific disclosures offer companies the opportunity to disclose entity-specific material sustainability information that is not sufficiently covered by the sector-agnostic or sector-specific disclosure requirements.

The sector-agnostic ESRS disclosures rely mostly on materiality

The sector-agnostic ESRS adopted by the European Commission are based on technical advice from EFRAG, but with some important modifications.

Some of the mandatory disclosures, such as ESRS E1 (Climate), were made dependent upon materiality. Only the information from the cross-cutting standard ESRS 2 (General Disclosures) must be disclosed regardless of the outcome of the materiality assessment. The same holds for the IRO-1 (Description of the process to identify and assess material impacts, risks, and opportunities) in the topical ESRS.

Some of the more challenging reporting requirements were made voluntary instead of mandatory, by referring to “may be” instead of “shall be” disclosed. An important example is the drafting of a biodiversity transition plan.

Companies also have more time to meet certain reporting requirements. For the first year they may omit information on the anticipated financial effects from material physical and transition risks and potential climate-related opportunities (E1-9). The current financial effects (ie IFRS 9, IAS 37) must be disclosed however and cannot be postponed.

Companies with less than 750 employees were given an additional year for disclosures on their scope 3 and total GHG emissions (E1 1-6) or Own workforce (S1). They also have two more years to prepare info on Biodiversity (E4), Workers in value chain (S2), Affected communities (S3) and Consumers & end-users (S4).

While this does give some extra breathing space, companies within and outside the EU still face quite a task to ready themselves for the ESRS disclosures.

How do corporates prepare themselves for the CSRD

With the first CSRD reporting for full year 2024 to be published in 2025, about half of the large corporates we studied already communicate information based on the ESRS standards. That being said, some of the European corporates subject to the CSRD reporting in 2025 already report under the Non-Financial Reporting Directive (NFRD). These companies have already put in place structures inside their organizations to address sustainability questions. While most structures have good foundations, reporting under the CSRD is not a smooth process.

Sustainability departments and sustainability plans

With scrutiny on sustainability that has grown over time, corporates did not wait for the CSRD to start looking inward at their businesses and activities. Most large corporates have already put in place administrative units in charge of ESG information. These units have taken several forms, from standalone ESG departments to ESG committees including audits and control functions as well as the direct involvement of top managers and boards.

With the active participation of their ESG departments, most European corporates have developed sustainability plans with mid to long term objectives, structured around pillars such as pollution and climate change, human rights and employees, governance and diversity, transparency, and corruption. With sustainability themes becoming more import for stakeholders and investors, coupled with the growing success of green bond instruments, corporates have solicited ESG ratings. As a result, and on top of what corporates publish themselves, more ESG KPIs and assessments are available on the market.

The NFRD is good preparation

The NFRD applies to large public-interest entities with more than 500 employees. This includes listed companies, banks, insurance companies, and other corporations designated by national authorities as public-interest entities. These organizations can include non-financial statements in their annual reports, detailing their policies, risks, and outcomes concerning ESG matters. The directive aims to enhance the transparency and comparability of non-financial information across the EU, enabling investors to make more informed decisions and encouraging companies to adopt sustainable practices. While the NFRD does not include any obligation to publish targets, it still seeks to prepare corporates to align with broader EU policy goals on sustainability, such as the European Green Deal and the EU's climate neutrality target by 2050.

Under the NFRD, companies are required to report on:

- **Environmental Matters:** Information on the impact of the company's operations on the environment, including issues related to climate change, use of renewable and non-renewable resources, pollution, waste management, and biodiversity.
- **Social and Employee-Related Aspects**: Details on the company's social policies, working conditions, respect for labour rights, gender equality, diversity, and inclusion.
- **Human Rights:** Policies in place to identify, prevent, and mitigate adverse human rights impacts in the company’s operations and supply chain.
- **Anti-Corruption and Bribery:** Measures taken to combat corruption and bribery, including risk assessments, and the reporting of incidents of corruption.
- **Board Diversity:** Information on the diversity of the company's administrative, management, and supervisory bodies concerning age, gender, education, and professional background.

To assist companies in complying with the NFRD, the European Commission has issued non-binding guidelines. These guidelines provide a framework for reporting and include principles such as materiality (focusing on information that is relevant to stakeholders) and balance (ensuring both positive and negative aspects are reported).

> *To enhance the quality of their non-financial information, companies can refer to various roadmaps, international standards, and reporting frameworks.*

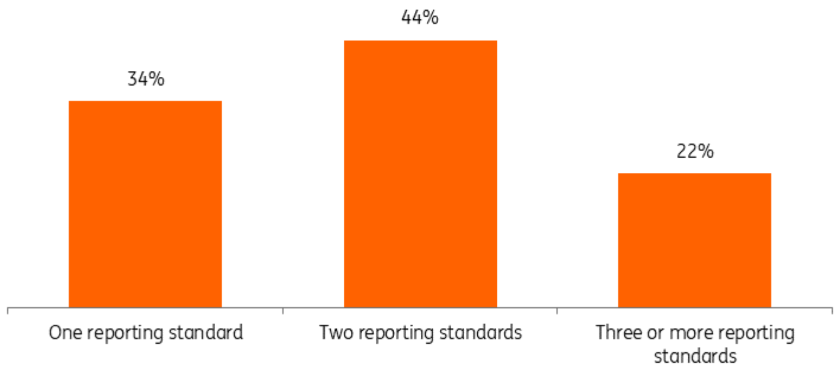
We have selected 50 European large corporates representative of diverse industrial sectors: TMT, Utilities, Oil & Gas, Transport, Automotive, Goods & Services, and Retail. Of these 50 corporates, 42 (or 84%) declare that they gather and analyse information based on the 17 sustainable development goals adopted by the United Nations. The remaining 16% cite the **UN Global Compact Index** and its 10 principles or the **SBTi** (Science Based Targets Initiative), with its proposed standards and guidance for companies to set greenhouse gas emission reduction targets. A few companies refer to using two or three standards together, depending on specific targets, to define and report on their ESG information.

84% of the 50 corporates studied use the UN SDGs

The United Nations adopted its 17 sustainable development goals (SDG) in 2015, as a universal call to end poverty, protect the planet, and ensure that by 2030 all people enjoy peace and prosperity. These goals aim for, and focus on: 1. No poverty, 2. Zero hunger, 3. Good health and well-being, 4. Quality education, 5. Gender equality, 6. Clean water and sanitation, 7. Affordable and clean energy, 8. Decent work and economic growth, 9. Industry, innovation and infrastructure, 10. Reduced inequalities, 11. Sustainable cities and communities, 12. Responsible consumption and production, 13. Climate action, 14. Life below water, 15. Life on land, 16. Peace, justice and strong institutions, 17. Partnerships for the goals.

As far as the reporting standards and frameworks are concerned, corporates have the choice of a few international frameworks, of which the **Global Reporting Initiative** (GRI), the **Sustainability Accounting Standards Board** (SASB) and the **International Sustainability Standards Board** (ISSB) are most commonly used. Corporates can also make use of national reporting frameworks and/or frameworks developed by organizations specialized in specific sectors. Amongst the 50 corporates in our benchmark, the Global Reporting Initiative (GRI) is the most utilized. 44% of the companies use two reporting standards and 22% three or more standards. Currently, the proliferation of standards allows companies to better answer requests from organizations and (ESG) rating agencies but adds to the complexity of ESG analysis for investors.

Corporates use one or more reporting standards for their ESG disclosures



Source: Companies, ING

The methods and reporting models offered by the international reporting standards cited above have synergies with the ESRS. The CSRD has the ambition to offer more granularity and improvements in the analysis and reporting of environmental, social and governance information. Global standardisation will be possible thanks to a template that should be reported in a machine-readable manner.

From the NFRD to the CSRD

For corporates already reporting under the NFRD, switching to the CSRD implies they will first conduct a gap analysis of their current reporting practices against the CSRD requirements. ESG experts must identify the stakeholders and the material sustainability topics. Also to be developed are the objectives, action plans and resources available for each of the material standards as well as how sustainability is embedded in the organization. The development of a roadmap for the CSRD implementation is a second step with the appropriate reporting framework. The reporting of the CSRD also requires the choice of a specialized firm for the assurance process.

How far are corporates in the ESRS process?

With the CSRD taking effect in 2024 and with the first reported disclosures awaited in 2025, European corporates reporting under the NFRD now have a basis to gather, analyse and report their sustainability related information. Reading the European corporates' 2023 annual report and/or dedicated sustainability documents, we understand that the amount of progress varies amongst the companies included in our benchmark.

50%

of the 50 corporates studied declare that they have already identified material ESRS topics

According to our readings, 50% of the companies constituting our group have identified their material ESRS topics and 40% their double materiality topics. The amount of identified material topics differs a lot, between 3 and 16. A number of corporates underline the fact that their list of topics will expand or change as time goes by.

7 corporates (14%) reported on their topics following the CSRD requirements in their 2023 annual or sustainability report. 3 of them also reported their double materiality topic information, in the form of qualitative information, as allowed by the CSRD.

How well prepared are European banks

Thanks to a flood of regulatory and supervisory initiatives, European banks have stepped up their non-financial disclosures in the past few years. Most progress has been made on climate related and environmental disclosures with, among others, the ECB turning up the pressure on banks regarding their ESG risk management practices and disclosures through its thirteen supervisory expectations and climate stress tests. In addition to their non-financial sustainability disclosures under the NFRD, European banks must also report information on ESG risks in their Pillar 3 reports. From this year this includes information on their EU Taxonomy alignment, as a measure of how environmentally sustainable banks are according to the EU Taxonomy's technical screening criteria.

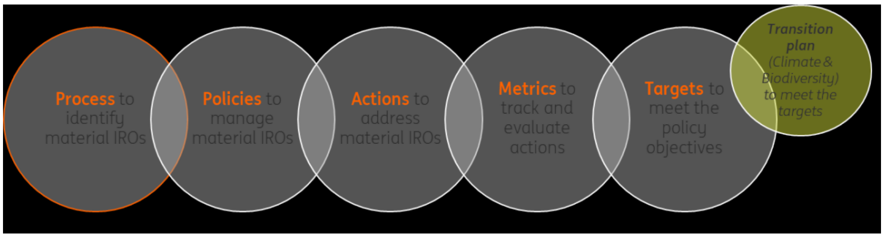
Despite efforts made to live up to these, often varying, ESG disclosure expectations, banks still have quite some work to do to meet the CSRD reporting obligations, not least against the backdrop of the move in time from a limited assurance to a much tougher reasonable assurance auditor sign-off on non-financial disclosures. While a few banks started preparing their non-financial disclosures along the lines of the ESRS for the year 2023, most banks readied their ESG disclosures with reference to sustainability reporting frameworks or guidelines, such as the Global Sustainability Standards Board (GSSB) **Global Reporting Initiative (GRI) Standard** and the IFRS Foundation's International Sustainability Board's (ISSB) **SASB Standard**, the (disbanded) Financial Stability Board (FSB)'s **Task Force on Climate-related Financial Disclosures** (TCFD) or the **UN Guiding Principles Reporting Framework** on human rights. The implementation of concepts such as double materiality, value chain and transition planning, therefore remains work in progress.

Double materiality at the heart of the ESRS disclosures

The ESRS requires companies to perform a double materiality assessment, where they must analyse both the ESG-related impact materiality of their own actions (from the inside out) and the financial materiality of the risks and opportunities arising from ESG factors (from the outside in). This in essence combines the concepts of the impact materiality approach of the GRI Standard and the financial materiality approach of the SASB Standard.

A sustainability matter is material if it meets the criteria for impact materiality and/or financial materiality. The due diligence process put in place to analyse and manage actual and potential negative impacts on people and the environment forms an important input variable to this materiality assessment. The identification of actual and potential **impacts** is substantiated by stakeholder engagement. Subsequently, the distinguished negative and positive impacts are prioritised according to their scale, scope and likelihood, as well as remediation of negative impacts. Impacts and dependencies (such as on resources) can also be sources of **risks and opportunities**. The likelihood of occurrence and potential magnitude of the thereto related financial effects determine their financial materiality.

Identifying and addressing material impacts, risks and opportunities



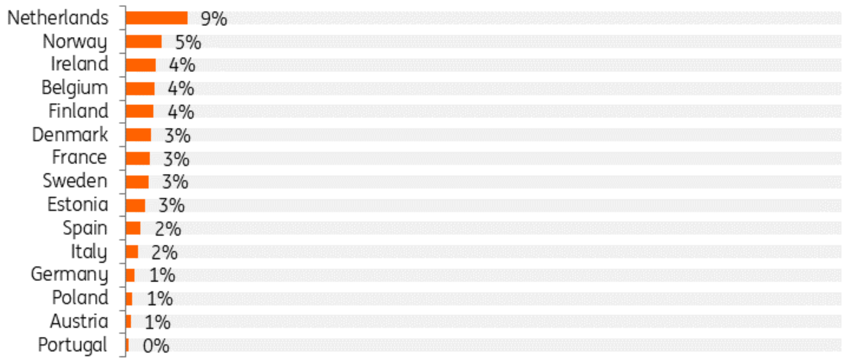
Source: European Commission, ING

Banks already identify material topics. They do so mostly on a bi-annual basis, with stakeholder dialogue playing an important role in determining materiality. The topics are often defined based on the GRI principles, sometimes complemented by entity-specific topics. Several banks also took the ESRS into consideration in their latest materiality assessment. Multiple banks have already performed a double materiality analysis, even though not all of them have used the outcome as a basis for their disclosures over 2023. They will start doing so for reporting year 2024. However, there are still several banks that must take the next step of identifying their material topics via a double materiality analysis. Even for banks that did follow the ESRS double materiality assessment, the disclosures of material topics often lack comparability. Some disclose the material topics on a key topic level, while others list them on a sub-topic or sub-subtopic level. Due to topical differences between GRI and ESRS standards and the recognition of entity specific topics, the material topics identified are also often not clearly traceable to the ESRS. These include topics such as sustainable investments or cybersecurity. One thing is clear however - climate change does rank highly as a material topic for European banks.

Scope extension of the CSRD is supportive to bank taxonomy disclosures

When it comes to measuring the environmental sustainability of banks, the ESRS facilitate the reporting of the EU Taxonomy Article 8 disclosures. Banks included information on the taxonomy alignment of their activities in their non-financial disclosures for the first time for financial year 2023. These first disclosures confirm low Taxonomy alignment, even for banks with more Taxonomy-eligible assets. There are several reasons for this, with data availability issues and the cautious approach taken by banks on claiming full Taxonomy alignment being one of them. Besides, the 2023 GAR disclosures were fully based on the climate change mitigation and adaptation objectives. GAR coverage of the other four environmental objectives (sustainable water use, circular economy, pollution prevention and control, biodiversity) might enhance future GAR disclosures.

Average green asset ratio (GAR) by banking sector

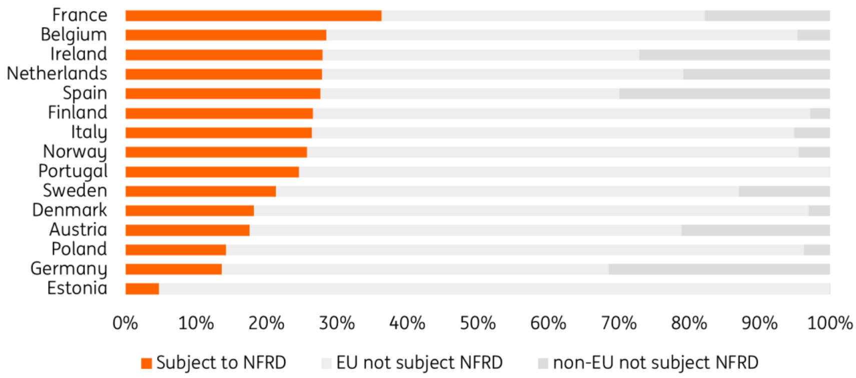


Source: EU Bank Pillar 3 disclosures (44 banks), ING

Another important fact is that exposures to (EU and non-EU) financial and non-financial undertakings, currently not subject to NFRD disclosure obligations, such as SMEs, are excluded from the numerator of the GAR calculations while they do add to the denominator. The percentage of EU Taxonomy eligible assets covered by the GAR will improve as the scope of companies subject to the CSRD disclosures expands.

The country averages in the graphic below confirm that, at best, 36% of European banks' financial and non-financial counterparties is currently subject to the NFRD/CSRD disclosure requirements. This percentage will increase in the coming years, as the CSRD reporting scope widens to include all large companies and listed SMEs, as well as branches/subsidiaries of non-EU corporations.

Most bank exposures to companies are now not in scope of the NFRD



Source: EU Bank Pillar 3 disclosures (44 banks), ING

Thanks to the ESRS, data availability issues, including with reference to companies already subject to NFRD reporting requirements, should also improve. Better data availability for a wider group of companies will not only be supportive to the GAR disclosures of banks, but ultimately also to their value chain reporting.

CSRD's international impact

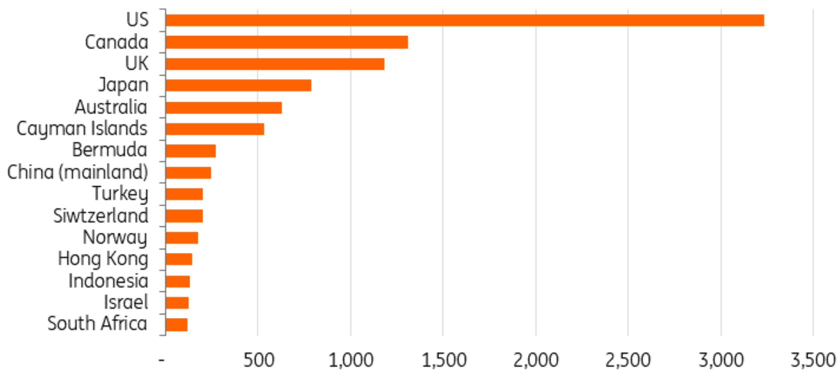
The CSRD will have profound influence on companies beyond the European Union. The CSRD requires non-EU companies to comply to the reporting rules if they meet any of the following criteria:

1. Non-EU companies that have securities listed on EU stock exchanges;
2. Non-EU companies meeting one or both of the thresholds below:
    - Annual turnover of €150m or more at the consolidated or individual level for two consecutive financial years;
    - A qualifying EU subsidiary or branch within the EU with an annual turnover of €40m or more.
3. Non-EU parents of above-mentioned entities, and controllers of EU branches with >€40m revenues, when the group generates >=€150m of revenues in the EU.

Refinitiv estimates that roughly 10,000 non-EU companies are listed on EU stock exchanges or meet the €150m local revenue threshold of the CSRD. While this estimate only includes non-EU companies listed on EU stock exchanges and those that have over €150m in local revenue, it is already 20% of the EU's official estimate of 50,000 EU companies to be impacted by the rule. Among the non-EU companies, the US makes up the largest share of the 10,000, followed by Canada, the UK, and Japan.

Scope of the CSRD goes far beyond the EU

Number of impacted companies



Source: Refinitiv, Forbes

Note: The estimate includes non-EU companies listed on EU stock exchanges and those that have over 150mn in local revenue.

The clock is ticking. EU-listed non-EU companies (large or small, under standard 1 above) and other large non-EU companies under standard 2 are required to report climate data starting in 2025, 2026, or 2027 (financial years 2024, 2025, or 2026), depending on their size. For non-EU parent companies under standard 3, reporting will start in 2029 (financial year 2028).

The magnitude of coverage of the CSRD outside of the EU, as well as the fast-approaching compliance timeline, means that international companies doing business in the EU need to start seriously forming strategies to comply with the CSRD's ambitious set of disclosure rules. For large non-EU companies that are already subject to the NFRD, the additional reporting requirements under the CSRD should be manageable within their disclosure timelines. However, for smaller companies lacking sufficient resources, or companies that do not yet have a climate reporting framework or dedicated teams to ensure interdepartmental collaboration, it will be challenging to meet the CSRD's standards on time.

Bloomberg reported last year, based on an interview with a law firm, that some companies with securities listed on EU-regulated stock exchanges were caught off-guard with the 2025 reporting deadline applied to them and were considering delisting their securities. While this approach seems like a last resort for companies unprepared for their CSRD timelines, we doubt it will gain broad popularity. The EU remains a large, dynamic, and valuable market: benefits from having securities listed outweighs the complexity to report under the CSRD, and the potential loss from delisting from EU exchanges can also be high. But the reported unpreparedness is a warning to other companies under the scope of the CSRD.

Multinational companies will soon have nowhere to hide under the global trend toward mandatory climate disclosure. As of May, the International Sustainability Standards Board (ISSB) has seen more than a dozen jurisdictions including China, the UK, Canada, and Brazil make efforts toward integrating its sustainability reporting standards. These jurisdictions, plus the EU as covered by the CSRD, represent at least half of the world's GDP. Although the US SEC paused its climate disclosure rule on April 4 amid material legal challenges following its adoption on March 6, California will mandate climate data reporting from large US companies doing business in the state in phases starting from 2026, provided the laws hold up in court.

Multinational companies outside the EU can expect mandatory climate reporting rules affecting their operations in the medium to long term. Companies will benefit from preparing proactively instead of finding themselves overwhelmed by the various implementation timelines.

The first mover advantage

Sustainability data gathering and reporting incur supplementary costs in the form of additional staff, IT resources and external consulting services. The data gathering and standardisation of measures are a challenge within a maze of national and international methods and standards. The more products and geographical diversity a corporate has, the more effort is needed to collect and measure data.

With its ESR standards, the directive wants to bring standardisation in the reporting of elements across environmental, social and governance domains. Corporates believe that the process will be a learning curve as standardising measures is making apparent the complexity of this. While companies say sustainability regulation and reporting create an extra burden, they also say this can be leveraged to build a competitive edge and to manage business risks. This is how first CSRD movers can benefit from CSRD reporting:

Reducing the risk of greenwashing through better data quality and comparability

Most European corporates that will publish CSRD information in 2025 already report under the NFRD. The NFRD allows companies to choose from different reporting systems, but the CSRD mandates the adoption of ESR standards. Efforts by corporates to align their already disclosed ESG information alongside the ESRS requirements should boost the quality of information.

With provided methodologies and standards, we expect earlier adopters to offer better quality information than competitors who will have not/are not required to submit themselves to the CSRD obligations. The ESR standards will enhance sustainability data comparability in general amongst corporates of the same sector.

Enhance credibility and attract investors

With more accurate sustainability information, corporates will be able to demonstrate their willingness to adapt their business to more sustainable practices as well as the targets they aim to reach. High-quality sustainability reporting can boost trust and help companies access funding from investors actively prioritizing ESG performance.

ESG investment funds currently fail to get harmonized criteria to perform their due diligence regarding the sustainability information provided by corporates. On top of this, the depth of the information provided varies greatly among players. With the CSRD reporting, it is believed that investors will be provided with the information necessary to make an informed investment decision. The ESRS have the potential to address the shortcomings in many ways. Compared to the NFRD, a broader range of reporting undertakings are required under the CSRD. The directive includes all large undertakings, irrespective of whether they are listed or not (excluding micro listed undertakings). The previous threshold of 500 employees is no longer considered. Additionally, the ESRS require a higher level of granularity of the reported data compared with other reporting standards such as the GRI, SFDR or IFRS ISSB, also specifying the data collection methodologies. The standards additionally cover a broader range of environmental issues, including new topics such as water and marine resources or biodiversity and ecosystems, and expand the reporting requirements to include social and governance issues. The broad spectrum of reporting requirements allows investors to incorporate numerous sustainability aspects into their decision-making process. Further, the ESRS are mandatory and often include a reporting template that should be reported in a machine-readable manner.

Better collaboration and knowledge for corporates themselves

Within organizations, the gathering of information should improve the coordination and collaboration of different departments working together on CSRD requirements. This will be especially true in the first years of the preparation of sustainability statements. The benefits could fade away after several years of CSRD reporting. The other benefit will be uncovering sustainability aspects of the products and services offered. The gathering of information along the different value chains will see the eruption of facts and figures probably not previously considered by certain parts of the business. With increased information sharing, trust and collaboration will aid the inclusion of sustainability aspects in supplier selection. The impact will vary across sectors, but we would expect corporates with the most complex value chains to benefit from the requirements imposed by the CSRD.

Enhancing behaviour changes and sustainability practices

The CSRD expands the scope of mandatory sustainability reporting to include all large and listed undertakings, excluding micro-enterprises. This will necessitate more detailed and standardized reporting. The implementation of sustainability reporting requirements under the CSRD and the European Sustainability Reporting Standards (ESRS) is anticipated to change the behaviour of various organizations. These changes include heightened awareness of sustainability issues, new internal processes, policy revisions, and modifications to business models and value chains.

Mitigating risks for companies and the whole economy

According to the World Commission on Environment and Development of the United Nations: "Sustainable development meets the needs of the present generation without compromising the ability of future generations, ensuring a balance between growth and environmental protection". Corporates have a role to play in the climate change issue through reduction of pollution. They also play a direct role in mitigating economic and social development risks by ensuring employees and contractors fair treatment and equal opportunities for all.

At a corporate level, mitigating risks is also a question of preventing scandals and financial penalties that could negatively impact corporates' financial and non-financial performance. The CSRD aims to force corporates to have clear objectives and align their goals through commitments to improve their sustainability performance.

The costs occurred by CSRD reporting could also bring cost saving opportunities

The CSRD and its goals to bring relevant, comparable, reliable, and usable information have a cost for corporates. ESG information is relevant to the corporates themselves as well as for investors, rating agencies, ESG (rating) agencies, and certification agencies. Corporates are asked to fill in questionnaires in different formats. The multitudes of standards, methodologies and disclosure practices at the disposal of companies, sectors and asset classes mean that the standardization and the depth of the data required by the CSR directive will help in reducing the costs occurred by the gathering, analysis and disclosure of ESG data in the long run. Organizations should be able to directly compare the reported ESRS data amongst peers and sectors, at lower costs in the long run.

Conclusion

The deadline for the first disclosures under the ESRS for full year 2024 is quickly approaching and (EU and non-EU) companies are at different levels of readiness. Reporting according to the ESRS is a huge task. For those that meet the requirements at an early stage this will come with benefits. The ESRS not only promote a broader range of ESG disclosures, but they also enhance the comparability of the data reported. This will improve the useability of these disclosures to investors, with the move from limited to reasonable assurance ultimately supporting comfort on the quality and accuracy of company non-financial disclosures. But there is more to gain for companies, with their ESG risk awareness and management being a simple but important example.

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