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Cover Note on the LSME Working paper V2

Objective of the session

- 1 Discuss the version 2 of the draft LSME ESRS and address remaining questions.

Papers provided

- 2 EFRAG SR TEG has been provided with the draft V2 LSME ESRS
 - section 1 “General requirements”
 - section 2 “General Disclosures”
 - section 3 “Environmental disclosures”;
 - section 4 “Social disclosures”;
 - section 5 “Business conduct disclosures”
- 3 The overview table with the list of DRs, decision tree and simplifications applied following SR TEG decisions on 21 February: [.05-02 Summary of developments in the LSME working paper.xlsx \(efrag.org\)](#)

Next steps and timeline

- 4 Detailed comments by EFRAG SR TEG will be requested on the version presented today (v2 draft LSME ESRS). SRB approval is foreseen in April. Consultation period 100 days.

Update since last SR TEG discussion on 21 February 2023

- 5 EFRAG secretariat has held a session with a small sub-group of preparers and financial market participants members of the LSME Community on 24 February. The main outcome of the session was: i) general support for SFDR, Benchmark and Pillar 3 being under materiality assessment, ii) general feasibility to report the SFDR, Benchmark, Pillar 3 datapoints (some difficulties were expressed by the small non-complex credit institutions representative), iv) agreement with proposed simplifications in social DRs, if needed prioritisation for collective bargaining (breakdown employees/non-employees); v) general issues from the small and non-complex credit institutions perspective, related to value chain for banks.
- 6 The EWG will meet on 8 March to comment the latest available draft LSME ESRS. There is general support for the proposal so far.
- 7 EFRAG secretariat has integrated the changes required by SR TEG on 21 February as summarised in the [overview table](#), and described in the cover notes of each section. The paragraphs in the text of the v2 LSME ESRS in grey are the changes that the secretariat would like to review with SR TEG. This also includes proposals for further simplifications.

- 8 To note that EFRAG secretariat has attempted to implement SR TEG suggestion to move the DRs for transition plans (climate and biodiversity) to IR4 and SBM3 in Section 2, General Disclosures. This attempt was finally reconsidered by the secretariat because it concluded that such a change would result in inconsistency with the rest of Section 2 for the following reasons:
- Transition plans only apply to two topics: i) climate change mitigation and adaptation and ii) biodiversity and ecosystem. Thus, there is a topical approach that is not in line with the General Disclosure section.
 - For climate transition plan the datapoints related to EU legislations have been retained. They include mostly metrical datapoints that suited for the topical section.
- 9 Regarding the human rights due diligence, it was decided to reinstate the two disclosure requirements related to (i) processes for engaging with stakeholders about impacts, and (ii) processes to remediate negative impacts and channels to raise concerns; after insight received from the European Commission. Following that decision, EFRAG Secretariat has merged the simplified proposals of those two disclosure requirements for S1 to S4.

Additional proposals to be considered

- 10 The secretariat has attempted a simplification of the footnotes related to EU datapoints (SFDR, Benchmark, Pillar 3) to make the text of the LSME ESRS lighter. The proposal is in annex 1.
- 11 The Secretariat, based on feedback received from EWG and community members, has added a specific AR to support undertakings in reporting on their stakeholder engagement process and on the outcomes of the related stakeholder engagement activities.
- 12 The secretariat would like to discuss the possibility to further simplify the provisions for:
- Presenting comparative information, deleting the requirement on updated estimates
 - Sources of estimation, keeping consistency of data and assumptions with the financial statement and the reference to qualitative characteristics of information
 - Events after the end of the reporting period, deleting it due to the fact that it doesn't occur often in practice also for large undertakings
 - Changes in preparation, reporting errors in prior periods, deleting these requirements to address proportionality
 - Consolidated reporting and subsidiary exemption, simplifying this provision because in practice would not expect significant differences between group and subsidiary in an SME
- 13 The secretariat would like to discuss the possibility to introduce mechanisms to address proportionality or to facilitate the application (i.e. reasonable and supportable information that is available without undue cost or effort, the use of "unable to do", temporary relief, etc) of specific DRs (i.e. Climate-related scenario analysis, Measurement of Scope 3, Potential Financial effects of material risks arising from environmental-related impacts, value chain information) taking as reference the [IFRS Staff paper issued in February 2023](#).
- 14 The secretariat would like to discuss the possibility to simplify GOV 1, referring only to "bodies responsible for sustainability matters" instead of "administrative, management and supervisory bodies" (3 different bodies). Then the undertaking has flexibility considering its national legislation for its governance model. This would then also allow to simplify the 15 datapoints of para 18-20.

- 15 The secretariat would like to discuss the possibility to define a new Appendix in Section 2. Appendix D “Disclosure/Application Requirements in [draft] topical ESRS that are applicable jointly with [draft] ESRS 2 General Disclosures” would not be applicable due to the fact that GOV, SBM and IR have been centralised in Section 2 and deleted from topical sections (if confirmed). The proposal is to define a table showing the list of DRs according to whether they are mandatory / subject to materiality / voluntary. This table could be a useful guide for undertakings in understanding the 3 categories of DRs.
- 16 Art 29c(2) of the CSRD indicates that *Sustainability Reporting Standards for small and medium sized undertakings (...) shall also, to the extent possible, specify the structure to be used to present this information*. The secretariat would like to discuss with SR TEG if the Appendix G in section 1 (currently example of structure in ESRS1 set 1) shall be changed and if shall be binding rather than example.
- 17 The written feedbacks received from LSME Community and EWG (written questionnaires) show the need to add illustrative examples to the LSME ESRS to facilitate preparers. In particular:
 - impact materiality
 - value chain guide
 - financial materiality
 - HR and Due Diligence
- 18 Hence, the EFARG secretariat would support the additional illustrative requirements, subject to resources and time availability. The current timeframe would suggest that illustrative examples may only be added after the launch of the public consultation. Another element for consideration is if existing tools and questionnaire (I.e. UN Global Compact) could be used for this purpose and how. SR TEG views are welcome.
- 19 Regarding the human rights due diligence, EFRAG secretariat would like to discuss three possible options on where to better locate the two disclosure requirements that were reinstated, in relation to the other disclosure requirements for the social topics.
 - (a) Option 1 proposes a mixed approach, where policies, actions and targets are centralised in Section II, while processes for engaging with stakeholders and processes to remediate negative impacts and channels to raise concerns are centralised in Section IV (*see Annex 2 – Mapping table of Human Rights Due Diligence related Disclosure Requirements Option 1*).
 - (b) Option 2 proposes to move all disclosure requirements related to social to Section IV (policies, actions and targets simplified and merged for S1-S4, processes for engaging with stakeholders and processes to remediate negative impacts and channels to raise concerns simplified and merged for S1-S4, and metrics for S1).
 - (c) Option 3 proposes to keep policies, actions and targets for S1-S4 in Section II, plus the two disclosure requirements related to processes for engaging with stakeholders and processes to remediate negative impacts and channels to raise concerns simplified and merged for S1-S4 (these two would be inserted after the IR disclosure requirements). Only metrics for S1 would remain in Section IV (*see Annex 3 – Mapping table of Human Rights Due Diligence related Disclosure Requirements Option 3*).

Questions to EFRAG SR TEG members and observers

- 20 Do EFRAG SR TEG members agree with the changes introduced by the secretariat as agreed on 21 February and described in the cover note of each section?
- 21 Do EFRAG SR TEG members agree with the proposed simplifications / and additional proposals (see par. 9-19)?
- 22 Which option do EFRAG SR TEG members find more appropriate, regarding the human rights due diligence?
- 23 Do EFRAG SR TEG members have suggestions for additional simplifications?

Annex 1 – Proposal for simplification of EU Datapoints footnotes

The EFRAG Secretariat would like to introduce the idea of simplifying the footnote references of the LSME ESRS (SFDR, EBA Pillar 3, EU Climate Law and Benchmark Regulation) in comparison to Set 1 ESRS. The following table portrays examples of such simplifications.

EU Datapoint	Set 1 Footnotes (selected examples)	Proposed simplification for LSME (selected examples)
SFDR	This information supports the information needs of financial market participants subject to Regulation (EU) 2019/2088 as reflecting a mandatory indicator related to principal adverse impacts as set out by indicator #6 in Table 1 of Annex 1 of the related Delegated Regulation with regard to disclosure rules on sustainable investments (respectively “Energy consumption intensity per high impact climate sector”).	This information supports Regulation (EU) 2019/2088, indicator #6, Table 1, Annex 1 (“Energy consumption intensity per high impact climate sector”).
SFDR + Benchmark 1st example	This information supports the information needs of financial market participants subject to Regulation (EU) 2019/2088 as reflecting a mandatory indicator related to principal adverse impacts as set out by indicators #1 and #2 in Table 1 of Annex 1 of the related Delegated Regulation with regard to disclosure rules on sustainable investments (respectively “GHG emissions” and “Carbon footprint”). This information is aligned with the Commission Delegated Regulation (EU) 2020/1818 (Climate Benchmark Regulation), Articles 5 (1), 6 and 8 (1).	This information: a) supports the Regulation (EU) 2019/2088, indicators #1 and #2, Table 1, Annex 1 (“GHG emissions” and “Carbon footprint”), and b) is aligned with the Commission Delegated Regulation (EU) 2020/1818 (Climate Benchmark Regulation), Articles 5 (1), 6 and 8 (1).
SFDR + Benchmark 2nd example	This information supports the information needs of financial market participants subject to Regulation (EU) 2019/2088 as reflecting a mandatory and additional indicator related to	This information supports: a) the Regulation (EU) 2019/2088, indicator #10, Table 1, Annex 1 (“Violations of UNGC principles and OECD”) and indicator #14,

EU Datapoint	Set 1 Footnotes (selected examples)	Proposed simplification for LSME (selected examples)
	principal adverse impacts as set out by indicator #10 in Table 1 of Annex 1 and by indicator #14 in Table 3 of Annex 1 of the related Delegated Regulation with regard to disclosure rules on sustainable investments (“Violations of UNGC principles and OECD” and “Number of identified cases of severe human rights issues and incidents”) and benchmark administrators to disclose ESG factors subject to Regulation (EU) 2020/1816 as set out by indicator “Number of benchmark constituents subject to social violations (absolute number and relative divided by all benchmark constituents), as referred to in international treaties and conventions, United Nations principles and, where applicable, national law” in section 1 and 2 of Annex 2.	Table 3, Annex 1 (“Number of identified cases of severe human rights issues and incidents”), and b) Regulation (EU) 2020/1816, indicator “Number of benchmark constituents subject to social violations (absolute number and relative divided by all benchmark constituents), as referred to in international treaties and conventions, United Nations principles and, where applicable, national law” in section 1 and 2 of Annex 2.
Benchmark	This information is aligned with the Commission Delegated Regulation (EU) 2020/1816 (Climate Benchmark Regulation), Annex II.	Same as Set 1
Pillar 3	This disclosure requirement is consistent with the requirements included in EBA Pillar 3 ITS - Template 5: Banking book - Climate change physical risk: Exposures subject to physical risk.	This disclosure requirement is consistent with EBA Pillar 3 ITS - Template 5: Banking book - Climate change physical risk.
EU Climate Law + Benchmark	This information is aligned with the Regulation (EU) 2021/1119 of the European Parliament and of the Council (EU Climate Law), Article 2 (1); and with the Commission Delegated Regulation (EU) 2020/1818 (Climate Benchmark Regulation), Article 2.	This information is aligned with a) Regulation (EU) 2021/1119, (EU Climate Law), Article 2 (1) and b) the Commission Delegated Regulation (EU) 2020/1818 (Climate Benchmark Regulation), Article 2.

Annex 2 – Mapping table of Human Rights Due Diligence related Disclosure Requirements Option 1

HRDD	Section 2	Section 4
0. Embedding sustainability due diligence in governance,	<ul style="list-style-type: none"> Disclosure Requirement SBM-2 Material IR and their 	

strategy and business model(s)	<ul style="list-style-type: none"> interaction with strategy and business model(s) Voluntary Disclosure 2 Material opportunities 	
1. Engaging with affected stakeholders	<ul style="list-style-type: none"> Voluntary Disclosure 1 Interests and views of stakeholders Disclosure Requirement IR-2 Description of the processes to identify and assess material IR Disclosure Requirement IR-3 Policies adopted to manage material sustainability matters 	<ul style="list-style-type: none"> Disclosure Requirement 1 Processes for engaging with stakeholders Disclosure Requirement 2 Processes to remediate and channels to raise concerns
2. Identifying and assessing negative impacts	<ul style="list-style-type: none"> Disclosure Requirement IR-2 Description of the processes to identify and assess material IR Disclosure Requirement SBM-2 Material IR and their interaction with strategy and business model(s) Voluntary Disclosure 2 Material opportunities 	
3. Taking action	<ul style="list-style-type: none"> Disclosure Requirement IR-4 Actions and resources in relation to sustainability matters 	
4. Tracking effectiveness	<ul style="list-style-type: none"> Voluntary Disclosure IR-5 Targets in relation to sustainability matters 	<ul style="list-style-type: none"> Disclosure Requirements S1-1 to S1-9 Voluntary Disclosures S1-1 to S1-2

Annex 3 – Mapping table of Human Rights Due Diligence related Disclosure Requirements Option 3

DDHR	Section 2	Section 4
0. Embedding sustainability due diligence in governance, strategy and business model(s)	<ul style="list-style-type: none"> Disclosure Requirement SBM-2 Material IR and their interaction with strategy and business model(s) Voluntary Disclosure 2 Material opportunities 	
1. Engaging with affected stakeholders	<ul style="list-style-type: none"> Voluntary Disclosure 1 Interests and views of stakeholders Disclosure Requirement IR-2 Description of the processes to identify and assess material IR Disclosure Requirement IR-3 Policies adopted to manage material sustainability matters Disclosure Requirement 1 Processes for engaging with stakeholders Disclosure Requirement 2 Processes to remediate and channels to raise concerns 	
2. Identifying and assessing negative impacts	<ul style="list-style-type: none"> Disclosure Requirement IR-2 Description of the processes to identify and assess material IR Disclosure Requirement SBM-2 Material IR and their interaction with strategy and business model(s) Voluntary Disclosure 2 Material opportunities 	

Working paper on [draft] LSME ESRS – Cover Note

3. Taking action	<ul style="list-style-type: none">• Disclosure Requirement IR-4 Actions and resources in relation to sustainability matters	
4. Tracking effectiveness	<ul style="list-style-type: none">• Voluntary Disclosure IR-5 Targets in relation to sustainability matters	<ul style="list-style-type: none">• Disclosure Requirements S1-1 to S1-9• Voluntary Disclosures S1-1 to S1-2