Omnibus directive: simplification priorities

Introduction by the Chair

The Chair opened the discussion by noting that, as recently as a year ago, the concept of an "omnibus", a legal tool allowing to modify several EU rules in one go was not well known, but it is now widely understood to be part of the EU's simplification efforts. The Omnibus Directive on sustainability reporting was proposed by the Commission with the aim of reducing the administrative burden resulting from reporting obligations of the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD). However, this does not mean that the Commission is no longer committed to promoting sustainability reporting. Sustainability reporting remains important for investors and stakeholders and to achieve the EU's Green Deal objectives, while maintaining global competitiveness. The Omnibus is a necessary adaptation, introduced in response to feedback from users of the current legal framework.

1. The simplification of the European Sustainability Reporting Standards (ESRS) proposed by EFRAG

An official indicated that their remarks would focus on the level 2 aspect of the Omnibus initiative, which is the simplification of the ESRS. EFRAG received a specific mandate from the Commission in March. In addition to the aim of modifying the threshold and, therefore, the scope for the mandatory regime, there is also a focus on combining the objectives of reducing the reporting burden and focusing on core sustainability-related data. EFRAG exposure drafts were published at the end of July. A 60 day public consultation will conclude at the end of September. EFRAG will be ready to deliver its technical advice at the end of November, as requested by the Commission.

Six key levers are central to the simplification process. First is the simplification of the double materiality assessment. This determines which impacts, risks and opportunities must be reported on and is therefore highly relevant to proportionate reporting. Second is an improvement in the readability, conciseness and clarity of the reports. Third is prioritising a more principles-based system and a less prescriptive approach to information. Fourth is a focus on shorter and clearer standards. Fifth is an introduction of reliefs and clarification. Sixth is around further enhancement of interoperability with global frameworks and standards, with the International Sustainability Standards Board (ISSB)'s standards.

Wider collaboration is needed in some areas, but ambition should be prioritised in others. The EU's support of the sustainability reporting global baseline is crucial in the current geopolitical context. The proposal includes a reduction of data points by 68%, including all ambiguous voluntary data points. Work is ongoing on the proposal and initial feedback was positive. The aim is to deliver on the aims of the Omnibus proposal while ensuring that core data is still available.

2. The lessons of the first annual implementation of CSRD

An industry representative explained that AXA has leveraged the knowledge and experience gained through financial reporting processes in CSRD reporting. The reporting was taken seriously and prioritised and subject to an appropriate governance. The reporting is now more structured and factual than the sustainability disclosures in the past. Reporting in a well-structured framework reduces reputational risk. However, the reporting made up a disproportionately large part of the annual report. It will be crucial to balance genuine simplification with retaining focus on sustainability objectives.

Ensuring appropriately focused and correct corporate reporting will be essential.

As the ESRS revision is on-going, the focus should now be on developing a fair representation framework rather than a mere compliant framework. There is a legal debate around the fact that, in order to conduct the double materiality analysis appropriately, judgments will need to be made on sustainability topics. These judgments should be made following the core principle of fair representation.

3. Exchange of views on the Omnibus proposal

A regulator highlighted that the Omnibus initiative is the first attempt to centre competitiveness not just internally but also with respect to other jurisdictions. After securing the stop the clock as a matter of urgency, it would have been preferable to sequence the regulatory work in reverse order, beginning with the Sustainable Finance Disclosure Regulation (SFDR). The experience of initial implementation of the sustainable finance overall package could have been leveraged to identify what data financial intermediaries and advisors need to provide to investors. The streamlining of draft exposures and reduction in the number of required data points should only have started after this was complete.

EFRAG has announced the impressive goal of a 68% reduction in data points. A useful approach would be to agree on common metrics to calculate the real cost savings for reporting entities that would result from this goal. Otherwise, there is a risk that the exercise becomes too conceptual. It is critical that the mandated reporting standards continue to ensure interoperability with international standards. Transition plans should remain a primary focus. Also, prudential authorities consider this to be important from a financial stability perspective.

Caution should be exercised with regard to the ambition of reducing the scope of CSRD. Regulatory stability and legal clarity are vital for the industry. The most challenging element for corporates is obtaining reliable information from along the value chain. The EU's industrial fabric is made up primarily of SMEs, so excluding most of them from mandatory reporting could be problematic. The success of voluntary reporting will depend on the presence of strong reputational and market incentives.

The Chair commented that the timing of SFDR first and CSRD later has been seen as a problem because the two are linked. It would not be appropriate to make changes to CSRD without also making changes to SFDR in response. Work is underway in this area.

An official emphasised that the focus in any reduction in data points should be on what investors need, which has not always been the case in the past. A 68% reduction in data points would be a positive change in the right direction. Currently, sustainability reporting includes large amounts of irrelevant data. The only question should be whether the data points are relevant to investors, so it is very reassuring that EFRAG is working on this. Basel or Solvency II include many sustainability-related requirements. If this is not addressed, corporates and SMEs will need to repeatedly report the data points they are no longer required to disclose under the revised CSRD.

Unlike large corporates, SMEs do not have the resources to invest in complex reporting systems. Legislative requirements must take this into account. There are two issues facing SMEs. First, clients will request the data that they need for their sustainability-related reporting. In that situation, the SME needs to be shielded. Secondly, and less well appreciated to date, financial services companies will often require data if an SME wants a loan from a bank or is looking for insurance. Legislators and regulators need to take this into account when creating financial services legislation.

4. Voluntary sustainability standards for SMEs

An industry representative noted that EFRAG recently launched the voluntary sustainability reporting standard for-non listed SMEs (VSME) digital template. This is an easy-to-use tool whereby SMEs respond to a questionnaire and are then assisted with their reporting. The reporting is provided as machine-readable data. National authorities and governments should support EFRAG's initiative and encourage all types of companies to participate.

An official added that the VSME standard was recommended by the Commission. This tool was developed in collaboration with users and is very powerful.

5. Interoperability of ESRS with ISSB Standards

An official remarked that the Commission's focus on not only simplification but also enhancing interoperability with global standards, including the standards issued by the ISSB, is very welcome. Additionally, it is clear that EFRAG is trying to identify opportunities to enhance interoperability. A common objective will be an important part of making progress. Work done by the ISSB concluded that there is a great deal of common ground, although there are additional asks for information on the ESRS side. This is an opportunity for streamlining that will not affect interoperability.

EFRAG is exploring the introduction of some concepts that ISSB has used to support implementation, for example around undue cost or effort. Retaining the ability to use the ISSB industry-based guidance to support application of standards in Europe will be a useful step.

Some areas require review. Some of the data points proposed to be made optional are critically important in attracting investment into European companies, for example quantitative information about anticipated financial effects. The published interoperability guide aims to assist companies navigate between the ISSB Standards and ESRS. It is disappointing that the drafts include changes in language and concepts that detract from the usefulness of the interoperability guide and raise new questions.

6. The ways forward for sustainable reporting

An industry representative acknowledged that reporting is a major challenge, particularly for small companies. However, there is still an extremely high demand for good quality environmental, social, and governance (ESG) data. Machine-readable data can enable firms to provide high-quality data to investors at a competitive price. A machine-readable format reduces costs for investors and corporates as analysis is easier.

An industry representative stated that the simplification initiative is very welcome. A closer alignment of Europe with international standards would be welcome. Geopolitical developments have resulted in a very fragmented world, divided by rigid or region-specific frameworks.

The proposed reduction in the scope of CSRD will remove the burden from smaller entities. However, there is still a significant amount of work to do for larger entities. In the original version of the CSRD, the European entities of large groups were included is in scope and had to devote a considerable resources to presenting their own disclosure in line with the directive. However, this exercise has a relatively limited use as investors sit at group level, not at subsidiary level. Thus, all the data points provided at the subsidiary level have limited use for investors and comes at a great cost.

A more balanced approach should be considered. For example, disclosure requirements that go beyond requirements in ISSB Standards could be voluntary rather than mandatory and could therefore be tailored to different business models. Regulatory equivalence regimes could provide assurance that specific reporting requirements are already being met at group level and therefore do not need to be replicated at entity level. The work done by EFRAG and ISSB is commendable but is only the start of the process of developing a tailored model that aligns with international standards and helps investors to make the right choices. In addition to focusing on removing data points, a review of the entities in scope is needed.

An industry representative stated that CSRD is the directive with the most solid foundations and should be the cornerstone of sustainable finance. Leveraging the experience of financial reporting is the right approach. The desire to move fast in the Omnibus review is welcomed. However, the European authorities should pay attention to the different processes launched in parallel (Omnibus I package, ESRS review, Taxonomy DAs, upcoming SFDR review). The presence of good foundations and the appropriate governance around the fundamentals means that the system can be trusted, including in the way that ESRS are drafted.

A regulator mentioned that the previous year's Draghi report notes that the green transition will require the mobilisation of an enormous amount of capital, both private and public, although the context of the growing European public debt is difficult. After this premise, she highlighted that the green transition is not merely a financial matter but rather an industrial policy objective, for which transparency rules alone will not be enough to meet its objectives. Although transparency is a powerful tool, which has helped to mobilise private capital towards more sustainable assets, it will not work in isolation. Instead, it needs to be complemented by financial measures and a regulatory framework that allocates responsibilities at the level of corporates. In that context, postponement of CSDDD is a concern.

An official emphasised that consistency, particularly in EU regulation, is key. Other speakers have referred to SFDR. Information is the cornerstone of any further regulation and should be the starting point. Policy cannot be developed without data, so there is a need to review the taxonomy. Consistency in scope is also crucial, especially as the threshold is now being raised. The right decisions on what should be applied must be made for those firms with between 250 employees and the threshold.

International consistency is necessary but will not be easy to achieve. Modifying the approach in the EU away from interoperability and towards something stricter, such as an endorsement mechanism, would be the wrong way to proceed. The present approach works and is moving in the right direction. In the context of current geopolitical challenges, international collaboration will be vital to maintain momentum on sustainability reporting. It is important to remember that, in reality, the differences are minimal and there is more convergence than divergence. Competitiveness and change will be the focus in the future. Reporting is only a minor aspect of these elements. Forward-looking information to inform strategic decisions and communication will be vital, and this will need to be derived from high-quality data.

An official summarised that, although the Omnibus initiatives are a good starting point, there is still a great deal more progress to be made. A focus on simplification and burden reduction in the coming years will increase the competitiveness of the European economy, corporates and SMEs. Sustainability reporting will be an element of this. Germany requested the removal of the green asset ratio but this was not included in the Commission proposal. There are other elements where costs imposed on corporates should be reviewed to assess whether they are proportionate. Disproportionate costs should be corrected. The Danish presidency is expected to make good progress in this area, as the Polish presidency did, especially on the files currently under negotiation.

7. Simplification of the EU taxonomy

An industry representative suggested that the Omnibus package provides an opportunity to clarify and simplify the EU taxonomy and make it more usable for the market. A recent study reported that 76% of European financial players do not use the EU taxonomy, primarily because it is not simple and not aligned with global standards. There are more than 500 technical screening criteria and many are subjective or repetitive. The technical screening criteria are very EU-oriented, which discourages global financial institutions from using them.

The Chair shared that work is already underway on the taxonomy, especially around the 'do no significant harm' criteria.

8. International perspective on sustainable reporting

An industry representative advised that the EU should aim to continue providing leadership on sustainable reporting, but this leadership should be pragmatic, grounded in business reality and enabling, not prescriptive. Proportional material disclosures for global groups remain essential, but these disclosures must serve the broader purpose of directing capital deployment towards the real economy transition. Reporting alone does not drive change and a high level of focus must be maintained. Financial institutions must be empowered to help support clients, especially those that operate in hard-to-abate sectors. Otherwise, institutions will merely green their balance sheets and not invest in the hard-to-abate sectors that need capital to decarbonise. Open dialogue and debate will be needed to explore how reporting and disclosures can support in tackling these concerns.

A regulator noted that the two main comparator economies for Europe are the US and China. The US Inflation Reduction Act allocates nearly $307 billion over a decade to clean energy, using tax credits, grants and consumer incentives. China has taken a similar approach while also combining this bottom-up approach of financing measures with top-down planning at central government level. These examples highlight the need for a review of the European approach. Transparency alone has not delivered what was hoped for because the single market never reached the scale to realise the transition. In addition, Europe failed in exporting its regulatory model. However, there have also been positive developments. President von der Leyen's comment to the European Parliament that Europe needs and should have its own electric car reflect an increasing awareness of the need for strategic autonomy and clarity around how to achieve it.

An official shared that, excluding the European Union, there are now 36 jurisdictions globally that have started, or are moving towards, requiring reporting using the ISSB's standards. A significant number of companies will be required to use ESRS and ISSB Standards going forward. These companies will need access to information to support reporting for both ESRS and ISSB Standards, including data from supply and value chains. Investors need to be able to make valid comparisons of companies reporting under these systems. This demonstrates the critical importance of interoperability.

ISSB has always acknowledged the benefits of a 'building block' approach. ISSB is focused on investor information but acknowledges that policymakers or other stakeholders may need additional information. In line with this approach, one possibility could be to use the ISSB global baseline and require additional reporting. The Omnibus is an ideal moment to consider the wider context and explore how the system can work best for all stakeholders.