# COST-BENEFIT ANALYSIS OF THE FIRST SET OF DRAFT EUROPEAN SUSTAINABILITY REPORTING STANDARDS

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FINAL REPORT

November 2022

CEPS

# Cost-benefit analysis of the First Set of draft European Sustainability Reporting Standards

FINAL REPORT

Brussels, 22 November 2022

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# ABSTRACT

This is the final report of the "Cost-benefit analysis of the First Set of draft European Sustainability Reporting Standards (ESRS)" prepared by CEPS and Milieu for EFRAG. The report is prepared in the context of the obligation for EFRAG under Article 49(3a)b of the Corporate Sustainability Reporting Directive (CSRD) to accompany their technical advice by a cost-benefit analyses that include analyses of the impacts on sustainability matters.

This report aims to assess the costs and benefits of the first set of draft ESRS and presents evidence and data collected in the context of this costs and benefits analysis. Moreover, in order to support the costs and benefits analysis, this report also presents an assessment of the impact of the first set of draft ESRS across different stakeholder groups, these are mainly EU undertaking (under the scope of the CSRD or that form part of their value chain), investors, NGOs, trade unions and society at large.

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# EXECUTIVE SUMMARY

## Background

Since 2018 about 2 000 large public interest entities (listed undertakings, banks and insurance companies) with more than 500 employees are required to publish sustainability information under the Non-Financial Reporting Directive (NFRD). This will be expanded to almost 50 000 large undertakings under the Corporate Sustainability Reporting Directive (CSRD) that was politically agreed in June 2022.

The NFRD requires undertakings to report minimum information on sustainability matters. The CSRD will change this by requiring undertakings to publish sustainability information in line with the European Sustainability Reporting Standards (ESRS). EFRAG is responsible for preparing the sustainability standards in its role as technical advisor to the European Commission. The draft ESRS should be accompanied with a cost-benefit analysis.

## Objectives

The objective of this report is to provide a cost-benefit analysis on the first set of draft ESRS. For this, the report presents evidence and data collected on the costs and benefits as well an assessment of the impact of the first set of draft ESRS across different stakeholder groups. These stakeholder groups include the EU undertakings in scope of the CSRD, as well as the SMEs in their value chain, investors, NGOs, trade unions and society at large.

## Methodology

The assessment of the costs and benefits of the first set of draft ESRS follows the European Commission's Better Regulation guidelines. Indeed, only the mandatory reporting obligations of the disclosure requirements are considered and only the costs that are necessary to fulfil the legal obligations (e.g. reporting on the policies in place does only cover the costs to report on the policies not the costs for preparing, executing and monitoring the implementation of the respective policies). Additionally, the assessment uses the Commission's Better Regulation tools to identify impacts, determine the types of costs and estimate the costs and benefits.

When possible, the impacts have been estimated following the standard cost model. Hence, the average costs and benefits were estimated for a normally efficient undertaking within the relevant sub-group (listed undertakings in scope of the NFRD; non-listed undertakings in scope of NFRD; listed undertakings in scope of the CSRD but not the NFRD; and non-listed undertakings in scope of the CSRD but not NFRD). These were afterwards multiplied by the number of undertakings in the respective sub-group to determine the expected costs and benefits. When it is not possible to come to indicative point estimates for any given impact, either a range has been provided or the impact is described qualitatively.

The necessary information for both the quantitative indicators as well as qualitative discussions are obtained from a literature review, data analysis based on an extension of the databases used for European Commission studies on NFRD and the Audit Regulation/Directive, and stakeholder consultation.

In the context of this report more than 2 000 stakeholders were contacted for quantitative and qualitative information related to the costs and benefits for their organisation or their members. In total, 115 preparers, undertakings in their value chains, assurance networks, sustainability standard setters, rating agencies and users of sustainability information participated by either completing the survey and/or participating in an interview. The response rates were negatively effected by the short

period available for consultation and that the consultations had to be conducted during the summer period.

## Limitations

In considering the findings of this report, it is further important to consider that the estimates of the cost (savings) are mostly based on expectations of preparers and assurers based on their experiences with sustainability reporting. The experience with sustainability reporting is for most especially smaller non-listed preparers fairly limited and the implications of the disclosure requirements not entirely clear, which is reflected in the larger differences in the estimates and might result in deviations with the actual costs and benefits experienced after the implementation.

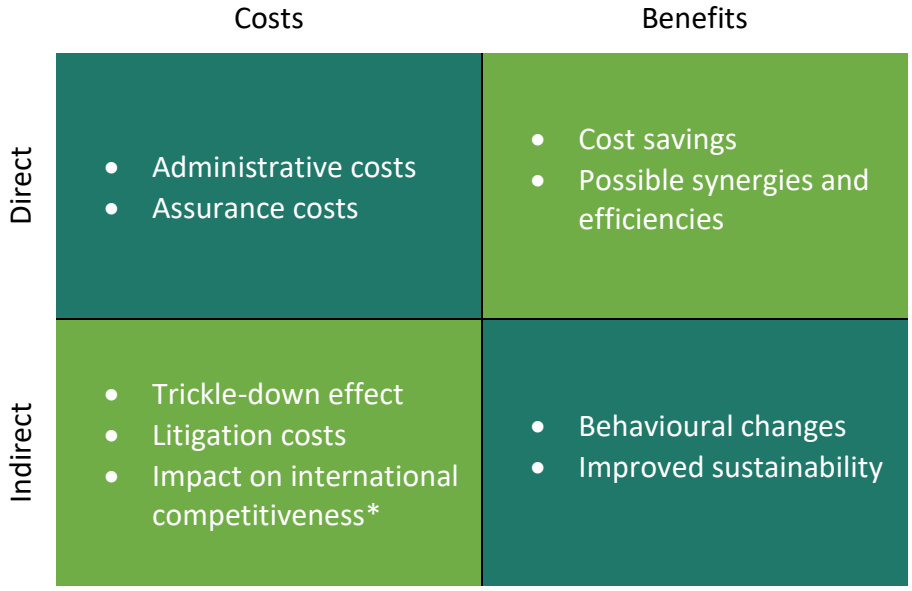
Moreover, the results are presented for an average normally efficient undertaking at the current price levels, which means that costs for individual undertakings can deviate significantly. For example, because their undertaking is smaller/larger, simpler/complex in structure, experience higher/lower labour costs per hour, use relatively more/less external service providers, etc. than the average undertaking in the cost estimates.

Furthermore, the costs can be quantified much easier than the benefits. The costs in general have a more direct nature and easier measurable than the benefits that are often intangible and conditional to other (behavioural) factors. The benefits are for this mostly described qualitatively.

## Costs and benefits

The costs and benefit assessment distinguishes between direct costs and benefits, and indirect costs and benefits (see Figure ES.1).

*Figure ES.1 Overview of key costs and benefits of first set of ESRS*




*Note:* *Can be considered both a cost and a benefit.

*Source:* CEPS (2022).

## Direct costs

All large EU undertakings are likely to experience administrative costs (one-off and recurring) under the ESRS. The costs per preparer vary depending on the characteristics of the preparer (size, complexity, etc.). NFRD listed undertakings are expected to have the largest costs for the preparation of the sustainability statements in line with the ESRS. The additional costs due to the introduction of

the ESRS are estimated to be about EUR 320 000 per year for an average NFRD listed undertakings after all requirements have been phased in (i.e. more than two FTE inhouse plus EUR 146 000 external costs). For the first year of compliance with all the disclosure requirements the NFRD listed undertakings are expected to spend another EUR 287 000 per undertaking. The one-off costs are about half for NFRD non-listed undertakings and non-NFRD listed undertakings and less than a fifth for non-NFRD non-listed undertakings, which is the largest groups of undertakings covered by the CSRD. These undertakings are on average much smaller and complex than the NFRD listed undertakings. The total incremental costs are estimated to be around EUR 1.7 billion in terms of one-off costs and an additional EUR 1.9 billion in recurring costs. An approximate one-quarter of these costs could be attributed to the information that is necessary for financial institutions to comply with the SFDR and CRR Pillar 3 requirements.

Similarly, all large EU undertakings are expected to incur assurance costs. The expected assurance costs for the preparers are, on average, likely to be significantly less than the financial assurance costs, which has served as a reference for the estimates. The assurance costs for limited assurance are expected to be at least EUR 360 000 for NFRD listed undertakings after all requirements have been phased in. These costs are expected to be around 30% higher in the first year the sustainability statement is assured because of the need to become familiar with the requirements and to overcome the initial challenges with establishing the assurance procedures. Ultimately, the CSRD envisages reasonable assurance of the sustainability statements, which is likely to cost more than twice as much as limited assurance. The limited assurance of the sustainability statements is estimated to cost an incremental amount between EUR 2.6 and 3.9 billion per year, while the reasonable assurance is estimated to cost between EUR 6.0 and 9.7 billion per year.

Both for the preparation and assurance of the sustainability of the report, the costs are especially high for the coverage of the gross scope 1, 2, 3 and total GHG emissions (DR E1-6). There is some further uncertainty about the materiality assessment, the coverage of certain forward-looking aspects (e.g. climate change mitigation and adaptation plans) and standardised methodologies to measure certain quantitative indicators, which can affect the costs in practice.

## Indirect costs

The large undertakings with an obligation to prepare a sustainability statement in line with ESRS might have to reach out to their value chain for certain – predominantly environmental – information. The costs of providing this information could be substantial if all preparers would reach out to the estimated about 60% of SMEs in the value chain of preparers. However, in practice this is unlikely to be the case. Assuming that preparers will follow the approach indicated in the survey for the relevant requirements, the recurring incremental costs might range between EUR 0.2 billion when only EU SMEs (excl. micro undertakings) in the first tier of the value chain are considered and EUR 1.5 billion when the other tiers are also considered. Importantly, this estimate assumes that the SMEs must prepare the information themselves with the potential support from external advisors. The costs could be significantly less when large undertakings aid undertakings in their value chain instead.

There is a significant chance that some preparers will be confronted with additional litigation costs relating to the quality of their reporting, but also financially more importantly on the information reported. For example, especially larger listed undertakings are likely to be confronted with lawsuits on their lack or insufficient commitment towards achieving the international goals to reduce climate change. Nevertheless, the large majority of most of the undertakings expect the competitive impact to be limited as the majority of their competitors are also likely to report and thus the sensitive corporate information disclosed is limited. Some – especially globally active – preparers that need to obtain information from undertakings in their value chain and will not obtain the same information

from their competitors and are therefore expecting a negative impact on their competitive position. There is further a risk that innovation efforts will be reduced when the marginal benefit of innovating in new and more sustainable technologies is reduced.

## Direct benefits

The benefits from more harmonised, comprehensive, and better-quality reporting, as established in the first set of draft ESRS, are in general very difficult to reliably estimate. Therefore, they are mostly assessed qualitatively.

There are potential cost savings for all relevant stakeholder groups. Hence, the preparers could benefit from a reduction in *ad hoc* information requests from the users that are having difficulties in finding comparable, relevant, and adequate sustainability information. Sustainability data providers and rating agencies currently struggle to obtain reliable and harmonised sustainability information, of which the ESRS could reduce the costs for the undertakings in scope of the CSRD.

Investors and other users might further save on requests to preparers and benefit from time savings and expenses on third party data providers when all the relevant sustainability information is accessible digitally. However, stakeholders are expected to experience limited benefits in practice. On the one hand, sustainability data providers and rating agencies are uncertain about additional alignment with the ESRS. On the other hand, the users of sustainability information often need information from undertakings across the globe. For example, preparers are estimated to be able to have a potential savings equivalent of 24% of the administrative costs to prepare a sustainability statement under the ESRS but they expect only 5% to be realised.

Indeed, the benefits increase when there is a larger alignment with international sustainability reporting practices. Looking at the different sustainability standards, the analysis finds heterogeneity in the degree of synergies across the different disclosure requirements. Indeed, while in some cases the ESRS fully cover requirements of existing other frameworks or legislation, this is not true for all disclosure requirements. Limited synergies do not only stem from a mismatch of information to be disclosed across the various standards but also from the higher degree of detail and granularity often required by ESRS.

## Indirect benefits

Since the positive societal effects take some time to manifest, they are currently not quantifiable in monetary terms. The ESRS is likely to contribute to the reporting of more relevant, comparable, reliable and usable, digitally accessible, and mandatory sustainability information of a larger number of undertakings than NFRD. This will allow investors to take environmental and social risks better into account in their investment decisions and allows citizens, trade unions, NGOs, and other societal organisations to hold undertakings accountable for their societal and environmental impacts. The proper implementation of the ESRS is likely to ultimately contribute to a reduction in the systemic risks to the economy, increased capital flows to undertakings addressing sustainability issues and the strengthening of the social contract between undertakings and citizens. Moreover, it will contribute towards achieving the ambitious goals of the European Green Deal.

The indirect benefits of the ESRS further manifest through changes in the preparers' and SMEs in their value chain's behaviour, which lead to improved sustainability. The ESRS has the potential to contribute to changes in preparers' behaviour. In general, these behavioural changes are mostly triggered by the fact that the undertakings must prepare a sustainability statement, and to a lesser extent by the standards expected. Nevertheless, the ESRS is expected to deliver a significant contribution to behavioural changes.

According to survey results, most respondents expect a positive impact (full to a high extent) on increased awareness, the integration of sustainability risk, better communication within the organisation, and/or better communication with the value chain. There is also consensus among the various consulted stakeholders that most changes are expected to be related to the environment and, to a lesser extent, social aspects. The reporting on more stable areas of fundamental rights and anti-corruption is likely to lead to fewer changes in internal policies.

## Conclusions

Overall, the costs are much more visible, tangible and measurable in the short term, while the benefits of the ESRS are mostly intangible and non-measurable, dependent on other legislative and non-legislative developments, and will only become evident in the medium to long term. Moreover, the benefits will increase significantly when standards equivalent to the ESRS are adopted. Therefore, the conclusions concerning measurable costs and benefits need to be treated with caution, as the benefits are described qualitatively but not estimated quantitatively.

# 1. INTRODUCTION

## 1.1 Non-Financial Reporting Directive (NFRD)

Since 2018, undertakings bound by the Non-Financial Reporting Directive (NFRD) are required to publish a non-financial statement with material information on their business model, policies, outcomes, risks and risk management, in addition to key performance indicators related to at least environmental, social and employee matters, respect for human rights, anti-corruption, and bribery matters. The NFRD applies only to large public interest entities (PIEs) such as listed undertakings, banks and insurance companies with more than 500 employees. As of 2020, 1 956 undertakings fell within the scope of the NFRD, or nearly 11 000 if those covered by the national transpositions of the NFRD and the Accounting Directive are also included (CEPS, 2020).

The NFRD does not impose the use of any reporting framework or standard, but if preparers rely on particular frameworks, they should state this in their non-financial statement. The Member States are allowed to determine whether the statement should be integrated into the management report or published as a separate report. Although integration into the management report is the default option, in practice most Member States require non-financial information to be detailed in a separate report.

The NFRD only requires the statutory auditor or audit firm to assess whether to include the non-financial statement in the management report or to publish it as a separate report. Indeed, the NFRD imposes no assurance engagement requirement on the content of the non-financial statement. The statutory auditor in principle does not have to assess and provide an opinion on the content of the non-financial statements. There are nevertheless some Member States (Italy, Spain and France) that require an independent assurance provider to verify the content of the non-financial statement. The level of confidence in the quality of the information provided is either of limited or reasonable assurance. In those Member States where the non-financial statement forms part of the management report, the assurance requirement is often in line with the verification of the remainder of the management report (Czechia, Hungary, the Netherlands, Slovenia).

In assessing the impact of the non-financial reporting requirement, it is also important to consider compliance with the requirements as well as the positive spillover effects. The latter are, for example, undertakings that do not fall within the scope of the NFRD, but nevertheless voluntarily include a non-financial statement in their management report ( estimated at about 9 000 undertakings in 2020) (CEPS, 2020).

Besides the NFRD, there are four more non-financial or sustainability reporting obligations at EU level. First, the Regulation on sustainability-related disclosures in the financial services sector (i.e. SFDR) which requires financial market participants and financial advisers to disclose non-financial information at entity and product level. Second, the Capital Requirement Regulation (CRR) and Capital Requirement Directive (CRDIV) that requires large listed banks in the EU to disclose information on ESG risks, including physical risks and transition risks. Third, the Regulation on the establishment of a framework to facilitate sustainable investment (EU taxonomy) provides a common classification system for sustainable economic activities. Fourth, the Regulation on sustainability-related disclosures in the financial services sector (SFDR) requires financial market participants to provide detailed information about how they address the (potential) negative impacts of their investments on both the environment and society.

## 1.2 Corporate Sustainability Reporting Directive (CSRD)

In April 2021, the European Commission published, as part of the sustainable finance package, a proposal for a Corporate Sustainability Reporting Directive (CSRD). The CSRD replaces the NFRD, expanding its scope and content with the aim to improve the quality of the reported information and to standardise sustainability information for EU reporters. In June 2022, the final text of the CSRD was politically agreed by the co-legislators. There are two important differences between the CSRD and NFRD.

First, the CSRD increases the number of undertakings required to disclose non-financial information. According to the final text, all large undertakings, whether listed or not and whether they have at least 500 employees, will be subject to the same reporting obligation. Moreover, listed SMEs (except for listed micro-enterprises) are also currently included in the Directive. This would increase the number of undertakings covered to about 48 000.

Second, the NFRD did not envisage EU-wide non-financial reporting standards, which could lead to inconsistent information being reported. As attention on sustainability increases, there is a need to ensure that the reported information is in line with the existing EU framework (EU taxonomy and SFDR) and with the different initiatives at global level (including, among others, the proposals made by the International Financial Reporting Standards Foundation's International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI)).

## 1.3 European sustainability reporting standards (ESRS)

The responsibility for drafting European sustainability reporting standards has been assigned to EFRAG due to its role as technical adviser to the Commission, which will issue its technical advice in the form of a first set of draft European Sustainability Reporting Standards (ESRS) to the European Commission in November 2022. This set will be applied to reports published in 2025. Regarding 2024 indicators, for those entities that are already reporting under the NFRD, the final text of the CSRD determined a staggered approach for undertakings to report. It will be followed by sequential sets of ESRS in the following years, with the specific standards for all the undertakings covered by the legislation at both SME or sector-specific level, together with those of non-EU undertakings with subsidiaries or branches in the EU above certain thresholds, from 2025. Moreover, EFRAG is expected to provide a cost-benefit analysis of the proposed draft ESRS.

## 1.4 Objectives

In the context of the work performed by EFRAG on the ESRS, this report aims to assess the costs and benefits of the first set of draft ESRS and presents evidence and data collected in the context of this costs and benefits analysis. Moreover, to support the costs and benefits analysis, this report also presents an assessment of the impact of the first set of draft ESRS across different stakeholder groups. These are mainly EU undertakings (under the scope of the CSRD or that form part of their value chain), investors, NGOs, trade unions and society at large.

*The report thus fulfils the legal obligation for EFRAG under Article 49(3a)b of the CSRD to accompany their technical advice by a cost-benefit analysis that includes analyses of the impacts on sustainability matters.*

## 1.5 Reading guide

The remainder of this report first provides, in **chapter 2,** a brief overview of the **methodologies** used. Such methodologies define the data analysis performed to identify undertakings falling withing the scope of the draft ESRS and the users of the ESRS sustainability report, together with the tools and consultation techniques used. Finally, the chapter addresses the main limitations of the methodologies used.

**Chapter 3** assesses the **direct costs** arising from the disclosure requirements in the first set of draft ESRS. Specifically, the distinctive costs resulting from disclosing sustainability information for undertakings (administrative costs) and the costs resulting from the assurance provided by any third-party assurance provider (assurance costs). This chapter also assesses the impact of various factors that can drive direct costs.

**Chapter 4** provides an overview of the **indirect costs** attributed to the sustainability disclosure requirements. Specifically, the costs for the undertakings in the value chain to provide the requested information to the preparers, litigation costs, and the potential loss of competitiveness at international level due to higher costs resulting from the first set of draft ESRS.

**Chapter 5** describes the **direct benefits** arising from disclosing sustainability information. These cover the reduction of costs both for undertakings and users and who would be able to access comparable and reliable sustainability data more easily among undertakings.

**Chapter 6** evaluates the **indirect benefits** of the sustainability requirements of the first set of ESRS. Specifically, it discusses the impact on undertakings' behaviour and the impact on sustainability for society at large in the areas covered by the ESRS.

**Chapter 7** draws **conclusions** regarding the costs and the benefits of the proposed first set of ESRS.

Additionally, the report covers several **boxes** specifying the types of ownership of the undertakings subject to ESRS; a comparison between the estimates by specific undertaking and for all undertakings combined in the Commission's impact assessment and this report; and finally the cost and benefits of ESRS aligned sustainability reporting into XBRL format.

# 2. METHODOLOGY

This chapter describes the methodology used for data collection and consultation as well as the analysis tools. These include the assessment of the number of undertakings affected by the ESRS whether directly as preparers or indirectly as part of their value chains. The identification of the potential users of sustainability reporting information; seven types of surveys and interviews among undertakings affected by the ESRS and other stakeholders; and analysis of a standard costs model. Finally, this chapter discusses the known limitations and any mitigating measures taken.

## 2.1 Standard Cost Model (SCM)

The assessment of the costs and benefits of the draft first set of ESRS follows the European Commission's Better Regulation guidelines, as defined in Tool #63 on the Better Regulation Toolbox. The assessment further builds on other tools to identify the impacts (Tools #29 to 36) and types of costs and estimate the costs and benefits (Tools #56 to 58).

To ensure comparability of results, a very similar approach to estimate the administrative costs of the NFRD was used (CEPS, 2020). Therefore, to quantify the costs generated by the first set of ESRS, the Standard Costs Model (SCM), was adopted, as defined in Tools #58 of the Better Regulation Toolbox.

Administrative costs usually include two components: i) the so-called 'business-as-usual' (BAU) factor, i.e. costs that regulated entities would incur even in the absence of the obligation under analysis (in this specific case, the costs incurred under the NFRD or voluntary reporting); and ii) the administrative burdens, i.e. the additional costs directly resulting from those administrative activities that regulated entities only perform to comply with a legal obligation.

In a nutshell, the SCM methodology requires measuring the annual cost of each relevant reporting obligation and to identify the share of these costs that are directly generated by regulatory compliance, both recurring (i.e. ongoing) and one-off.

In the assessment of the costs a distinction is made between own costs (e.g. personnel costs) based on the number of hours spend and external expenses (e.g. consultants) based on monetary amounts.

Furthermore the assessment made a distinction between one-off and ongoing obligations/costs, considering that administrative costs may vary across time and usually are higher in the first year of compliance.

For each requirement, the BAU factor, based on direct assessment or empirical data was assessed. This allowed to estimate both the administrative costs as well as the incremental costs, i.e. additional costs for preparers to meet the reporting obligations.

The total costs for the population are calculated by multiplying the average costs per undertaking by the number of undertakings concerned.

## 2.2 Mapping disclosure requirements

The costs and benefits were original estimated for the draft disclosure requirements included in the 13 published draft ESRS exposure drafts (EDs). The estimates were afterwards revised for the disclosure requirements in the draft of the first set of the draft ESRS as provided by the EFRAG Secretariat on 31 October 2022. The mapping was performed for both the original disclosure requirements as well as the revised version. These disclosure requirements were mapped, by carefully reviewing the text of the disclosure requirements. More specifically, the following aspects were mapped:

- A short title of the obligation;
- Indication of the location in the ESRS;
- The type of requirement. notification of activities, submission of reports, cooperation with audit/inspections, application for authorisation/exemptions, registration, etc.;
- The type of required actions (e.g. training of staff, retrieving relevant information, designing information material, completing table and forms, submitting information to the relevant authority, etc.), estimated by focusing on a "normally efficient business";
- A short description of the requirement;
- The target group;
- The frequency of the required actions, i.e. one-off (star-up) or ongoing (indicating the frequency per year);
- Expected cost categories; and,
- Extent that the disclosure requirement has changed compared to the original disclosure draft (only for revised disclosure requirements).

It is important to underline that the EU SCM, and therefore this study, only assessed the costs for the mandatory and additional disclosure requirements as defined in the First Set of draft ESRS. This means that voluntary disclosure requirements are excluded.

## 2.3 Undertakings in scope of the CSRD

The number of undertakings potentially affected by the ESRS was assessed by building on the database prepared for the context of the study on the Non-Financial Reporting Directive. The methodology for the preparation of this database is described in the study on the Non-Financial Reporting Directive (Chapter 2.1 starting on page 16). This study included an estimation of the number of undertakings in scope of the NFRD, but also for the number of large undertakings that will be in scope of the CSRD (about 48 000 in total).

The database prepared for the NFRD study has been used to determine the total number of undertakings in scope and their financials (total assets, turnover, and number of employees), but also the number of undertakings and the financials of the various sub-groups considered for the cost-benefit analysis (listed vs non-listed, undertakings already in scope of NFRD vs those not yet (fully) in scope of NFRD but in scope of CSRD).

## 2.4 Estimation of trickle-down effect

The "trickle-down effect" is estimated based on desk research and stakeholder consultations. The total costs are estimated by multiplying the following factors:

- the number of SMEs in the value chain of preparers of sustainability statements in line with the ESRS;
- the share of SMEs that are likely to be contacted within their value chain by the preparers obtained from the survey among preparers; and,
- the time of own workers and external costs of each disclosure requirement as indicated by the undertakings in the value chain that participated in the survey.

The number of SMEs in the value chain of preparers is estimated based on a similar methodological approach developed by Todeva and Rakhmatullin (2016) to the map the Global Value Chains (GVCs). In simple terms, the value chains of preparers were modelled for different NACE sectors based on the composition of vertically integrated corporate groups proxied by the most innovative European undertakings. The modelled vertically integrated corporate groups were transposed to the universe of

EU undertakings (see CEPS, 2021) to estimate the share of SMEs in the value chain preparers (see Annex 1).

## 2.5 Surveys and interviews

In order to retrieve information from a wide number of stakeholders on the exposure drafts between July and September 2022, five different questionnaires were used for two groups of undertakings and three other groups of relevant stakeholders. In addition, in early November there were two additional surveys conducted among preparers and assurers to update the direct cost estimates.

Based on desk research (and in particular the identification of the disclosure requirements), the draft questionnaires were prepared. The questionnaires on the original exposure drafts were circulated among the EFRAG secretariat as well as among various of the groups working on the ESRS to ensure that the main aspects were covered and test the feasibility of some of the stakeholder groups to complete the questionnaires. The questionnaires on the revised disclosure requirements followed a similar style, but only covered questions related to the compliance costs related to the original exposure drafts that had been subject to major revisions and the new disclosure requirements.

The types of stakeholders and the responses are listed in the table below (see Table 2.1).

*Table 2.1 Types of stakeholders, responses and response rate*

| Type of stakeholder | Responses | Response rate |
|---|---|---|
| **Preparers** | 89 | 6% |
| **Value chain undertakings** | 7 | 1% |
| **Assurers** | 4 | 57% |
| **Other standard setters/rating agencies** | 4 | 14% |
| **Users (e.g. labour unions, investors, NGOs, etc.)** | 11 | 20% |

*Source:* CEPS (2022).

The response rate was negatively influenced by the relatively short period in which the stakeholders were consulted, the conducting the consultation during the summer period and the week of All Saints, and the more detailed questions that were asked to have information by disclosure requirement. The duration and period of the consultation were inevitable considering the delivery date of the report and the detailed questionnaire was necessary to be able to adjust the estimations for revisions of the draft ESRS during the short finalisation period.

The preparers which responded to the survey are in general fairly evenly split across ESRS sectors (see Table 2.2). Among respondents, almost one-third (31%) were part of the manufacturing sector. This represents by far the largest single group among respondents and a higher share than manufacturing undertakings make up amongst all preparers (18%). About one-fifth of respondents (21%) belonged to financial institutions, which is well within range of the share of all preparers belonging to that sector (24%). The next largest group are preparers belonging to the energy sector (10%), which is an overrepresentation of these undertakings in the sample, as they only constitute 2% of all preparers. Sales and trade (7% in sample vs 21% among all preparers in population) and services (4% vs 16%) are conversely underrepresented in the sample. The remainder of the sectors in the sample are all represented within a 2-3% range of the shares these undertakings make up amongst all preparers, except for the hospitality sector which is not represented in the sample. For 3% of all preparers the sector is unknown.

*Table 2.2 Numbers and shares of responding preparers and total preparers by ESRS sector*

| ESRS Sector | Number of responding preparers | Share of responding preparers | Total number of preparers | Total share of preparers |
|---|---|---|---|---|
| Agriculture | 3 | 3% | 274 | 1% |
| Construction | 4 | 4% | 1 160 | 2% |
| Energy | 9 | 10% | 1 190 | 2% |
| Entertainment | 2 | 2% | 265 | 1% |
| Financial institutions | 19 | 21% | 11 312 | 24% |
| Health care | 3 | 3% | 1116 | 2% |
| Hospitality | 0 | 0% | 351 | <1% |
| Manufacturing | 28 | 31% | 8 417 | 18% |
| Mining | 1 | 1% | 175 | <1% |
| Real estate | 2 | 2% | 1 790 | 4% |
| Sales and trade | 6 | 7% | 9 798 | 21% |
| Services | 4 | 4% | 7 516 | 16% |
| Technology | 6 | 7% | 1 278 | 3% |
| Transportation | 2 | 2% | 1 520 | 3% |
| Unknown | 0 | 0% | 1 514 | 3% |

*Note:* The percentages of preparers and respondents do not always equal 100% due to rounding.

*Source:* CEPS (2022).

Responding preparers were also fairly evenly divided across Member States (see Table 2.3). Germany (19 % of all responding preparers) represents by far the largest group in the sample and is still somewhat underrepresented when comparing the share to the total amount of German undertakings among preparers (24%). About one-tenth (9%) of respondents were Austrian and Swedish undertakings respectively. These countries are therefore somewhat overrepresented in the sample, as only 3% of preparers are Austrian and 4% are Swedish among the whole population. Similarly overrepresented were Finland (5% in sample vs 2% in population), Portugal (4% vs 1%) and Belgium (6% vs 4%). All remaining overrepresentations amount to less than 1% each. Mostly the larger Member States were somewhat underrepresented in the sample, such as France (7% vs 12%), Italy (9% vs 12%). Some Member States, which represent only a small share of preparers in the population, are not represented at all in the sample. These countries include Czechia, Estonia, Hungary, Lithuania, Malta, Slovakia and Slovenia.

*Table 2.3 Numbers and shares of responding preparers and total preparers by EU Member State*

| Country | Number of responding preparers | Share of responding preparers | Total number of preparers | Total share of preparers |
|---|---|---|---|---|
| Austria | 8 | 9% | 1 501 | 3% |
| Belgium | 5 | 6% | 1 918 | 4% |
| Bulgaria | 1 | 1% | 374 | 1% |
| Croatia | 1 | 1% | 233 | <1% |
| Cyprus | 0 | 0% | 474 | 1% |
| Czechia | 0 | 0% | 844 | 2% |
| Denmark | 4 | 4% | 1 168 | 2% |
| Estonia | 0 | 0% | 141 | <1% |
| Finland | 5 | 6% | 835 | 2% |
| France | 6 | 7% | 5 932 | 12% |
| Germany | 17 | 19% | 11 454 | 24% |
| Greece | 1 | 1% | 470 | <1% |
| Hungary | 0 | 0% | 631 | <1% |
| Ireland | 2 | 2% | 762 | 2% |
| Italy | 8 | 9% | 5 683 | 12% |
| Latvia | 1 | 1% | 125 | <1% |
| Lithuania | 0 | 0% | 181 | <1% |
| Luxembourg | 1 | 1% | 1 603 | 3% |
| Malta | 0 | 0% | 204 | <1% |
| Netherlands | 5 | 6% | 4 087 | 9% |
| Poland | 4 | 4% | 1 497 | 3% |
| Portugal | 4 | 4% | 701 | 1% |
| Romania | 3 | 3% | 535 | 1% |
| Slovakia | 0 | 0% | 321 | 1% |
| Slovenia | 0 | 0% | 193 | <1% |
| Spain | 5 | 6% | 3 136 | 7% |
| Sweden | 8 | 9% | 1 709 | 4% |
| Unknown | 0 | 0% | 964 | 2% |

*Note:* The percentages of preparers and respondents do not always equal 100% due to rounding.

*Source:* CEPS (2022).

Besides the internal checks build in the questionnaires also the responses were verified with publicly available information and there were follow-ups on the survey responses with remarkably low and high reported amounts or deviating patters when possible. For the estimations in the report only the quantitative information that could be verified has been used.

In terms of follow-up questionnaires, 40 surveys were sent out to preparers for clarification, resulting in 17 responses. Furthermore, 3 questionnaires were sent to assurers, of which all provided responses to the questions. The response rate was similarly impacted by the relatively short timeframe in which the preparers had to fill out the questionnaires.

The presented results are adjusted for a relatively over-representation of bigger large undertakings in the sample. More specifically, the costs/benefits per preparer presented in the report are re-scaled based on the assurance costs of the preparers. The assurance costs for the population are estimated based on the "Study on the Audit Directive (Directive 2006/43/EC as amended by Directive 2014/56/EU) and the Audit Regulation" by Milieu, CEPS and Europe Economics (2022, forthcoming).

## 2.6 Limitations

In considering the findings of this report, it is important to keep in mind that there are some limitations to the methodology and responses received which should be kept in mind. The main limitations are listed below.

First, the vast majority of the information on the undertakings subject to the ESRS is sourced from CEPS (2020), all methodological limitations therein are equally affecting the results of this cost calculation (e.g. lack of socioeconomic indicators for some of the undertakings, treatment of non-LLCs).

Second, the CBA aims to capture the costs and benefits for the main stakeholder groups. Indeed, the results are presented both for an average or normally efficient undertaking as well as for all the undertakings and stakeholders affected by the legislation in the EU combined. This means that the results are not necessarily representative for each individual preparers or users. Moreover, the costs and benefits are only considered for the EU stakeholders, which means that potential costs and benefits for stakeholders outside the EU are excluded (e.g. reporting costs for undertakings in the value chain of preparers outside the EU are not considered).

Third, although there are many especially large PIEs that have experience with non-financial/sustainability reporting, there are no undertakings yet reporting under the draft ESRS. The preparers therefore had to make estimations based on their experiences with sustainability reporting in their organisation of what the ESRS is likely to cost their organisation. These estimations have a risk of deviating from the actual costs that will only be observed after implementation.

Fourth, the preparers and to a lesser extent other stakeholders expressed that the details of the disclosure requirements are unclear to them. For example, various stakeholders were uncertain about the expected data generation, appropriate methodologies to calculate the reporting indicators (e.g. estimate, sampling, continuous monitoring, etc.) as well as which information will have to be provided under the materiality assessment. This unclarity about the exact reporting requirements contributed to a larger deviation in the results between stakeholders. Similarly, for the assurance providers the assurance methodologies still have to be defined in the upcoming years.

Fifth, the estimations of the costs can be quantified much easier than the benefits, which are for this mostly described qualitatively. Indeed, the costs in general have a more direct nature and easier measurable than the benefits that are often conditional to other (behavioural) factors which are more difficult to predict.

Sixth, the empirical research on the indirect benefits of sustainability reporting are limited, which prevents a comprehensive assessment of these benefits in qualitative terms. This is understandable as the impact is likely to only become visible and thus observed in the medium to long-term.

Seventh, the costs are estimated based on current price-levels. Continued higher levels of inflation as well as shortages in sustainability reporting experts might significantly impact the cost and benefit levels going forward.

# 3. DIRECT COSTS

This chapter assess the direct costs linked to the First Set of draft ESRS. Specifically, it presents the administrative and assurance costs and their main potential drivers. The administrative costs are estimated by employing the SCM as defined in the Better Regulation Toolbox (see Section 2.1). The assurance costs include both the costs of existence check of the information by the statutory auditor and the assurance provided by third-party providers.

## 3.1 Administrative costs

Under the first set of draft ESRS, large undertakings must disclose information on environmental, social and governance (ESG) factors. As a direct impact of the CSRD, the disclosure requirements will likely impose a burden on these undertakings. The additional costs incurred can vary depending on the extent to which undertakings were already subject to the NFRD prior to the CSRD, and on their voluntary reporting. For example, large undertakings preparing non-financial reporting, otherwise known as preparers, already collect and report some sustainability information. By contrast, non-listed preparers that do not fall under the scope of the NFRD (non-NFRD) are much less likely to collect sustainability data, given that the cost of reporting voluntarily is significant. Also, non-NFRD undertakings that do not yet report may face difficulty in aligning themselves with reporting competitors. The degree of direct administrative cost burden will, thus, vary among different types of undertakings based on the extent to which each preparer is already preparing sustainability information.

As the first set of draft ESRS is still under revision, most undertakings that were not subject to the NFRD have expressed concerns regarding the methodology of collecting data. In turn, the direct administrative costs stemming from the ESRS can also vary between ESG factors. The amount of environmental and social matters to be reported on are more than double those on governance. Overall, preparers who were surveyed incorporate more environmental reporting than other sustainability data.

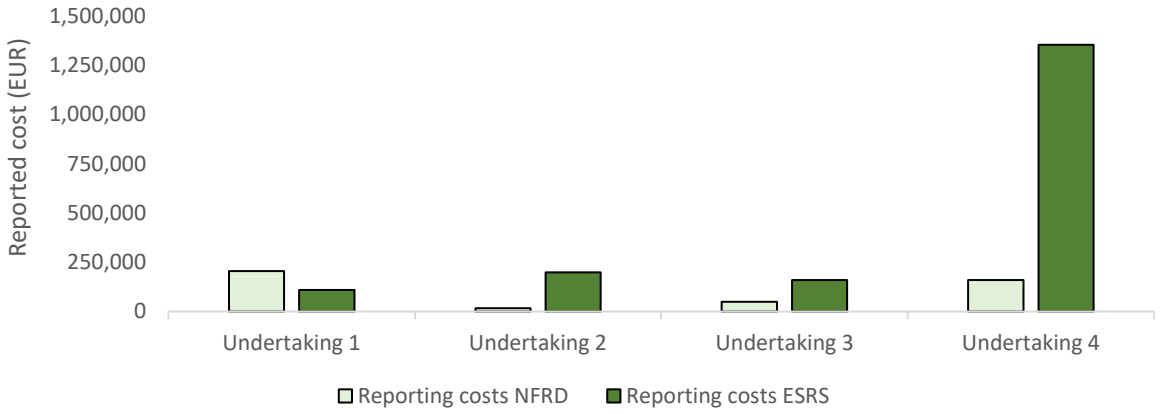
In addition, the initial cost (i.e. one-off cost) incurred exclusively at the first time of reporting is likely to be a substantial addition to the ongoing or recurring cost of sustainability reporting. This is because in the first year, the administrative burden of creating or implementing a reporting mechanism is large, especially for undertakings that have no experience in collecting this kind of information. Each one-off and recurring cost is divided into the cost incurred internally in an undertaking (i.e. own cost), and the cost of outsourcing the data collection and compilation process to third parties (i.e. external cost).

*Box 1. Change in administrative costs from NFRD standardised reporting to ESRS*

The scope of ESRS reporting requirements is substantially larger than that of the more comprehensive reporters under the NFRD[1], raising questions about the accompanying change in administrative costs. In general, comparing the results from both CEPS (2020) on the administrative costs under the NFRD and this report on the expected administrative costs under the ESRS, an increase in administrative costs is suggested. The administrative costs for preparers that responded to all three surveys (two for this report) differ greatly, possibly as a result of varying company sizes, economic sectors and characteristics of the value chain.

Based on a small set of four undertakings that reported their (expected) costs for both the NFRD and ESRS disclosure requirements, costs are expected to increase for three out of four undertakings (see Figure 3.1). Of those that reported an increase in costs, the range of increases is large. Increases in administrative costs range from double to an increase of over tenfold. This vast range of increases, coupled with the dispersion of values within it, shows that cost increases are expected to vary considerably based on the nature of the undertaking.

*Figure 3.1 Comparison of administrative costs under NFRD vs CSRD/ESRS*




*Note:* The figure indicates the undertakings that have responded to both CEPS surveys on the NFRD and ESRS respectively. The undertakings are presented in anonymised form.

*Source:* Analysis based on CEPS (2020 and 2022) results.

A closer look at the undertakings in question, as well as at the costs reported for the individual ESRS disclosure requirements, reveals that differences in cost increases can in part be explained by the sector to which the undertaking belongs and the length (and size) of its value chain. For example, the largest reported increase comes from an undertaking whose products (for a part) affect biodiversity and GHG emissions, requiring inputs from a large number of customers.

[1] The term 'more comprehensive reporters' is defined in line with 'standard reporters' in CEPS (2020). It covers those respondents who apply a reporting standard or framework or who follow several standards or frameworks that collectively result in equally detailed reporting.

At the other extreme, among those preparers reporting the lowest increase (or decrease) are undertakings that operate in the IT or telecom sectors. These sectors naturally have a lower impact on areas of the environment, either because they deliver services or because they focus on products with a lower environmental footprint. In addition, value chains in these sectors tend to be shorter and the amount of people employed lower. Especially when the employees of these preparers form a rather uniform, highly educated, group, reporting on fair remuneration practices and size of workforce becomes less resource-intensive. In general, smaller size, focus on services and a low environmental impact make (the increase in) reporting costs lower.

Overall, reporting costs are expected to increase among preparers, with large differences attributable to sector, size and complexity. Preparers with long and complex value chains that manufacture products with a large environmental impact expect to see the largest increases in administrative costs. Smaller, high-value service-delivering preparers that operate in the digital space (and thus tend to have a low environmental impact) are expected to see increases as well, albeit at a much lower rate.

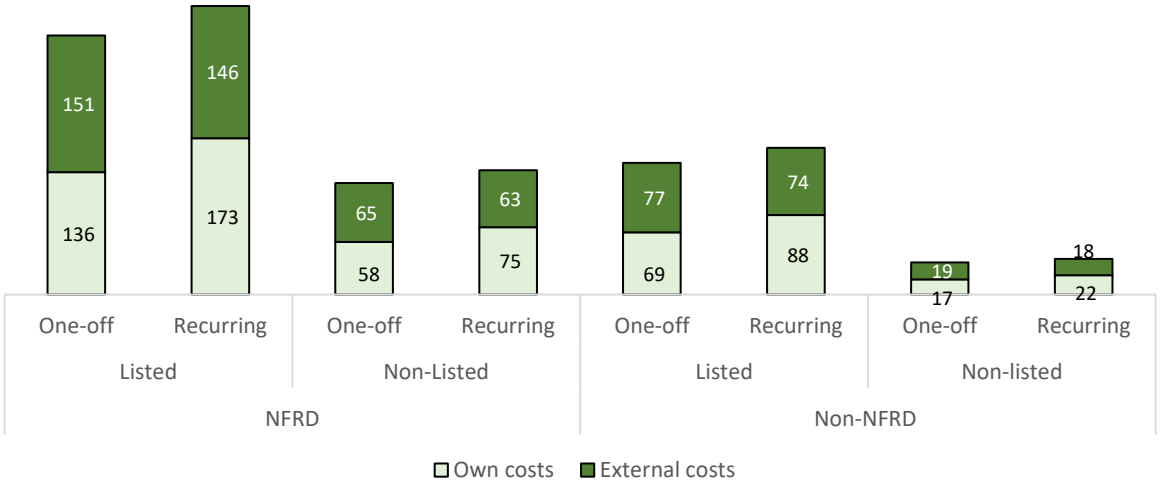
### *3.1.1 Cost per preparer*

Preparers expect to face substantial administrative burden on a one-off and recurring basis. In the first year of reporting the disclosure, EU preparers will face both one-off and recurring costs, as the former includes set-up costs and the latter staff costs (see Figure 3.2). One-off costs are primarily due to the new internal processes and models that have to be put in place by preparers to satisfy all the ESRS requirements, while recurring costs are primarily due to the reporting itself.

Overall, for all categories of preparers, recurring costs are only slightly larger than the one-off costs. Furthermore, preparers expect administrative costs of external advice to be overall as significant as own costs. In particular, the stakeholders who were surveyed expected to turn to external consultancies due to their lack of in-house expertise on sustainability reporting. The relatively recent move towards sustainability reporting implies the lack of incumbent internal mechanisms for some EU preparers. This is particularly the case for one-off costs, where the ratio of external to own costs is higher than for recurring costs. In practice, if the ESRS give more specific guidance on data collection, the administrative costs will be reduced.

Looking at administrative costs in absolute terms, the largest cost in absolute value (both one-off and recurring) is faced by NFRD listed undertakings. These are usually large undertakings requiring longer data collection processes. They expect to face, on average, a total of EUR 287 000 as a one-off cost of reporting and about EUR 320 000 on annual basis (of which EUR 173 000 for own costs equivalent to between 2 and 2.5 FTEs on average). Non-NFRD non-listed undertakings incur the lowest administrative costs, primarily due to their smaller average size. Their costs are expected to reach about EUR 36 000 on a one-off basis and EUR 40 000 on a recurring basis.

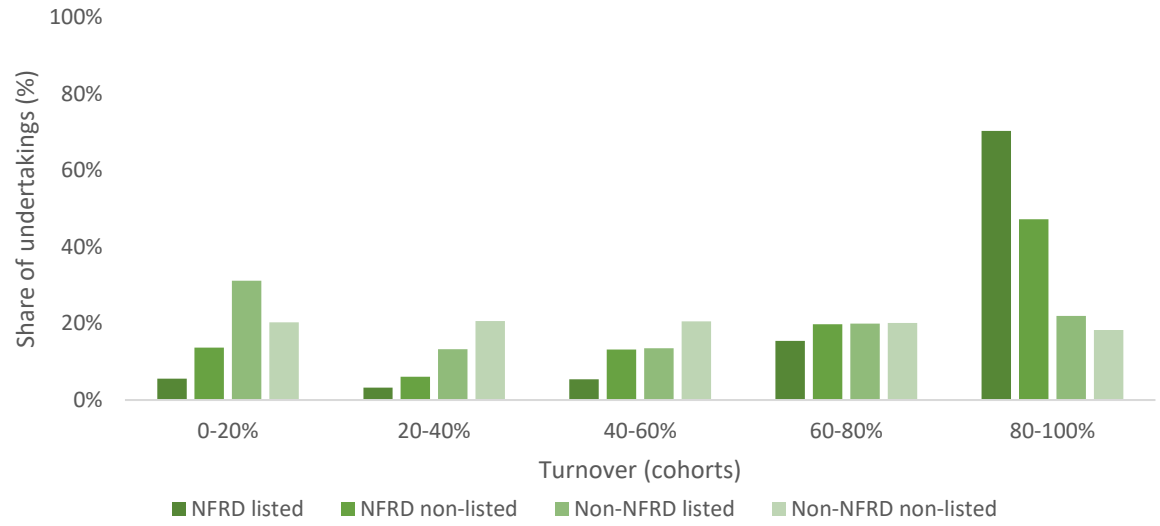
*Figure 3.2 Administrative costs per preparer (EUR thousand)*




*Source:* CEPS (2022).

In turn, in relative terms (i.e. share of turnover) NFRD listed undertakings have the smallest burden of reporting costs (see Figure 3.4). NFRD listed undertakings reported that they did not intend to significantly outsource ESRS reporting tasks. NFRD non-listed undertakings incur the most prominent administrative costs. An average EU preparer in this category is expected to spend about 0.02% of their turnover per year and the first time of reporting an addition 0.01% of their turnover. These costs are about double those of a preparer that is in the NFRD scope and is listed. This is largely due to the fact that the majority of non-listed undertakings are smaller in size compared to listed undertakings. For these preparers, the shares of own and external costs are also comparable (see Figure 3.3).

*Figure 3.3 Distribution of undertakings in population across turnover cohorts*



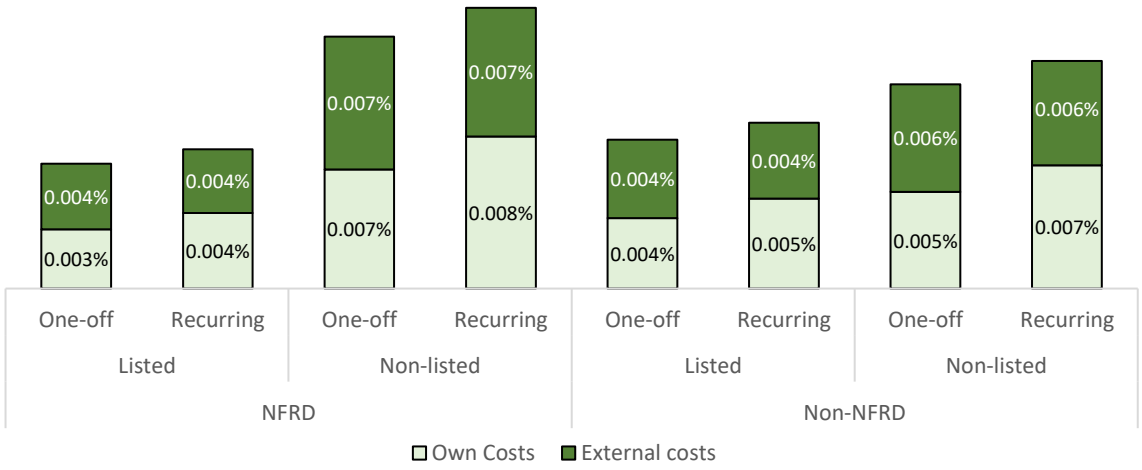

*Note:* The figure above illustrates the distribution of the different categories of undertakings in the population across turnover cohorts (e.g. 0%-20% captures the 20% of the undertakings with the lowest turnover in the population of large undertakings).

*Source:* CEPS (2022).

Non-NFRD non-listed undertakings will also incur substantial costs in relative terms, largely due to the fact that they do not currently report sustainability information and will have to start from scratch.

Indeed, according to the survey, the majority of administrative costs for non-NFRD undertakings arise from implementing due diligence processes and legal advice. For both NFRD and non-NFRD non-listed undertakings, the one-off costs as a share of turnover are estimated to be higher than the one-off costs for listed undertakings.

*Figure 3.4 Administrative costs per preparer (% of turnover)*

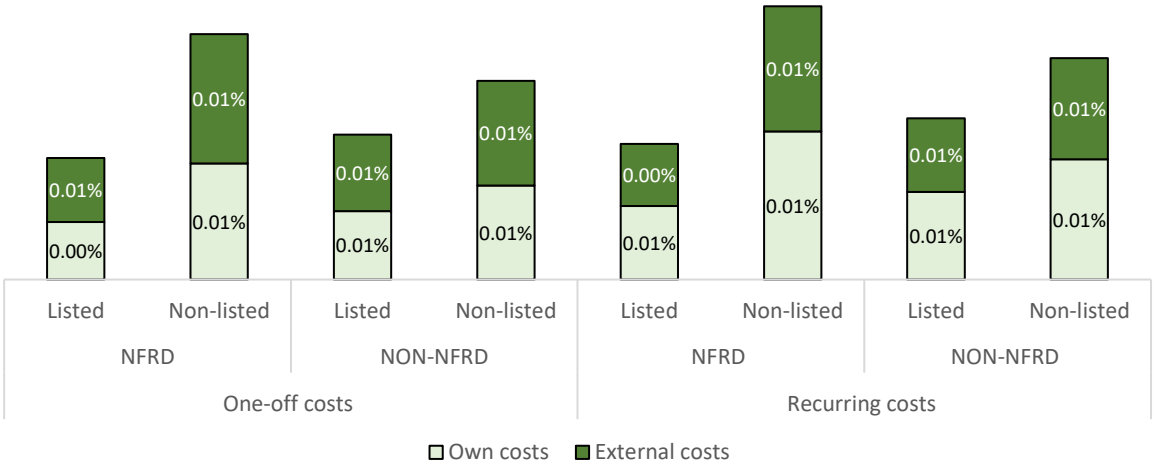



*Source:* CEPS (2022).

The expected relative costs in terms of operating expenses[2] (see Figure 3.5) largely reveal the same trend as the administrative cost relative to turnover. Operating expenses as a share of turnover are slightly higher as they include employee, administrative and sales expenses, which for a typical undertaking are less than the turnover.

[2] Operating costs are approximately 80% of the average sample turnover.

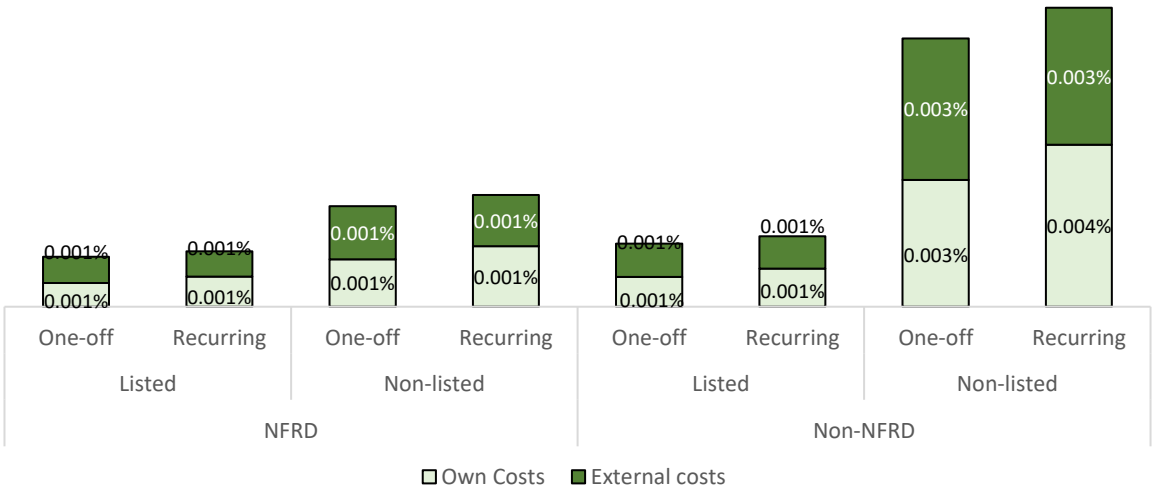
*Figure 3.5 Administrative costs per preparer (% of operating costs)*




*Source:* CEPS (2022).

Administrative costs as a share of total assets are most prominent for non-NFRD non-listed EU undertakings. These are expected to experience three times the one-off and recurring costs of reporting sustainability data (see Figure 3.6)[3]. These institutions are on average smaller than listed NFRD institutions, hence for them the additional burden of ESRS reporting will be more substantial. Overall, one-off administrative costs are largely similar in relative terms. This is especially the case for undertakings already disclosing sustainability information under the NFRD.

*Figure 3.6 Administrative costs per preparer (% of total assets)*




*Source:* CEPS (2022).

[3] Costs as a share of total assets are assessed because for financial institutions, assets are a more accurate measure of size compared with turnover.

Looking at the breakdown of the total recurring administrative costs by ESRS chapter, E1 on climate change is responsible for the largest share of recurring administrative costs incurred by prepares (see Table 3.1). In fact, almost one-third (28%) of total recurring administrative costs are related to this ESRS chapter, mostly due to the relative complexity of the technical information required under this ESRS chapter. E2 on biodiversity and ecosystems is the second largest chapter in terms of costs and accounts for slightly more than one tenth (11%) of total administrative costs. Two social (ESRS S3 and ESRS S4) and one governance chapter (ESRS G1) are the least costly, each accounting for about 2% of total recurring administrative costs. The share of costs related to the remaining seven ESRS chapters range between 7% and 10% of recurring administrative costs.

*Table 3.1 ESRS disclosure chapter by share of total recurring administrative costs*

| ESRS Chapter | Share (%) |
|---|---|
| ESRS 2 General disclosures | 9.6 |
| ESRS E1 Climate change | 27.5 |
| ESRS E2 Pollution | 8.8 |
| ESRS E3 Water and Marine Resources | 7.8 |
| ESRS E4 Biodiversity and ecosystems | 11.1 |
| ESRS E5 Resource use and circular economy | 9.4 |
| ESRS S1 Own workforce | 9.4 |
| ESRS S2 Workers in the value chain | 9.8 |
| ESRS S3 Affected communities | 2.1 |
| ESRS S4 Consumers and end-users | 2.1 |
| ESRS G1 Business conduct | 2.3 |

*Source:* CEPS (2022).

The top 10 ESRS disclosure requirements with highest recurring cost for preparers (see Table 3.2) are aligned with the breakdown of total costs by chapter. Undertakings face high administrative costs due to disclosure requirements mainly relating to the environmental aspect of sustainability reporting. In fact, 9 out of the top 10 disclosure requirements with the highest recurring costs are environmental requirements. In particular, disclosure requirement E1-6, 'gross scope 1, 2, 3 and total GHG emissions', imposes the largest cost (8.4% of total cost) on preparers. It requires that EU undertakings disclose GHG emissions in metric tons of CO2 equivalent and disaggregate the information for the parent and subsidiaries. Therefore, calculating all types of GHG emissions requires preparers to have the technical expertise and time to collect and process the data. This may involve setting up systems and processes for a preparer's own operations, but also throughout its upstream and downstream value chain. The second most costly requirement (6.5%) is disclosure requirement S2-2, 'processes for engaging with value chain workers about impacts', which requires undertakings to disclose general processes for engaging with value chain workers about their material impacts. Collecting sustainability information beyond the undertakings' own operations is likely to require time and processing.

*Table 3.2 Top 10 ESRS disclosure requirements with highest recurring administrative costs*

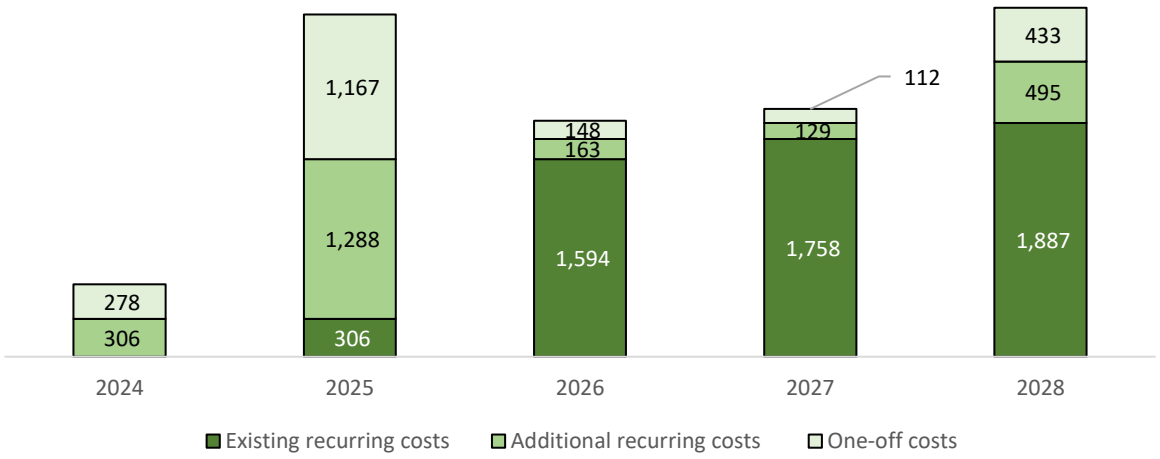
| Rank | ESRS disclosure requirement | Share (%) |
|---|---|---|
| 1 | E1-6 – Gross scope 1, 2, 3 and total GHG emissions | 8.4 |
| 2 | S2-2 – Processes for engaging with value chain workers about impacts | 6.5 |
| 3 | E1-9 – Potential financial effects from material physical risks, material transition risks and climate-related opportunities | 5.3 |
| 4 | E1-7 – GHG removals and GHG mitigation projects financed through carbon credits | 3.5 |
| 5 | E4-5 – Impact metrics related to biodiversity and ecosystems change | 2.5 |
| 6 | E2-6 – Potential financial effects from pollution-related impacts, risks and opportunities | 2.4 |
| 7 | E1-3– Action plans and resources in relation to climate change mitigation and adaptation policies and targets | 2.3 |
| 8 | E1-4 –Targets related to climate change mitigation and adaptation | 2.2 |
| 9 | E5-5 – Resource outflows | 2.2 |
| 10 | E5-3 – Action plans and resources in relation to resource use and circular economy | 1.9 |

*Source:* CEPS (2022).

Looking at the breakdown of total costs by year, the costs increase gradually as the ESRS comes into force (see Figure 3.7). Initially, EU undertakings will incur the one-off and recurring costs, adding up to EUR 584 million in order to implement those disclosure requirements that must be reported in the first financial year. In the following years, besides existing recurring costs, an additional recurring cost is incurred due to the phase-in of new disclosure requirements. The largest additional cost (EUR 1.9 billion of which EUR 1.3 billion recurring) is expected to be incurred in 2025. This is because non-NFRD undertakings will have to start disclosing sustainability information in 2025, one year later than NFRD undertakings.

The reporting year of 2028 is the final year of the CSRD phase-in, and therefore shows final total recurring costs that will be incurred on annual basis. The increase in costs in 2028 is largely due to the last wave of disclosure requirements concerning the value chain, which will be applied in 2027.

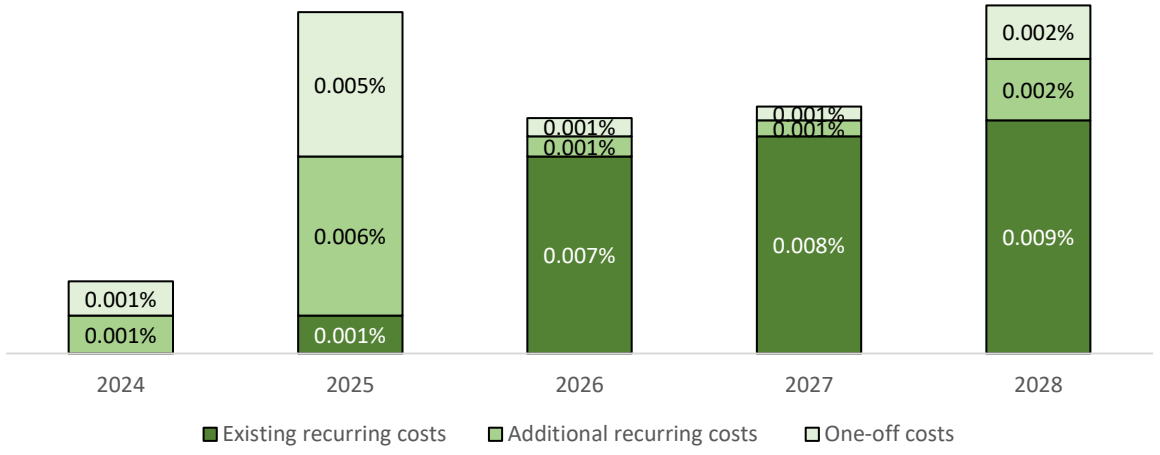
*Figure 3.7 Total administrative costs by year (EUR million)*




*Source:* CEPS (2022).

In relative terms, the total cost of implementing the disclosure requirements as a percentage of turnover also experiences the largest increase in 2025 and 2028 (see Figure 3.8). The initial cost in the first year of applying the disclosure requirements will represent a small proportion of EU turnover (0.002% in 2024). In 2025, the total costs are expected to increase and reach 0.01% of EU turnover. Finally, by 2028 the one-off and additional recurring costs as share of turnover would be double the initial one-off and additional recurring costs. Overall, EU undertakings would pay about 0.01% of the total turnover on an annual basis after 2028.

*Figure 3.8 Total administrative costs by year (% of turnover)*

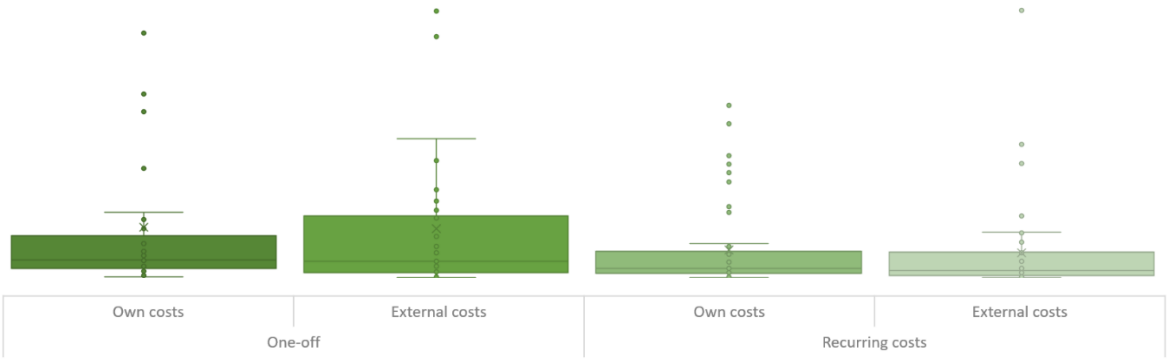



*Note:* This chart does not take future dynamics of turnover of undertakings into account.

*Source:* CEPS (2022).

When considering the results it is important to consider that the presented costs aim to capture the averages for the normally efficient undertakings in the respective categories. Within these categories there can nevertheless be significant differences in the costs for individual undertakings, as illustrated in Figure 3.9 below for the listed NFRD undertakings. This differences can have various potential reasons including, company size, complexity in structure, reliance on external service providers, differences in relative expected workload, price level, etc.

*Figure 3.9 Distribution of cost estimates for listed NFRD undertakings in the sample*




*Source:* CEPS (2022).

### *3.1.2 Total costs*

Scaling up the direct cost of sustainability reporting to the entire population of undertakings falling within scope of the CSRD allows to gauge the total cost of the first set of draft ESRS to the EU economy. In total, the population of undertakings used in a previous NFRD study (CEPS, 2021) encompasses a representative sample of 47 676 EU undertakings. The same population of preparers is used for this report to preserve consistency and comparability. The preparer population is divided into four categories: i) NFRD listed; ii) NFRD non-listed; iii) non-NFRD listed; and iv) non-NFRD non-listed. Most of these undertakings (95%) are neither listed nor subject to the NFRD.

The estimated total costs of the ESRS at EU level (see Figure 3.10 and Figure 3.11) point to three key findings:

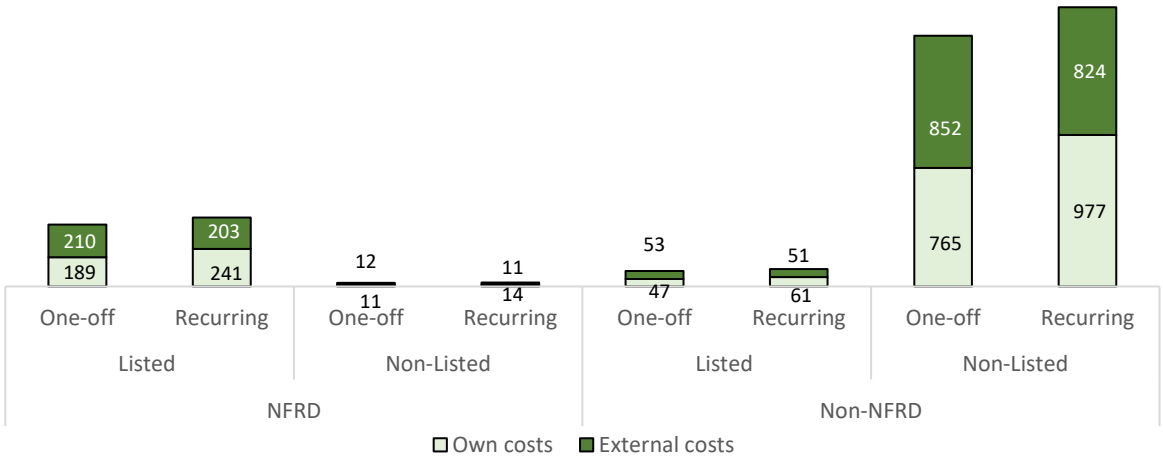
- Administrative costs are, on average, about the same on both a one-off and recurring basis for all preparers' categories.
- External costs and own costs account for approximately a similar share of one-off and recurring costs.
- Non-NFRD non-listed undertakings are expected to have the highest relative administrative and incremental costs.

Preparers across all categories will incur the majority of costs at their first time of reporting. Administrative costs at the first time of reporting include both one-off and recurring costs, which makes the initial cost of reporting under the ESRS higher than in subsequent years.

Additionally, the share of external costs in total costs varies across preparer category. External costs largely cover the outsourcing of data collection, estimation and reporting. As some undertakings already have methodologies for these activities in place, they will incur lower external costs. For example, the external cost as a monetary amount is much larger for non-NFRD non-listed undertakings than for other categories.

Overall, non-NFRD non-listed undertakings are set to experience the largest collective direct costs as a result of the ESRS. For these preparers, the total one-off cost is estimated to be around EUR 1.6 billion and recurring costs at EUR 1.8 billion. Such large costs for non-listed non-NFRD undertakings can be explained by their dominant share (95%) of undertakings in the population of preparers. The total administrative costs for all undertakings combined are estimated at EUR 2.1 billion in one-off costs and EUR 2.4 billion in recurring costs.

*Figure 3.10 Total administrative costs (EUR million)*




*Source:* CEPS (2022).

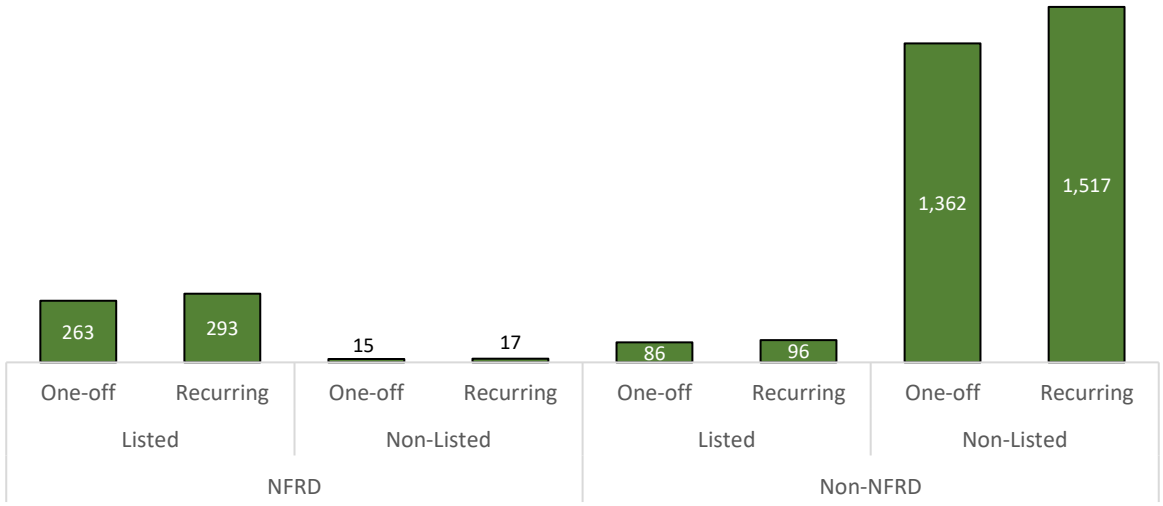
### *3.1.3 Incremental costs*

Incremental costs are described as additional costs that arise from undertakings conducting activities in order to comply with legal obligations and would have not been otherwise incurred. These costs are on top of the business-as-usual costs that result irrespective of legal requirements.

Looking at these incremental costs, the total incremental costs are estimated at EUR 1.9 billion recurring and an additional EUR 1.7 billion in one-off costs (see Figure 3.11). Non-NFRD non-listed undertakings are expected to have the highest incremental costs in absolute values. This also holds true when looking at the share of administrative costs that would have been incurred as good practice in the absence of the ESRS. For NFRD undertakings, this share stands at 34% of total one-off and recurring costs. However, non-NFRD undertakings would incur a much smaller share of estimated administrative costs if the ESRS were not implemented – only an estimated 16% of total one-off and recurring costs.

The extent of additional costs to the wider EU population of undertakings signifies that the most affected group under the ESRS in terms of total incremental administrative costs is non-listed non-NFRD undertakings. This is primarily due to their lack of experience and in-house expertise with sustainability reporting.

*Figure 3.11 Total incremental administrative costs (EUR million)*




*Source:* CEPS (2022).

Administrative costs will not be incurred all at once. This is largely for two reasons: i) the implementation deadline differs across disclosure requirements; and ii) the implementation date differs across preparer type (2024 for NFRD undertakings and 2025 for non-NFRD undertakings).

For the first years of the CSRD application, some disclosure requirements are subject to a specific number of years to 'phase-in' the disclosure requirement in their reporting. This is particularly the case for the requirements regarding the value chain, given the difficulty in obtaining such information. For example, disclosure requirement E1-6 on 'gross scope 1, 2, 3 and total GHG emissions' allows for a three-year phase-in period. Otherwise, disclosure requirements need to be implemented in the first year of the legislation's introduction.

Additionally, non-NFRD undertakings that previously did not have to report sustainability information have been given a one-year derogation compared to NFRD undertakings (2025 instead of the 2024 financial year).

Incremental costs also include costs stemming from disclosure requirements that allow preparers and financial institutions to comply with other legislation. In particular, the ESRS overlaps with the Sustainable Finance Disclosure Regulation (SFDR) and the sustainability reporting requirements under pillar 3 as defined in the Capital Requirements Regulation (CRR) across a number of disclosure requirements.

The ESRS overlap with the SFDR mostly relates to the requirements applicable to investments in investee undertakings. The overlap touches upon climate and other environment-related indicators, indicators related to social and employee matters, respect for human rights, anti-corruption and anti-bribery issues. On top of their general application, these areas of application also include indicators affecting FMPs and advisors. The climate and environment-related indicators mainly have an impact on investments in investee undertakings and investments in real estate assets. The indicators for social and employee rights, respect for human rights, anti-corruption and anti-bribery matters apply to investments in investee undertakings.

Sector-specific reporting requirements on climate and environmental indicators apply specifically to real estate assets in which FMPs have invested, which will be further developed under the second set of ESRS (indicated in Article 19b(1)b(ii) CSRD).

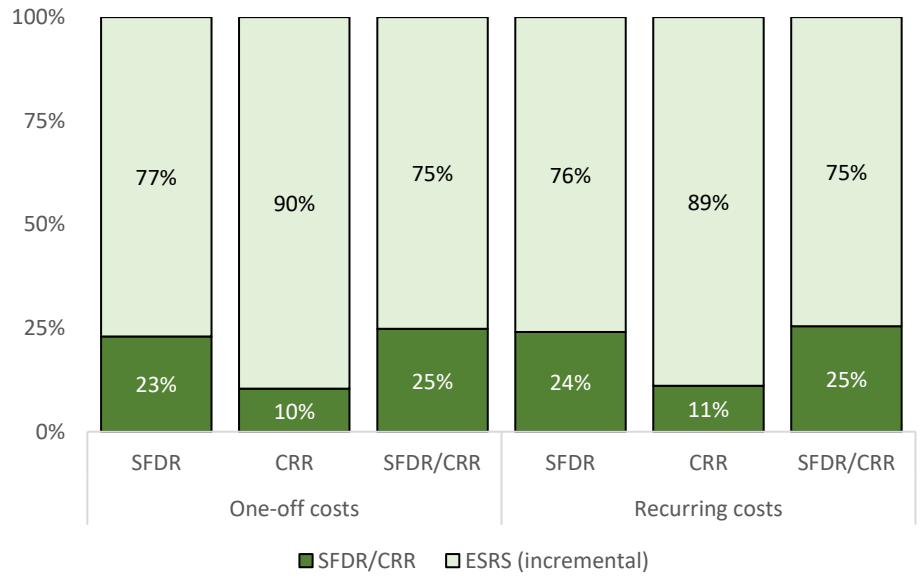
The sustainability reporting requirements under the ESRS embed some of the requirements for pillar 3 reporting under the CRR. There are three specific areas that overlap with the ESRS, including:

- Environmental transition plan. Under disclosure requirement E1-1, the undertaking is required to indicate whether it is exempted from reporting under the Climate Benchmark Standards Regulation (CBSR). Added is also a clear plan for the undertaking on how to reduce its environmental impact.
- GHG emissions under disclosure requirement E1-6. The undertaking has to report its total GHG emissions split by scope.
- Financial effects originating from physical risks. What has been added to the reporting, found in disclosure requirement E1-5, is that undertakings reporting under pillar 3 are now required to split by EU location the significant exposure of their assets.

The reporting requirements under the ESRS that are not mentioned with regard to the SFDR or the CRR do not overlap with any of the requirements under CRR pillar 3 and are potentially entirely new reporting requirements for these undertakings.

Overall, up to a quarter of the incremental administrative costs can be attributed to SFDR and CRR pillar 3 sustainability reporting (see Figure 3.12). Only slightly less than one quarter of one-off costs (23%) are due to the SFDR, and about one tenth (10%) are due to the CRR. Taken together, the share of incremental costs stemming from both the SFDR and CRR is estimated at a quarter (25%) due to the overlap between the legal provisions of the two regulations. The estimates are similar for the recurring costs, with the share of incremental costs attributable to the SFDR and CRR being about a quarter (25%).

*Figure 3.12 Share of incremental costs for requirements overlapping with SFDR/CRR (%)*




*Source:* CEPS (2022).

### *3.1.4 Conclusions*

As a result of the ESRS implementation, undertakings falling within the scope of the CSRD are likely to incur a similar burden from one-off and recurring administrative costs. For each one-off and recurring cost, the share of own and external costs is of similar magnitude. At the first time of disclosure, undertakings will face a one-off cost but also the recurring cost. This holds true for undertakings that were already reporting non-financial information prior to the implementation of the ESRS and for those that have yet to start reporting.

Listed undertakings that were already reporting under the NFRD are expected to have the largest administrative costs in absolute terms. This is in line with the understanding that large and more complex undertakings, such as public interest entities (PIEs), experience larger absolute costs for the same requirements. These incremental costs, compared with the current non-financial reporting under the NFRD, are mainly attributed to additional ESRS disclosure requirements that were not previously reported by most undertakings subject to the NFRD. In turn, listed NFRD undertakings face the lowest administrative costs relative to turnover, operating expenses and total assets.

Undertakings that previously did not fall within the scope of the NFRD are set to face the highest relative administrative costs. Non-listed non-NFRD undertakings are particularly affected. This is primarily due to their smaller average size, as well as more limited experience and in-house expertise when it comes to: i) collecting detailed sustainability information; and ii) the broad scope of reporting requirements (i.e. own operations and value chain). In this context, incremental costs for non-NFRD undertakings represent a higher share of turnover and operating costs than administrative costs. This implies that the additional cost arising solely from the legal obligation to report sustainability information is substantial.

## 3.2 Assurance costs

This section assesses the assurance costs that are likely to be incurred by large undertakings that would need to report under the first set of draft ESRS. More specifically, assurance costs cover the expected assurance costs for the preparers that are related to the provision of a sustainability statement aligned with the draft ESRS. Such assurance costs may differ depending on the type of assurance obtained by the statutory auditor, which can be either limited assurance or reasonable assurance. The former is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement, as the basis for a positive form of expression of the practitioner's conclusion. On the other side, limited assurance implies a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusions.

The CSRD introduces a general assurance requirement to report sustainability information. Even though the main objective is to reach a similar level of assurance for both financial and sustainability reporting, the intention is first to start with a limited assurance requirement in order to avoid imposing a reasonable assurance in this first step. A limited assurance requirement has the advantage of being more affordable for undertakings, as well as being more consistent with regard to the current situation of the audit services market. In addition, the proposal allows the sustainability assurance market to be broadened to include 'independent assurance service providers', which are undertakings other than common auditors on financial information that can be chosen to assure sustainability information.

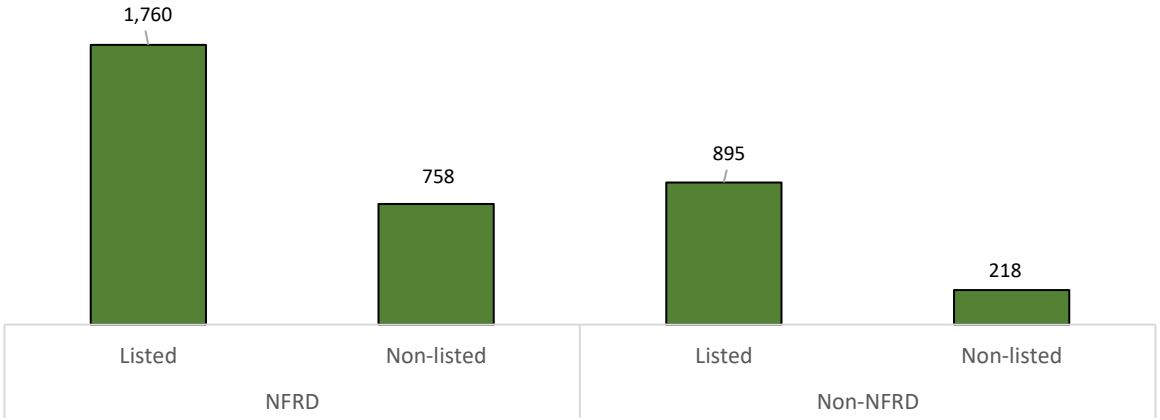
### *3.2.1 Costs per preparer*

Assurance costs for preparers vary depending on the undertaking's characteristics (size, complexity, economic sector, etc.) and implementation phase. In order to reflect these characteristics, the assurance costs have been estimated based on the annual (financial) audit costs. These costs, which are also known as financial assurance costs, include the fees paid to the audit firm or auditor for the audit of the financial statements. Financial assurance costs include the audit fees, leaving aside other audit fees such as audit-related fees, tax advice fees, and other fees. In this sense, the annual financial assurance fees shown below are on average smaller than what could be expected for any undertaking, as it only includes a portion of the total audit fees an undertaking faces on an annual basis.

On average, listed undertakings have higher financial assurance costs than non-listed ones (see Figure 3.13). This difference can be partially explained by the additional reporting requirements placed on listed undertakings. In both cases, undertakings subject to NFRD reporting face much larger assurance costs on average than undertakings not in the scope of the NFRD. As these undertakings are PIEs (listed undertakings, banks, insurances), they have stricter audit requirements than non-PIEs. Therefore, the costs for listed NFRD undertakings are in general much higher than those for listed non-NFRD undertakings. The same holds for non-listed NFRD undertakings facing much higher assurance costs than non-NFRD non-listed undertakings.

This is explained by two facts. First, listed undertakings are required to prepare their financial statements in line with certain standards, such as IFRS. Second, listed undertakings and undertakings under the NFRD usually have more complex corporate structures than non-listed undertakings. As a consequence, the scope of the statutory audit is necessarily more comprehensive, which results in higher financial assurance costs for listed undertakings.

*Figure 3.13 Average financial assurance costs per year (EUR thousand)*




*Source:* CEPS (2022).

Initial average assurance costs are analysed based on the type of assurance engagement obtained by the statutory auditor (see Figure 3.14 and Figure 3.15). The applicable range for undertakings receiving limited assurance is from around 20% to 30% of average financial assurance costs, while for undertakings obtaining reasonable assurance the range is from 45% to 75% of average financial assurance costs. The differences in the ranges between limited and reasonable assurance are related

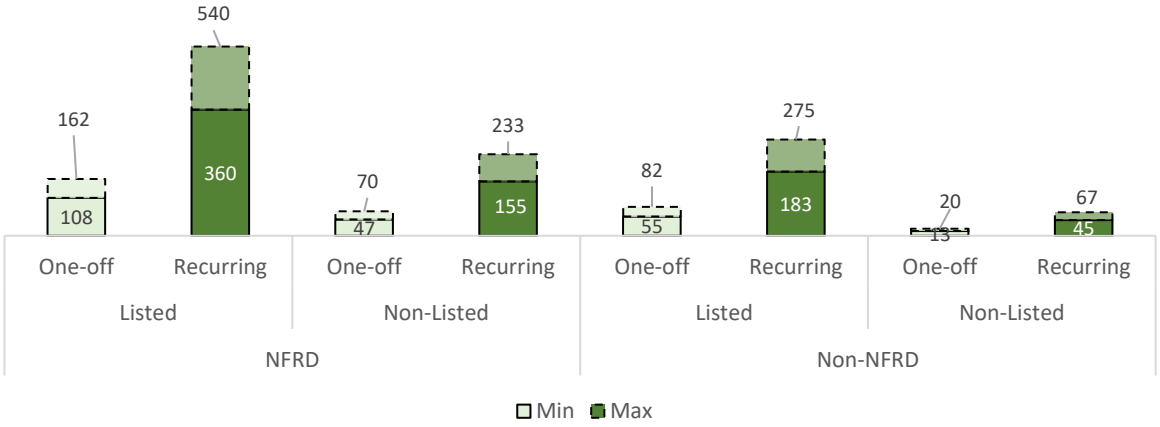
to the nature and extent of the audit procedure, which is significantly larger for reasonable assurance. Therefore, this has a direct impact on assurance costs.

Looking at the time-dependency of the average assurance costs for both limited and reasonable assurance, it is possible to see a difference between first-time assurance costs (i.e. one-off costs) and subsequent assurance costs (recurring costs). The difference considered is based on the assurers survey results, where auditors indicated that at least during the first two to three years after the implementation of the ESRS phase, undertakings might face higher initial costs. This is explained by the establishment of a reliable reporting practice, which is currently mostly absent. In addition, initial costs will be higher as assurance providers will have to gain or enhance an understanding of the systems and processes to provide the assurance work, which will require corrections and changes particularly during the first years. The assurance providers consulted in the context of this study indicated that one-off assurance costs are expected to be around 30% higher on average than ongoing costs.

As shown in the figures below, average assurance costs are higher for listed undertakings than for non-listed undertakings, for both one-off and ongoing costs. Listed NFRD undertakings have the highest average assurance costs for both limited and reasonable assurance engagement in the first and subsequent years. The minimum one-off cost for this group under limited assurance is EUR 108 000, and can reach a maximum of EUR 162 000. In addition, the same group of undertakings obtaining reasonable assurance face a minimum average compliance cost of EUR 246 000, which can reach a maximum of EUR 394 000.

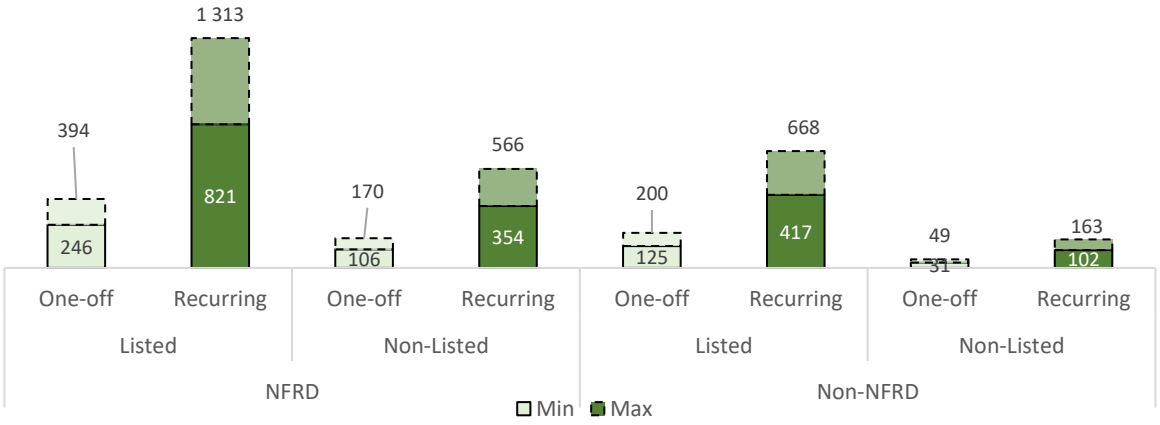
In turn, non-listed undertakings not subject to the NFRD have the lowest average assurance costs for both types of assurance engagement. This is explained by the fact that the majority of undertakings in this group are non-PIEs, which are subject to less strict audit requirements compared to PIEs subject to the NFRD.

*Figure 3.14 Assurance costs per undertaking for limited assurance (EUR thousand)*




*Source:* CEPS (2022).

*Figure 3.15 Assurance costs per undertaking for reasonable assurance (EUR thousand)*




*Source:* CEPS (2022).

### *3.2.2 Total costs*

Compared to the average costs for assurance and its variants discussed in the previous figures, where the costs were much larger for NFRD undertakings, the opposite is true for total costs. As there are many more non-NFRD undertakings than NFRD undertakings, the total cost borne by all undertakings together is much higher than for the small number of undertakings that are already NFRD compliant. Conversely, as the single undertakings that are NFRD compliant are on average much larger in terms of turnover and therefore costs, average costs for assurance are much higher for these undertakings. Furthermore, undertakings subject to NFRD reporting are PIEs by definition (either undertakings with securities listed on regulated exchanges, insurance companies or banks). They already face stricter audit requirements and have established the necessary auditing practices for CSRD reporting. This naturally lowers their initial one-off costs.

Looking at the total costs for limited assurance (see Figure 3.16), by far the largest share of total costs is borne by non-listed non-NFRD undertakings. In terms of one-off costs, these undertakings are estimated to pay EUR 0.6 billion to EUR 0.9 billion. The recurring costs fall in between EUR 2.0 billion and EUR 3.0 billion. Compared to these figures, listed non-NFRD undertakings' costs are miniscule, with EUR 38 million to EUR 57 million for one-off costs and EUR 126 million to EUR 189 million for recurring costs.

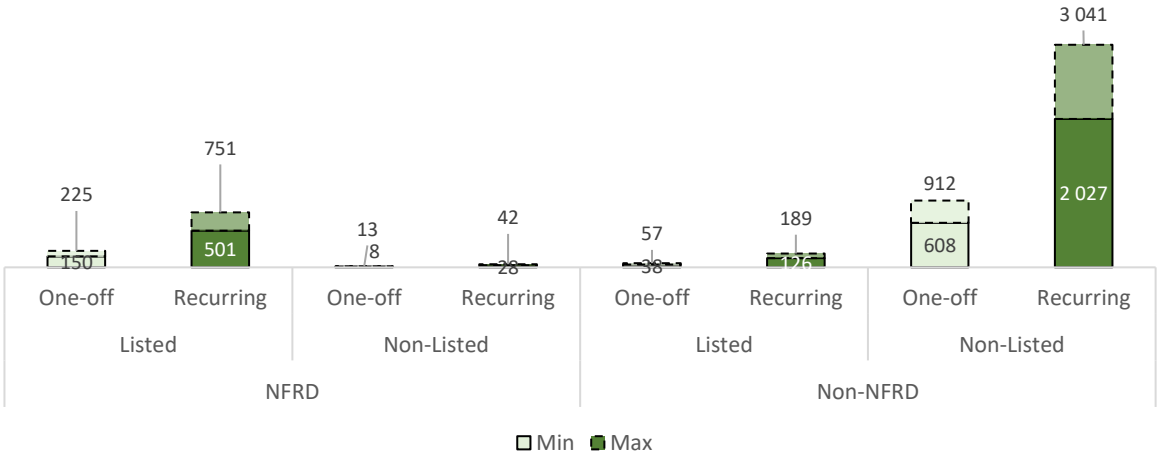
The total costs for NFRD-compliant undertakings are overall much lower than for those not obliged to report. Listed NFRD undertakings are expected to pay from EUR 150 million to EUR 225 million for the one-off costs for limited assurance and between EUR 501 million and EUR 751 million for recurring costs. This is much more than non-NFRD listed undertakings are expected to pay, which is due to the fact that there are very few listed non-NFRD undertakings, resulting in low total costs. Compared to non-listed non-NFRD undertakings, this figure is much lower. Non-listed NFRD undertakings have comparatively low costs, estimated to be between EUR 8 million and EUR 13 million for one-off costs and between EUR 28 million and EUR 42 million for recurring costs. These results are again influenced by the difference in the number of undertakings belonging to each respective category, driving the differences in total costs.

For reasonable assurance (see Figure 3.17), the amounts each category would have to pay is more than double the cost for limited assurance. In terms of one-off costs, non-listed non-NFRD undertakings are

estimated to pay between EUR 1.4 billion and EUR 2.2 billion. Recurring costs are estimated to fall between EUR 4.6 billion and EUR 7.4 billion. Listed non-NFRD undertakings' costs are much lower, at EUR 86 million to EUR 138 million for one-off costs, and EUR 287 million to EUR 459 million for recurring costs.

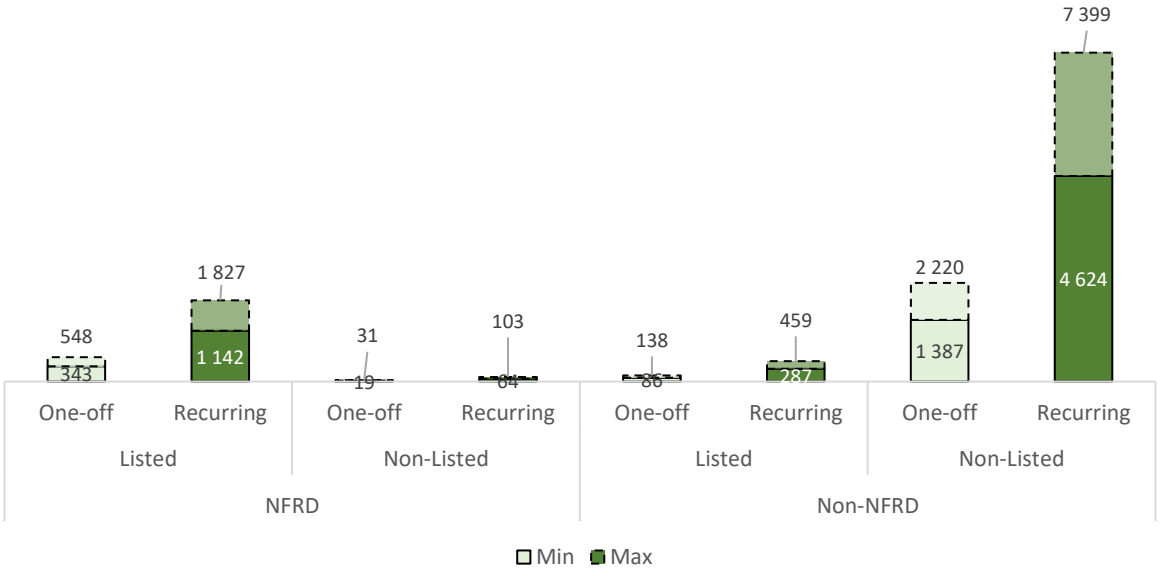
Overall costs for listed NFRD undertakings obtaining reasonable assurance are significantly higher than for those listed undertakings that are not obliged to report under NFRD. Listed NFRD undertakings pay an estimated EUR 343 million to EUR 548 million in one-off costs for reasonable assurance, and between EUR 1.1 billion and EUR 1.8 billion for recurring costs. This cost is higher than for non-NFRD listed undertakings. Conversely, compared to non-listed non-NFRD undertakings this figure is much lower. Non-listed NFRD undertakings are estimated to pay between EUR 19 million and EUR 31 million for one-off costs, and between EUR 64 million and EUR 103 million for recurring costs.

*Figure 3.16 Total assurance costs for limited assurance (EUR million)*




*Source:* CEPS (2022).

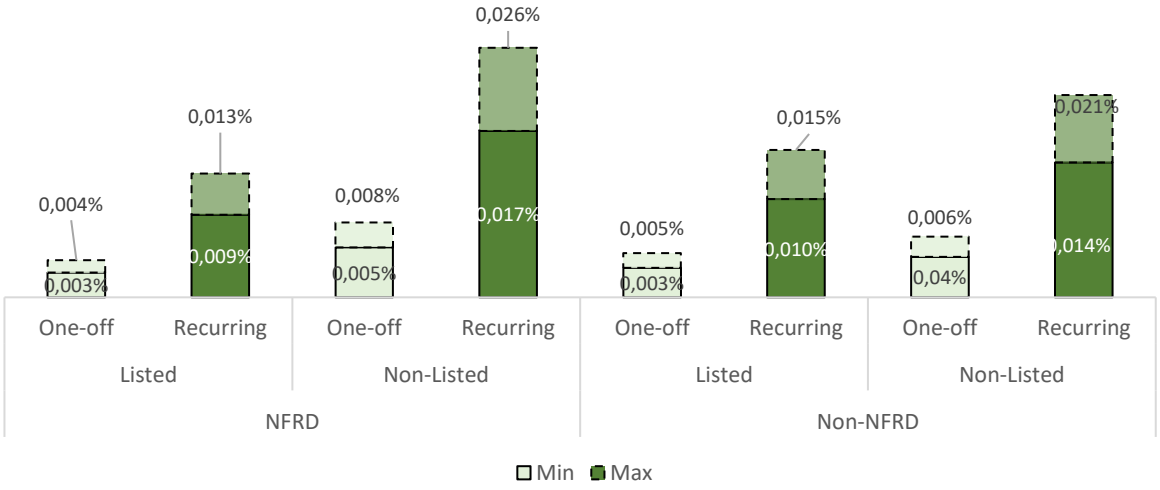
*Figure 3.17 Total assurance costs for reasonable assurance (EUR million)*




*Source:* CEPS (2022).

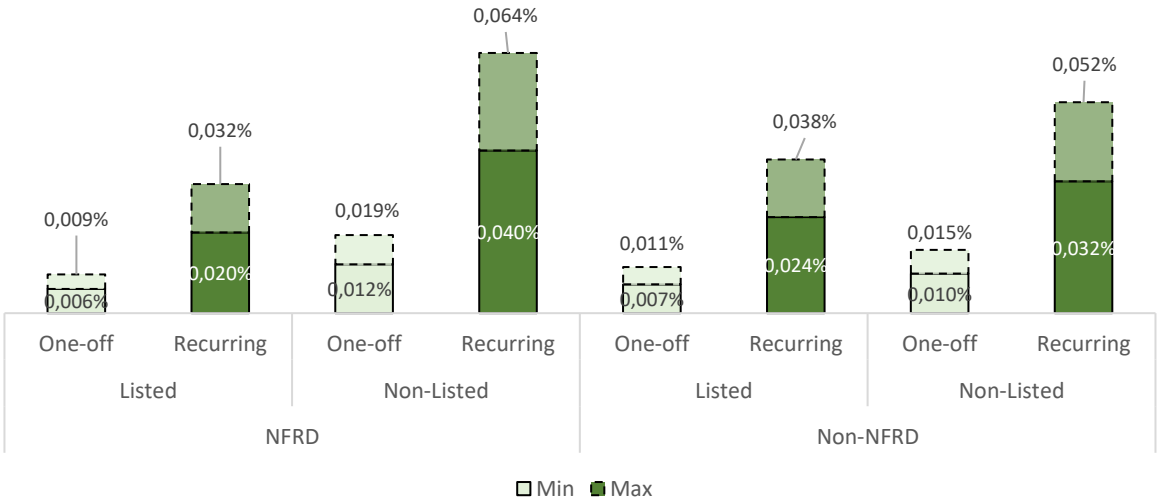
Total assurance costs can also be analysed as a share of turnover (see Figure 3.18 and Figure 3.19). Overall, these costs represent a very small share of the undertakings' turnover. Assurance costs for non-listed undertakings subject to the NFRD and obtaining limited assurance can reach up to 0.008% of total turnover for one-off costs, and 0.026% for recurring costs. In addition, listed undertakings subject to the NFRD may face one-off assurance costs from 0.003% to 0.004% of total turnover, and from 0.009% to 0.013% in terms of recurring costs. These results can be explained by the fact that non-listed undertakings have relatively lower levels of turnover than listed undertakings subject to NFRD reporting. Consequently, assurance costs are relatively higher for smaller undertakings. Similar considerations apply to undertakings receiving reasonable assurance.

*Figure 3.18 Total assurance costs for limited assurance (% total turnover)*




*Source:* CEPS (2022).

*Figure 3.19 Total assurance costs for reasonable assurance (% total turnover)*



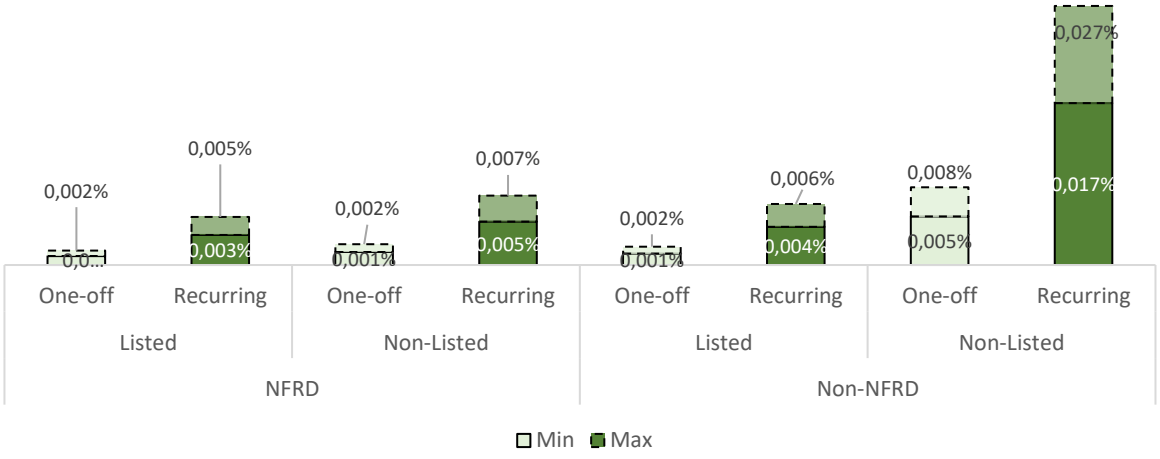

*Source:* CEPS (2022).

Assurance costs can be further analysed as a share of total assets (see Figure 3.20 and Figure 3.21). In this case, the respective shares are estimated to be smaller than for the relative turnover figures. This is explained by the fact that, in general, undertakings have a greater magnitude of total assets compared to their turnover.

*Figure 3.20 Total assurance costs for limited assurance (% total assets)*


*Source:* CEPS (2022).

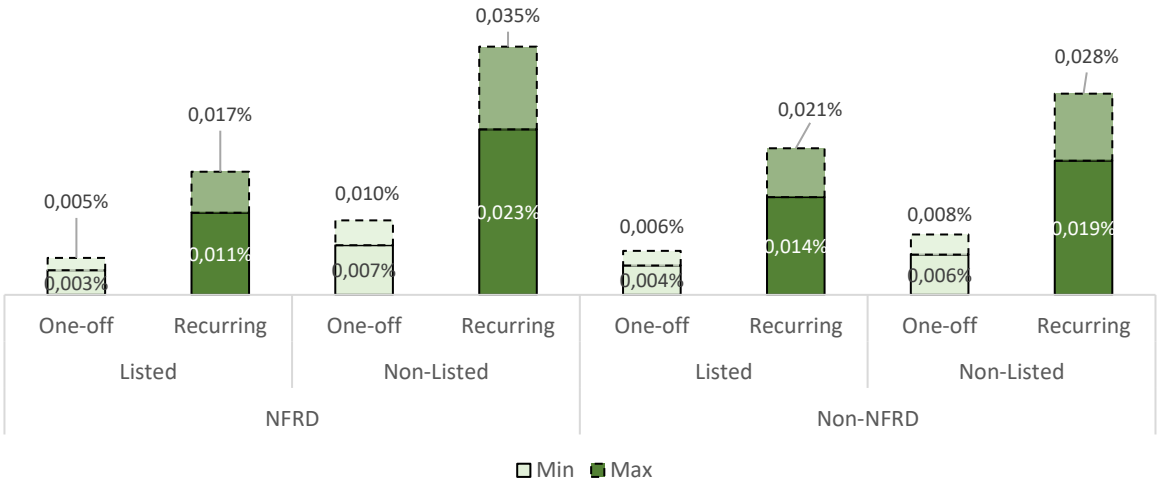
*Figure 3.21 Total assurance costs for reasonable assurance (% total assets)*




*Source:* CEPS (2022).

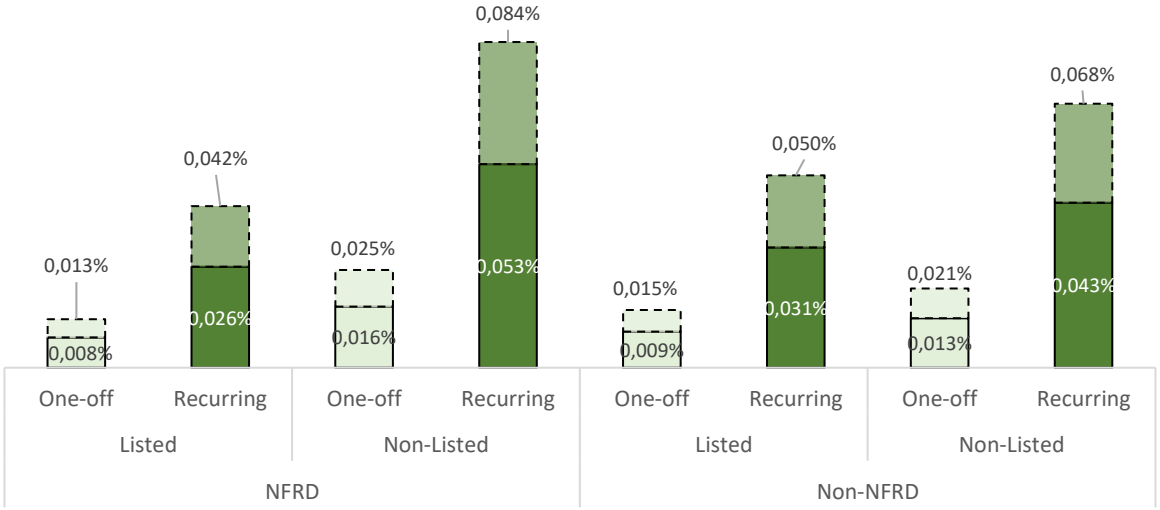
Looking at the total assurance costs as a share of total operating costs (see Figure 3.22 and Figure 3.23), it is possible to see a similar trend to the relative figures based on the turnover. Listed undertakings not subject to the NFRD (for both types of assurance) show the highest share of assurance costs over operating costs. This is mainly driven by the low proportion of undertakings belonging to this group among the population, which results in a low level of operating costs.

*Figure 3.22 Total assurance costs for limited assurance (% total operating costs)*




*Source:* CEPS (2022).

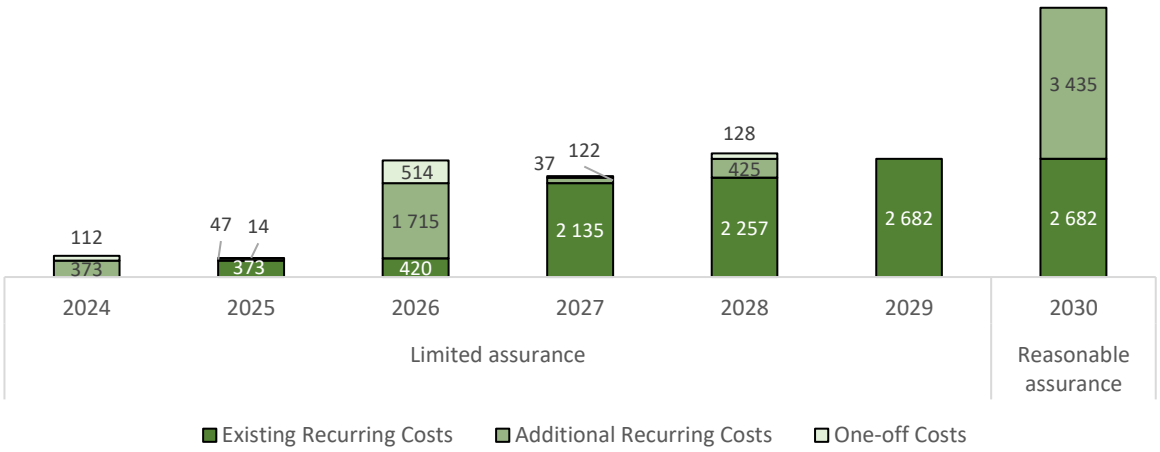
*Figure 3.23 Total assurance costs for reasonable assurance (% total operating costs)*




*Source:* CEPS (2022).

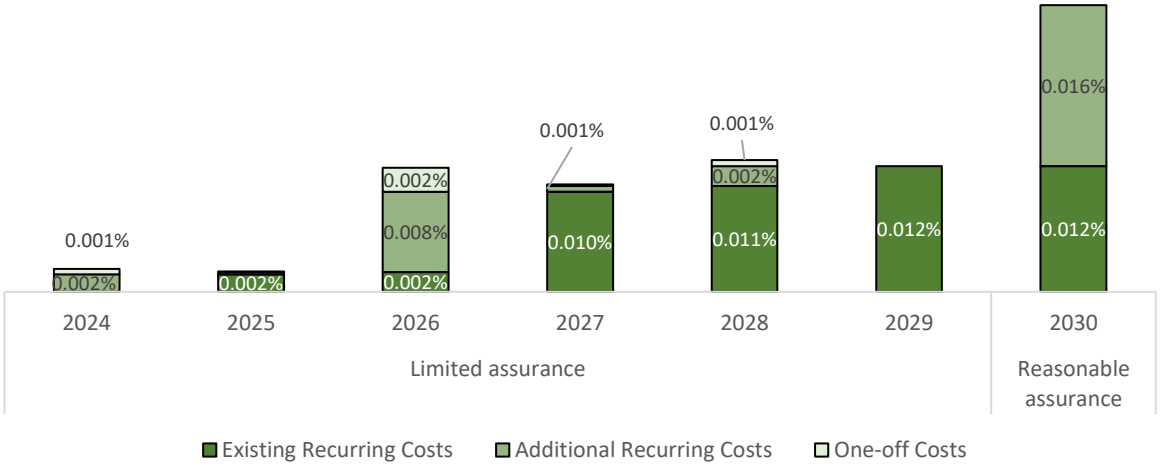
Once the CSRD enters into force, the application of limited assurance for sustainability information will be required. However, a transition on the level of assurance is expected after six years of entry into force of the directive, moving from limited to reasonable assurance. In addition, undertakings subject to the NFRD will have to report from the beginning (financial year 2024), while undertakings not subject to the NFRD will have to report starting from the financial year 2026. The figures below show the assurance costs in absolute and relative values (see Figure 3.24 and Figure 3.25), combining all types of undertakings (NFRD and non-NFRD). The number of disclosure requirements to be reported differ by year, which implies that costs also change per year. Initially, the number of disclosure requirements to be reported is lower, and so are the costs. However, the costs start to increase as the years pass and additional disclosure requirements are made. For instance, in the fiscal year 2026, it is possible to see the highest level of one-off costs and additional recurring costs. This is explained by the fact that several disclosure requirements must be reported as of this year.

*Figure 3.24 Total assurance costs per year (EUR million)*




*Source:* CEPS (2022).

*Figure 3.25 Total assurance costs per year (% total turnover)*




*Source:* CEPS (2022).

### *3.2.3 Incremental costs*

The CSRD proposal aims to reach a similar level of assurance for financial and sustainability reporting, starting with a limited assurance approach requirement. Due to more comprehensive coverage, assurance costs are expected to increase. This increase will differ depending on the type of assurance obtained, which could be either limited or reasonable. Nevertheless, assurance providers have indicated that the type of assurance engagement will not be the only factor determining the cost increase. In this sense, the sector, the complexity of the organisational structure, and the implementation of new systems and processes will have an impact on the assurance costs. Moreover, the less mature these systems and processes are (which is expected to be the case during the first years), the greater the cost increase will be. The increase in costs will be more limited for those undertakings that have their sustainability information already at least to some extent assured.

Incremental costs for undertakings not subject to the NFRD are expected to be greater than for undertakings that are subject to the NFRD (see Figure 3.26 and Figure 3.27). The total incremental costs for all undertakings follow the exact same pattern as can be seen for the total costs in terms of cost differences between the categories (see Figure 3.28 and Figure 3.29). Especially non-listed non-NFRD undertakings bear by far the largest amount of costs, simply because they represent the largest number of undertakings in the reporting population, thus naturally driving up total costs. In general, incremental total costs are slightly lower than just total costs across all categories.

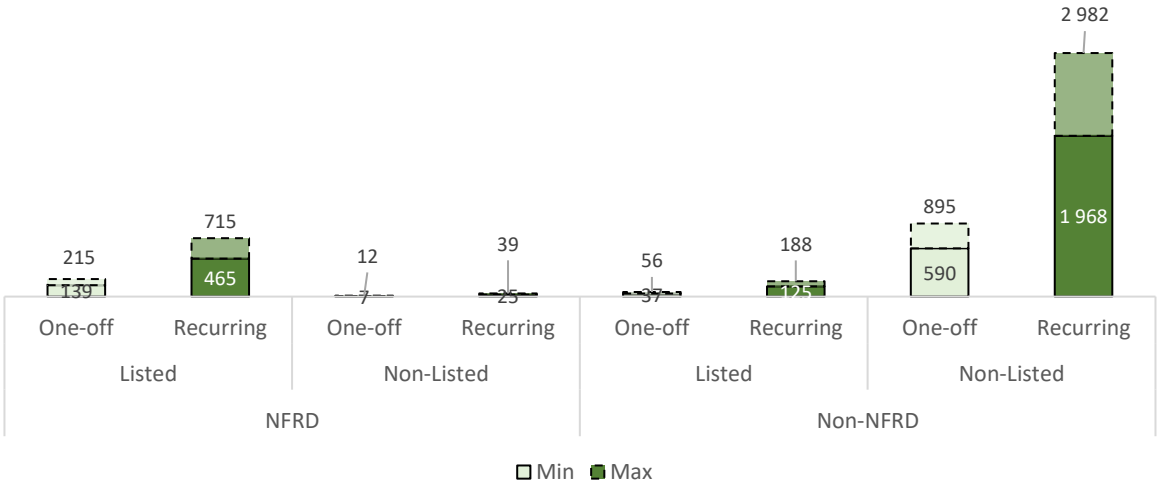
In terms of total one-off incremental costs for limited assurance, non-listed non-NFRD undertakings (see Figure 3.26) are estimated to pay EUR 590 million to EUR 895 million more as one-off costs. Recurring costs for the same group are expected to be between EUR 2.0 billion and EUR 3.0 billion. Comparatively much lower are the costs for listed non-NFRD undertakings, estimated to be between EUR 37 million and EUR 56 million for one-off costs, and between EUR 125 million and EUR 188 million for recurring costs.

Total incremental costs for NFRD-compliant undertakings are overall lower than for those not obliged to report. The costs for listed NFRD undertakings obtaining limited assurance are expected to range between EUR 139 million and EUR 215 million for one-off costs, and between EUR 465 million and EUR 715 million for recurring costs. The figure for non-listed NFRD undertakings is significantly lower. These undertakings are estimated to pay between EUR 7 million and EUR 12 million for one-off costs, and between EUR 25 million and EUR 39 million for recurring costs.

Turning to incremental costs for reasonable assurance (see Figure 3.27), once more the costs per undertaking fall between twice and three times the amount for limited assurance. For one-off costs, non-listed non-NFRD undertakings are estimated to pay between EUR 1.3 billion and EUR 2.2 billion. Comparatively, recurring costs are likely to be much higher and fall between EUR 4.6 billion and EUR 7.3 billion. Listed non-NFRD undertakings' costs are much lower, at EUR 86 million to EUR 137 million for one-off costs, and EUR 286 million to EUR 458 million for recurring costs.

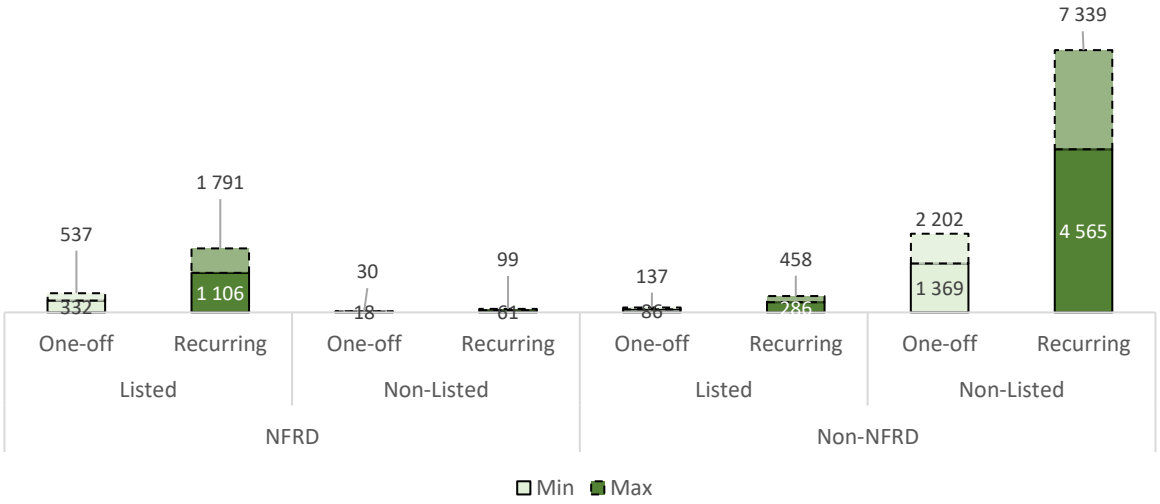
Overall incremental costs for NFRD undertakings are lower compared to non-reporting undertakings' costs. This result can be explained by the lack of experience of non-NFRD undertakings in disclosing sustainability information. In this sense, listed NFRD undertakings' incremental costs are expected to fall between EUR 332 million and EUR 537 million in one-off costs for reasonable assurance, and between EUR 1.1 billion and EUR 1.7 billion for recurring costs. Non-listed NFRD undertakings are conversely estimated to pay between EUR 18 million and EUR 30 million for one-off costs, and between EUR 61 million and EUR 99 million in recurring costs.

*Figure 3.26 Total incremental costs for limited assurance (EUR million)*




*Source:* CEPS (2022).

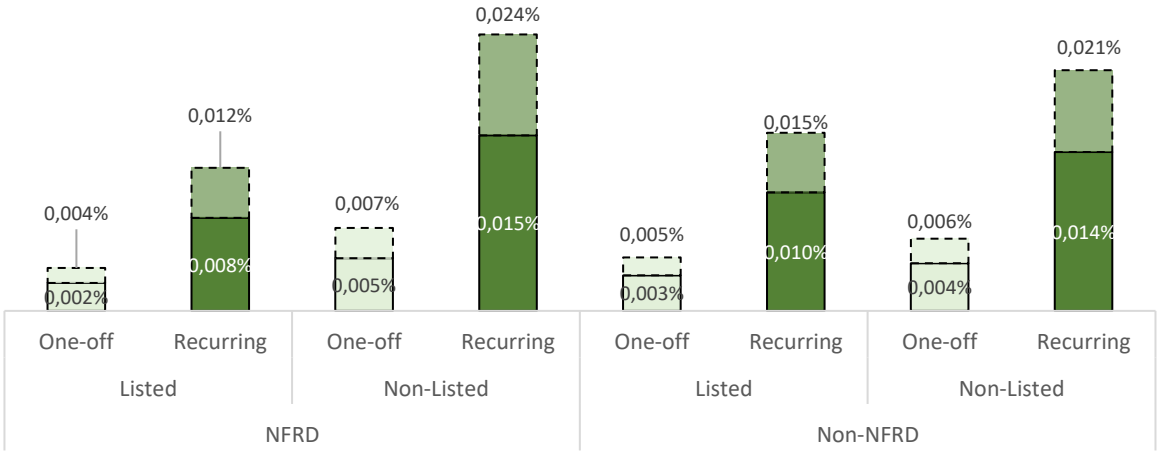
*Figure 3.27 Total incremental costs for reasonable assurance (EUR million)*




*Source:* CEPS (2022).

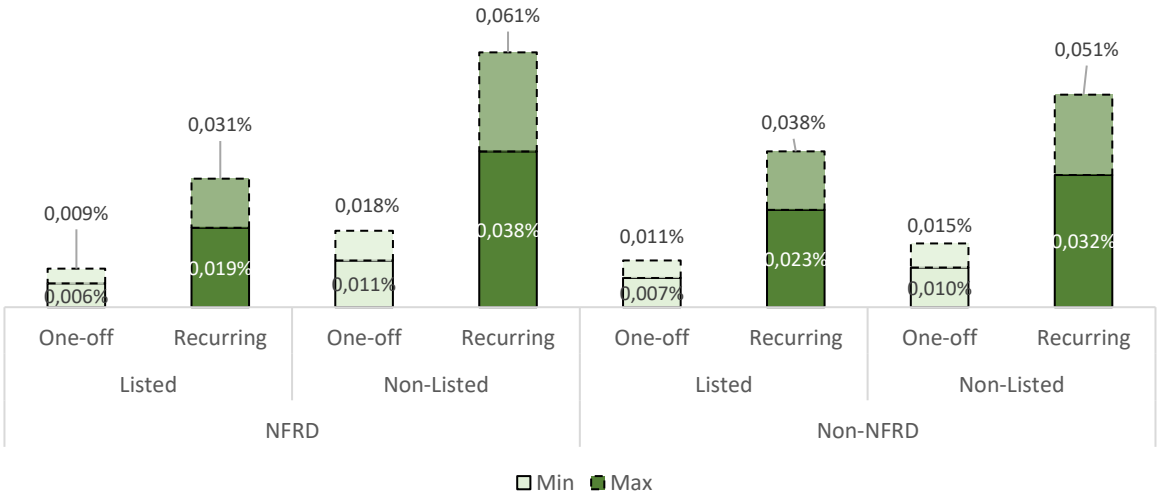
Incremental costs as a share of turnover (see Figure 3.28 and Figure 3.29) seem to exhibit a similar trend to the relative assurance cost shares over turnover mentioned above. Non-listed undertakings subject to NFRD reporting show the highest ratio, at 0.015% to 0.024% of turnover for recurring costs, and 0.005% to 0.007% of turnover for one-off costs. In contrast, listed undertakings subject to the NFRD show the smallest share for both one-off and recurring incremental costs (from 0.002% to 0.004% for one-off costs, and from 0.008% to 0.012% for recurring costs). This last result is, once more, explained by the fact that listed NFRD undertakings are on average larger in size, which implies that assurance costs encompass a smaller portion of total turnover.

*Figure 3.28 Total incremental costs for limited assurance (% total turnover)*




*Source:* CEPS (2022).

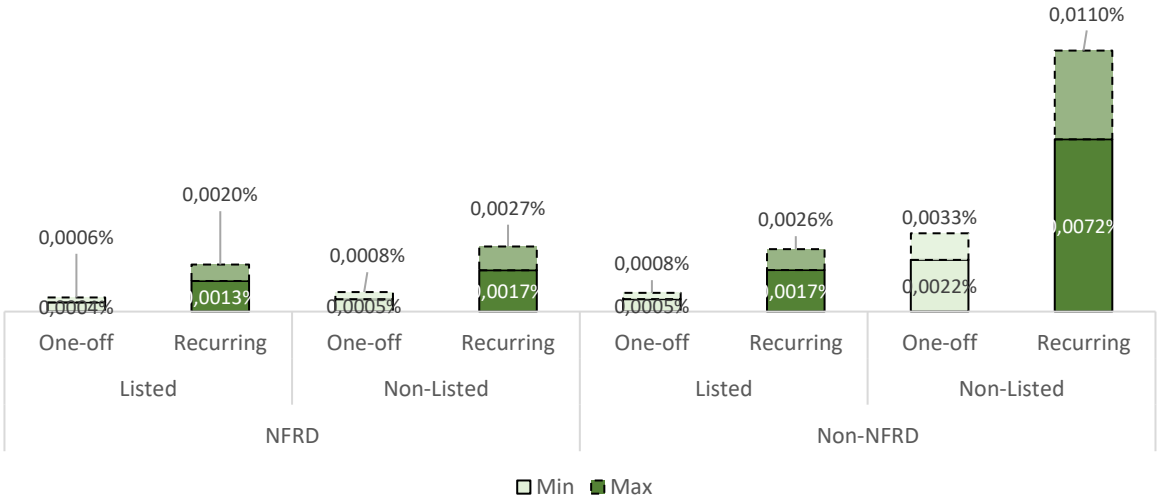
*Figure 3.29 Total incremental costs for reasonable assurance (% total turnover)*




*Source:* CEPS (2022).

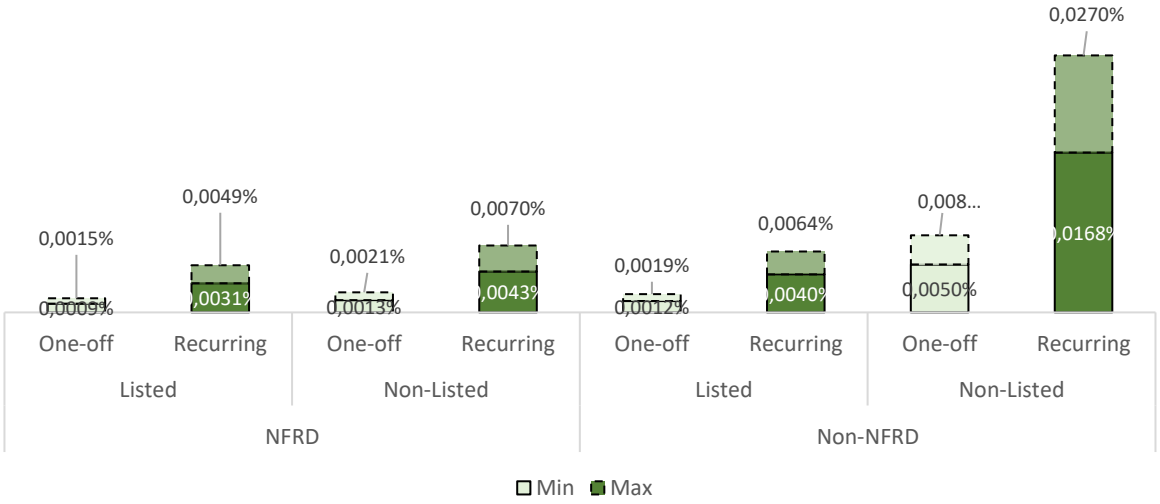
In addition, incremental costs as a share of total assets follow a similar trend to relative assurance costs, for both limited and reasonable assurance (see Figure 3.30 and Figure 3.31). This trend indicates that the share of incremental costs over total assets is very small for all undertakings. Non-listed undertakings not subject to the NFRD obtaining limited and reasonable assurance show the highest ratio, ranging from 0.0022% to 0.0033% for one-off costs, and from 0.0072% to 0.0110% for recurring costs under limited assurance, and from 0.0050% to 0.0081% for one-off costs, and from 0.0168% to 0.0270% for recurring costs under reasonable assurance. Furthermore, listed undertakings subject to NFRD reporting obtaining limited reasonable assurance exhibit the lowest share of incremental costs over total assets. This result is also seen under reasonable assurance.

*Figure 3.30 Total incremental costs for limited assurance (% total assets)*




*Source:* CEPS (2022).

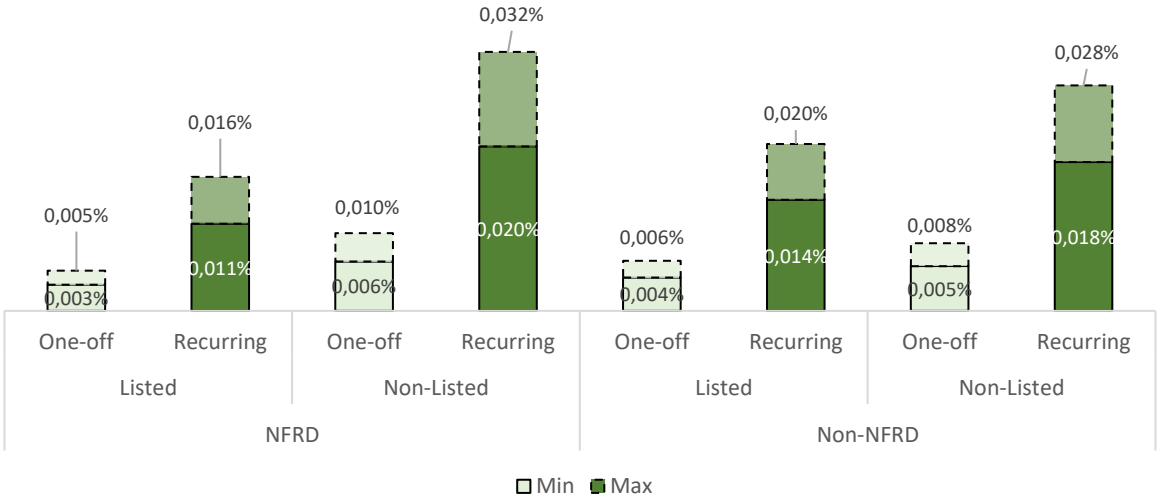
*Figure 3.31 Total incremental costs for reasonable assurance (% total assets)*




*Source:* CEPS (2022).

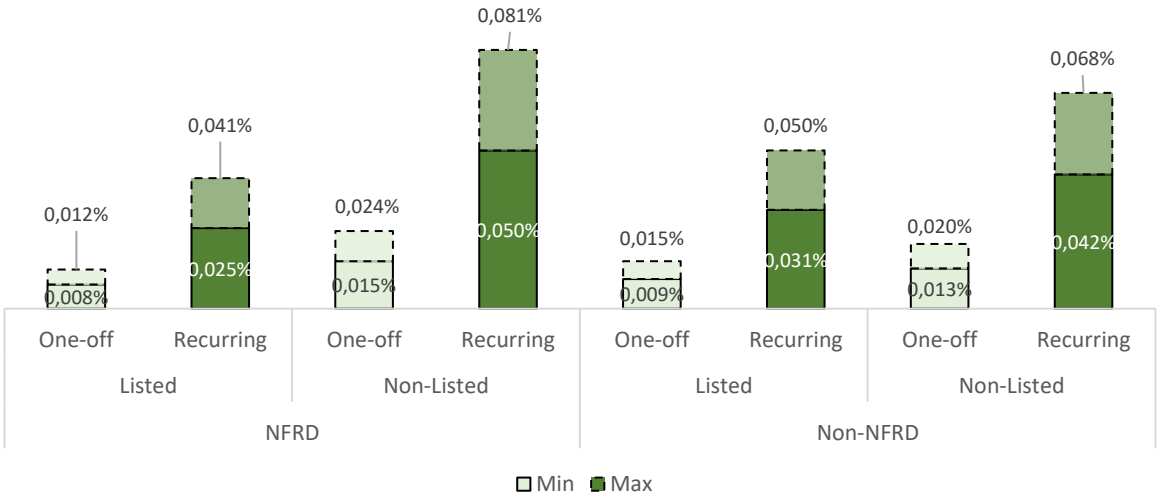
Results for incremental costs as a share of total operating costs are in line with those obtained for relative assurance costs (see Figure 3.32 and Figure 3.33). Once again, non-listed undertakings, due to their relatively lower level of operating costs compared to the rest of the population, exhibit the highest ratio for both limited and reasonable assurance engagement.

*Figure 3.32 Total incremental costs for limited assurance (% total operating costs)*




*Source:* CEPS (2022).

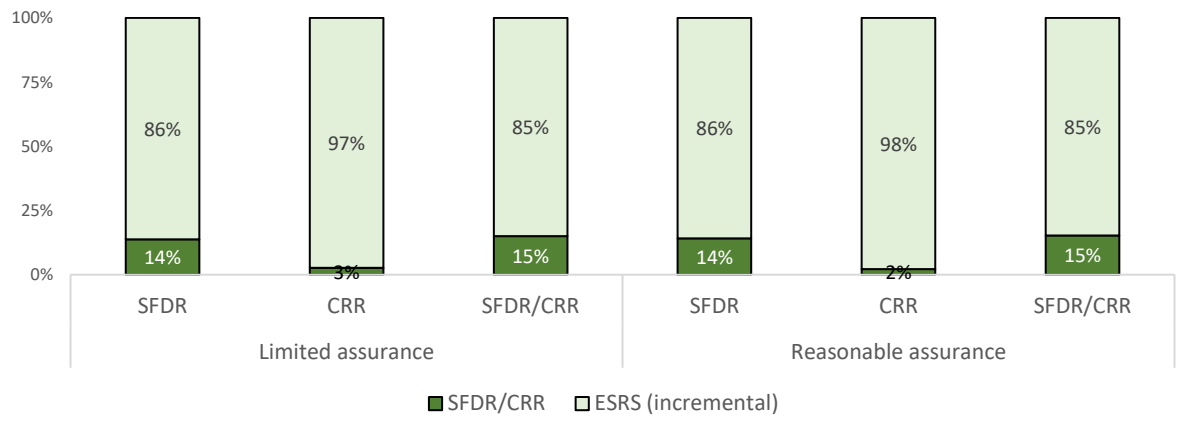
*Figure 3.33 Total incremental costs for reasonable assurance (% total operating costs)*




*Source:* CEPS (2022).

Some of the information contained under certain disclosure requirements in ESRS is necessary to fulfil other reporting requirements such as the SFDR and the sustainability reporting requirements under pillar 3 of the CRR. In this sense, part of the incremental costs may be overlapped (see Figure 3.34). It is possible to see that the overlap is larger when comparing ESRS with the SFDR, rather than with the CRR. Under both types of assurance, less than a fifth of the total incremental costs are estimated to be on disclosure requirements relevant under the SFDR (14% of total incremental costs). This share is much lower for the CRR (3% of the total incremental costs). In addition, information is also included in certain ESRS disclosure requirements that is already required to be reported under the SFDR and CRR. This represents less than one fifth of the total incremental costs under limited and reasonable assurance (15% of the total incremental costs).

*Figure 3.34 Incremental costs based on SFDR and CRR*




*Source:* CEPS (2022).

### *3.2.4 Conclusions*

The assurance costs are expected to increase significantly due to more comprehensive coverage. Initially, limited assurance will be required, transitioning into reasonable assurance after a six-year period from the entry into force of the CSRD. Due to the phase-in of the disclosure requirements, assurance costs will vary per year. In the first years the costs will be low compared to the following years, as not all disclosure requirements have to be implemented. In particular, in the financial year 2026, assurance costs will increase significantly because of the implementation of certain disclosure requirements.

Listed undertakings subject to the NFRD are expected to face the highest assurance costs, on average, followed by listed undertakings not subject to the NFRD. This is explained by the fact that listed undertakings are PIEs, which have larger and more complex structures that non-listed undertakings. In addition, these types of undertakings have stricter audit requirements, which implies higher assurance costs.

Overall, assurance costs represent a very small share expressed in some of the undertakings' key financials (i.e. total turnover, total assets and total operating costs). Smaller undertakings such as non-listed undertakings will be the most affected by the assurance cost increase. This is explained by the fact that assurance costs represent a bigger share of their total turnover (and operating costs), causing them a greater cost burden.

In addition, some information included in certain ESRS disclosure requirements can be attributed to other legislation such as the SFDR and/or CRR pillar 3 requirements.

*Box 2. Comparison of the estimated direct costs for the CSRD and first set of draft ESRS*

This box presents a comparison between the direct cost estimates for the CSRD included in the Impact Assessment and the first set of draft ESRS in this report.

For comparative purposes this box only considers the direct costs for large undertakings. This means that listed SMEs are excluded. Although listed SMEs will be subject to the CSRD, they will not have to adhere to the first set of draft ESRS considered in this report, but may use a different, proportionate set of sustainability reporting standards to comply with the requirements. The figures for the set of undertakings excluding SMEs are obtained from the costs analysis in Annex 17 of the CSRD Impact Assessment, and are obtained when looking for the "Package 2" figures instead of the SMEs-including "Package 3" figures.

In addition, the first set of draft ESRS only considers sector-agnostic reporting requirements. Sector-specific reporting requirements will be added to a next set of draft ESRS requirements. The CSRD Impact Assessment does include both sector-agnostic and sector-specific reporting requirements when making its costs estimations.

**Administrative costs**

The estimated administrative costs for the first set of draft ESRS are higher than estimated in the CSRD Impact Assessment (see Table 3.3) when it comes to one-off costs, while being lower for recurring costs. Total one-off costs are estimated at just over EUR 2.1 billion for the first set of draft ESRS, compared to just over EUR 1.1 billion in the CSRD Impact Assessment. Recurring costs are estimated at EUR 2.4 billion for the first set of draft ESRS, compared to EUR 3.1 billion in the CSRD Impact Assessment.

The increase in estimated one-off costs goes together with an increase of incremental costs as a percentage of total costs. Incremental one-off costs as a percentage of total costs are 60% for the CSRD Impact Assessment while 81% for the first set of draft ESRS estimates. For recurring costs, those figures are 67% and 81%. A potential explanation for the increase in incremental costs is that the first set of draft ESRS is a more constraining compared to the reporting practices underpinning the CSRD Impact Assessment. The share of one-off incremental costs grows faster than recurring incremental costs as a share of total costs, for new reporting requirements demand new reporting capacities to be created, an investment that is in principle a one-off cost.

*Table 3.3 Comparison of estimated administrative costs*

| Total cost (EUR million) | CSRD Impact Assessment | First set of draft ESRS |
|---|---|---|
| **One-off** | 1 134 | 2 138 |
| **(incremental)** | 673 | 1 726 |
| **Recurring** | 3 135 | 2 382 |
| **(incremental)** | 2 095 | 1 921 |

*Source:* European Commission (2020), CEPS (2022).

**Assurance costs**

The estimated assurance costs for the first set of draft ESRS are higher than estimated in the CSRD Impact Assessment (see Table 3.4). Total assurance costs (i.e. limited assurance) are estimated at EUR 1.9 billion in the CSRD Impact Assessment, compared to an estimated between EUR 2.7 and 4.0 billion for the final set of draft ESRS. This is in line with expectations as the estimates for the first set of draft ESRS standards assume the entire sustainability statement to be assured, whereas the information available at the time of the impact assessment covered the assurance costs for non-financial statements which were often only partially assured.

*Table 3.4 Comparison of estimated assurance costs*

| Total assurance costs (EUR million) | CSRD Impact Assessment | First set of draft ESRS (range low – high) |
|---|---|---|
| **Limited assurance** | 1 927 | 2 682 – 4 023 |

*Source:* European Commission (2020), CEPS (2022).

**Explanation for differences in estimated costs**

Taking a closer look at the factors that also contribute to the difference in cost estimates between the first set of draft ESRS compared and the CSRD Impact Assessment. They are as follows:

- The CSRD Impact Assessment's costs are ultimately based on the GRI (Global Reporting Initiative) and alike standards. For the first set of draft ESRS cost analysis the first set of draft ESRS standards as proposed by EFRAG form the basis for the cost estimates. Undertakings have provided higher costs estimates for this. There are several possible reasons for the higher estimates from undertakings; including the nature of the standards as well as that these standards will be mandatory under a legal framework requiring more rigor. The results presented in Box 1 support the estimated increase in costs, showing that the majority of the undertakings surveyed in both cost analyses expect an increase from the GRI-based estimates to the first set of draft ESRS-based estimates.
- The CSRD Impact Assessment estimates are based on a sample consisting only NFRD reporting undertakings, whereas the first set of draft ESRS analysis also considers non-NFRD reporting undertakings. The latter undertakings are generally smaller an in absolute terms have lower administrative and assurance costs. Everything else equal, this would lower the costs reported in the first set of draft ESRS requirements compared to those in the CSRD Impact Assessment. This also effects the incremental costs as the non-NFRD are currently much less frequently preparing a sustainability reports.
- Ultimately the costs for the undertakings follow from a large part from labour costs. Labour costs have increased from 2018 to 2021, the respective reference years for both analysis, by about 8%[4].
- The number of undertakings is slightly lower. This set compromises the undertakings that are currently required to report under the NFRD, large PIEs below 500 employees, large non-EU undertakings listed in the EU and large non-listed EU undertakings. In the CSRD Impact Assessment the number of undertakings is 48 080, in the first set of draft ESRS that number is 47 676, a small difference that follows from consolidation. The small decrease of number of undertakings brings total costs down of the first set of draft ESRS, albeit marginally.

**Conclusions**

Overall, the recurring administrative costs are estimated to be lower than anticipated in the CSRD Impact Assessment, whereas the one-off administrative costs and total assurance costs are estimated to increase compared to the earlier reported estimates. The biggest driver of this change is the increased rigor of the reporting requirements, which drives up costs and especially the one-off costs. In turn, the estimated costs considering also non-NFRD undertakings had a significant reducing impact on the estimated direct costs.

[4] Per Eurostat EU27 whole economy wage 2018 and 2021 (link)

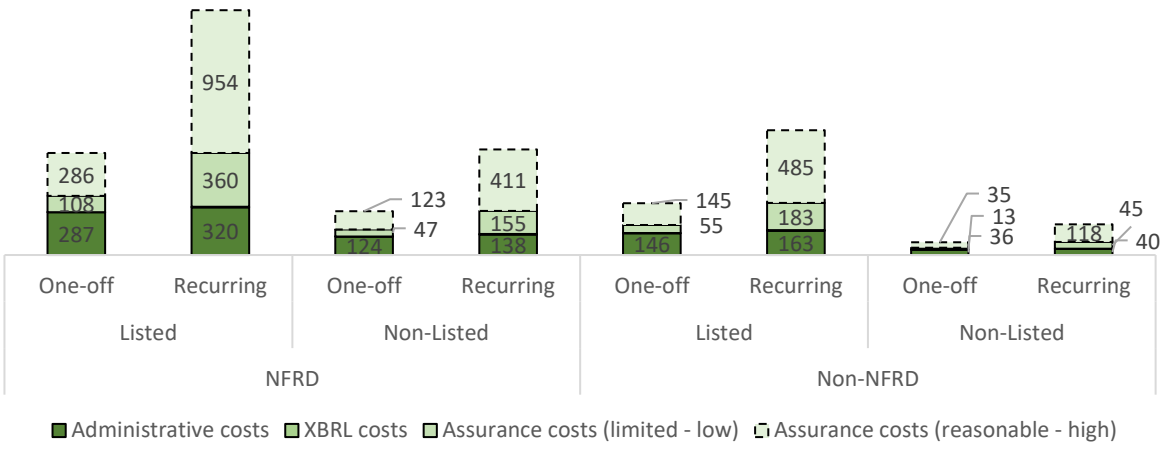
*Box 3. Estimated direct costs per undertaking for the CSRD and first set of draft ESRS*

This box presents the average aggregated direct costs for the undertakings subject to the CSRD, assuming that they have to comply with the first set of draft ESRS.

The average aggregated one-off and recurring costs are highest for listed NFRD undertakings. The average recurring costs assuming the sustainability statement to be reasonably assured amount EUR 1 636 000, while initially the one-off costs amount an additional EUR 682 000. Importantly, the maximum of the range for the reasonable assurance costs almost represents more than half of the recurring costs, while the XBRL costs (i.e. level 2) account for less than 1% of the costs. The average costs for non-listed NFRD undertakings (EUR 707 000 recurring costs), listed non-NFRD undertakings (EUR 834 000 recurring costs) and non-listed non-NFRD undertakings (EUR 206 000) are estimated to be significantly lower. The average incremental costs are estimated between 4% and 16% lower.

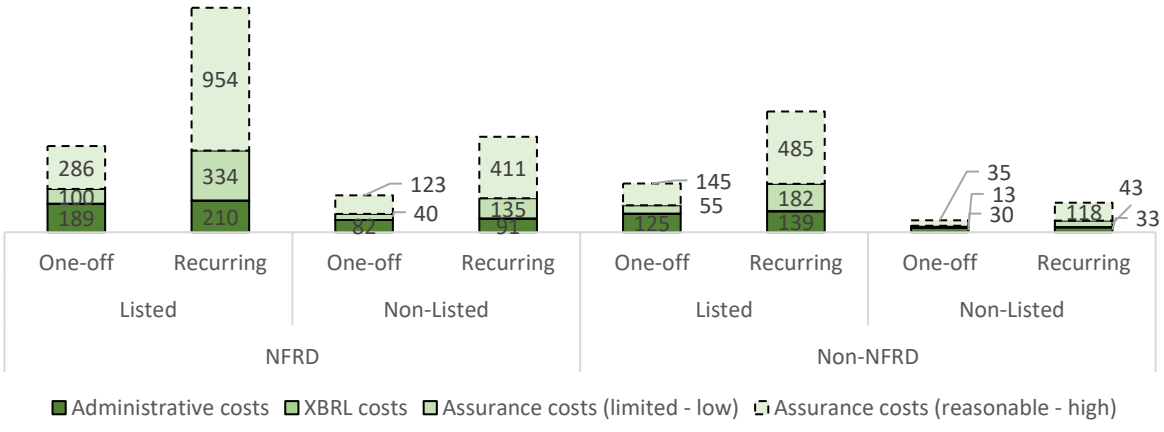
The estimates for the different types of costs are presented and discussed in the respective sections of the report.

*Figure 3.35 Aggregated direct costs per undertaking (EUR thousand)*




*Source:* CEPS (2022).

*Figure 3.36 Aggregated direct incremental costs per undertaking (EUR thousand)*




*Source:* CEPS (2022).

# 4. INDIRECT COSTS

This chapter assess the indirect costs linked to the First Set of draft ESRS, including the costs as a consequence of the trickle-down effect, costs resulting from litigation and costs resulting by the loss of competitiveness.

## 4.1 Trickle-down effect

This section assesses the administrative costs that are likely to be incurred by SMEs in the value chains of large undertakings that need to report under the ESRS. This so-called trickle-down effect is explained by the expected information requests from large undertakings and the expected costs for SMEs[5].

The administrative costs are estimated using the SCM as defined in Tool #60 of the Better Regulation Toolbox and detailed in Section 2. The methodological framework for this section is presented in Section 2.4.4. In line with the SCM and to measure the typical costs stemming from the ESRS, this section presents point estimates for the relevant costs and ranges for the number of SMEs affected.

### *4.1.1 Trickle-down effect in the context of ESRS*

In the context of the first draft of the ESRS, large undertakings[6] are required to disclose sustainability matters concerning undertakings in their value chain[7] that are beyond the direct scope of the CSRD. This effectively means that undertakings falling within the scope of the CSRD would need to have an understanding of their value chain, and in some instances have to request information from their suppliers, distributors and other entities that contribute to the process of producing and/or delivering a product or service to the final customer. While undertakings within the scope of the CSRD are expected to have this sustainability data due to their reporting obligations, undertakings outside the scope of the CSRD (non-listed SMEs) are unlikely to have this data available, considering also the low level of voluntary reporting among non-listed undertakings.

The trickle-down effect is likely to be noticeable, as the first set of draft ESRS do not envisage any limits or caps on the value chain length. This means that preparers will have to consider all the tiers of their value chain. Nevertheless, the scope of the sustainability information to be collected from the value chain is rather limited and covers only several technical indicators (i.e. GHG emissions and GHG removals), which limits the total costs incurred by SMEs in the value chain of preparers.

The degree of trickle-down might be influenced by the complexity associated with disclosing technical environmental information. More specifically, for environmental reporting[8], undertakings will have to collect data on indirect GHG emissions, removals and storage in metric tons of CO2 equivalent 'from entities and unaffiliated activities within the value chain that are neither owned nor financially controlled by the undertaking'. In contrast, social and governance-related disclosure requirements require undertakings to collect less or no information (see Figure 4.1). For reporting on social aspects, undertakings will primarily need to indicate potential social challenges in their value chains. For

[5] The estimation of trickle-down effect considers only information requests to the entire value chain and not other suppliers. Therefore, costs related to the information requests to non-own labour force are not included

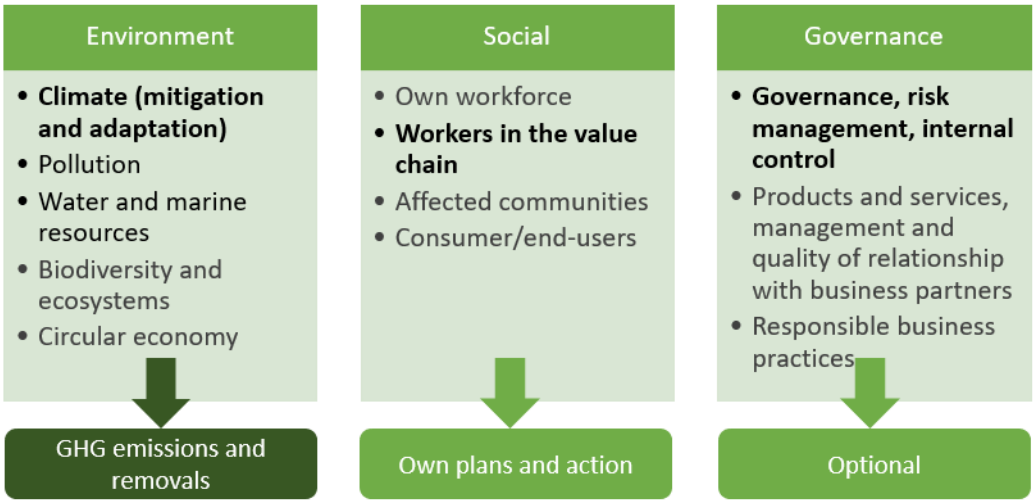
[6] This study assesses the costs and benefits associated with the first draft of the ESRS, which focuses solely on large undertakings. The ESRS for listed SMEs that also fall within the scope of the CSRD are not examined in the study.

[7] 'Value chain' covers the entire sequence of activities or parties that create or receive value through the provision of a product or service.

[8] Disclosure requirement E1-6 – gross scopes 1, 2, 3 and total GHG emissions, and disclosure requirement E1-7 – GHG removals and GHG mitigation projects financed through carbon credits.

reporting on governance aspects, undertakings will have to be informed about risks posed by business partners in the value chain.

*Figure 4.1 Topics and sub-topics of reporting requirements under ESRS*

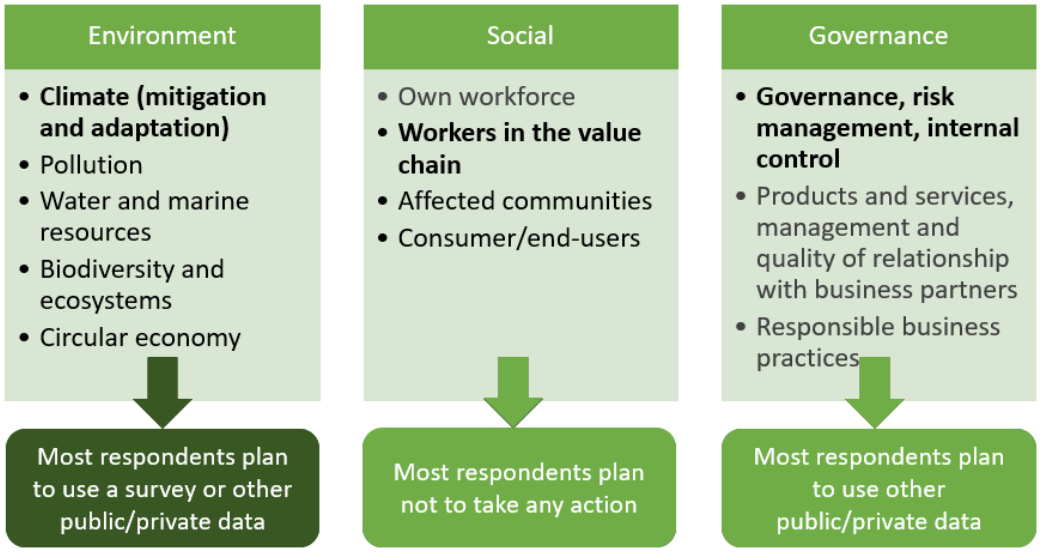



*Notes:* Sub-topics in bold are those for which large undertakings are expected to report some information on their value chain.
*Source:* CEPS (2022) summary of the ESRS.

As the first draft of the ESRS has only recently been decided, most undertakings still have to decide on how exactly to collect this information along their value chains. Based on findings of the survey among preparers, they are likely to resort to using surveys, focus groups, direct contact via email/phone or other public/private data sources. This might have an impact on the expected costs for SMEs.

In line with the complexity of disclosure requirements, preparers expect to be collecting information primarily on environmental aspects from undertakings in their value chain. For these, preparers expect to use surveys among value chain undertakings and other public/private data sources. As social and governance disclosure requirements are less technical and detailed, all respondents plan not to take any action to collect data on social aspects, and expect to use other public/private data to collect governance data. With significant guidance on how to contact, collect and analyse information from the value chains, the streamlining of disclosing sustainability data can be less costly.

*Figure 4.2 Actions planned by preparers to collect necessary information from their value chains*




*Notes: Sub-topics* in bold are those for which large undertakings are expected to report some information on their value chain. Actions in dark green are those likely to have the biggest impact on SMEs in value chains.
*Source*: CEPS (2022) summary of the ESRS.

Given that many SMEs are in the value chains of large undertakings, the magnitude of the trickle-down easily becomes significant, even when the amounts per undertaking are limited.

### *4.1.2 Costs per undertaking in the value chain*

SMEs in the value chains of large undertakings may face moderate **administrative costs** due to the trickle-down effect. These costs can be categorised into two main types. First, there are costs that undertakings are likely to incur only once in the first year in which the SME must disclose information (i.e. one-off costs). Second, there are recurring costs incurred annually to provide large undertakings in their value chain with information required for the ESRS. While SMEs may employ in-house expertise to collect and prepare the disclosure information (i.e. own costs), they may seek external professional advice for assurance (i.e. external costs). This depends highly on the complexity of the request(s) from the large undertaking in the value chain, as well as on the size and in-house expertise of the SME concerned. The external costs will likely depend on the extent of guidance from large undertakings, such that SMEs are able collect the data in house. Should there be sufficient and clear guidance from large undertakings, external costs will be minimised.

**Incremental costs** are costs associated with collecting information that is solely owed to complying with the ESRS[9]. These are important for SMEs since they represent a significant burden beyond business-as-usual (BAU) costs. Some parts of these administrative costs are unavoidable due to the new processes that enterprises have to implement to comply with the demands from large undertakings for their ESRS reporting.

The most common administrative costs that SMEs in the value chain are likely to face as a result of the ESRS are calculating the key aspects, creating practices to collect the necessary data and seeking legal advice. In particular, SMEs expect most costs to come from reporting environmental information. SMEs responding to the survey conducted for this report indicate that collecting environmental information, in particular data on Scope 3 GHG emissions, is the most time-consuming. Although many SMEs might

[9] According to the CSRD proposal (Recital 18), requirements for SMEs in value chains cannot exceed those for listed SMEs. This means that SMEs' costs due to the trickle-down effect will effectively be capped. Nevertheless, as the ESRS for listed SMEs are still in development, this cap has not been looked at in this study.

have the raw data for most of the environmental indicators, they indicate a lack of understanding on how to translate this information into the required indicators. They will thus have to change their processes to provide large undertakings with the necessary data.

The trickle-down effect also depends on the number of large undertakings whose value chains the SMEs belong to. For example, for SMEs that are part of several value chains, the reporting requests might be different depending on the large undertakings' requests.

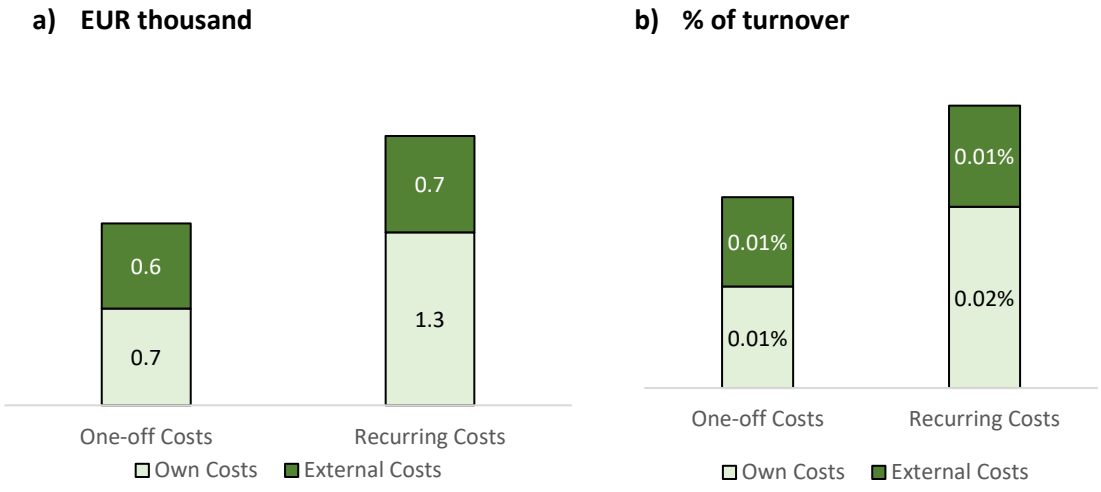
SMEs in the EU will experience moderate one-off costs in the first year of implementation of the legislation. Indeed, average one-off administrative costs make almost two thirds (65%) of the recurring costs both by amount (see Figure 4.4a) and in relative terms (see Figure 4.4b). An average EU SME in the value chain of a large undertaking is expected to spend about EUR 1 300 per undertaking or 0.02% of their turnover on one-off costs, while the recurring costs are estimated at about EUR 2 000 per undertaking or 0.03% of turnover.

Almost half of the one-off costs (EUR 600 out of EUR 1 300) would be for external contractors and accountants. These are primarily related to costs of legal advice and translating available data into the required indicators. The costs would weigh more on undertakings that do not yet disclose sustainability information and therefore do not have the in-house knowledge on such disclosures. In subsequent years, SMEs expect external costs to remain the same in monetary terms (EUR 700 out of EUR 1 300) but shrink in relative terms (one third or 35% of recurring costs).

The survey and interviews confirm these findings, indicating that most SMEs expect to resort to external consultancies in the first year to some extent. The stakeholders who were interviewed reported that external advice is often costly.

These estimated costs assume that SMEs are likely to prepare all of their sustainability information themselves. However, in practice they might receive specific guidance from the large undertakings, which would bring down the costs.

*Figure 4.3 Administrative costs per undertaking in the value chain*




*Note:* Due to limited reported data, one-off costs per disclosure requirement were approximated based on costs reported by large undertakings.

*Source:* CEPS (2022).

### *4.1.3 Total costs*

On a larger scale, the trickle-down effect from the ESRS value chain reporting requirements will have a moderate impact on the EU economy, albeit affecting the majority of EU SMEs. The estimated number of SMEs (excluding subsidiaries) affected indirectly by the first draft of the ESRS ranges from 3 million to 19 million, or between 60 and 380 SMEs per large undertaking. This corresponds to a range of 9% to 59% of the population of EU SMEs, depending on the tiers in the value chain considered. Furthermore, due to their size and capacity, micro enterprises are unlikely to be requested to provide the same extent of data as small and medium-sized enterprises. Excluding micro enterprises, the estimated range of SMEs that will be indirectly affected is reduced by up to 90%. The estimated number of small and medium-sized undertakings ranges from 0.3 million to 2.7 million, or 1% to 9% of the total number of EU SMEs. The figures below present the total costs of the trickle-down effect, excluding micro enterprises.

Scaling up the identified costs by the estimated number of SMEs is important to estimate the total cost that the ESRS trickle-down effect is likely to have on the EU economy. The findings support two key findings:

- One-off costs, on average, make up half or more of recurring costs due to new standards applicable to SME value chains.
- External costs for SMEs (i.e. relying on external service providers for parts of sustainability data preparation) account for almost half of the one-off costs.

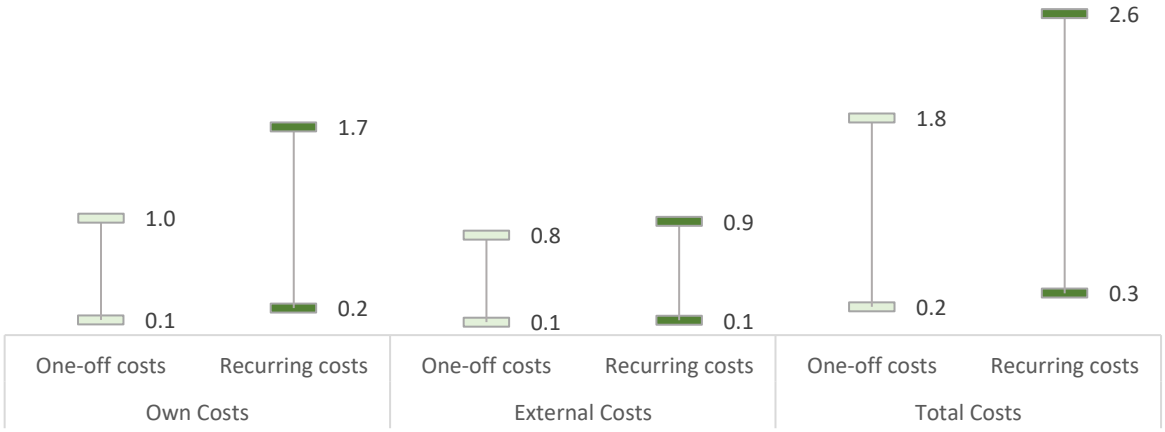
The one-off costs are estimated to be a minimum of EUR 0.1 billion and a maximum of EUR 1 billion (see Figure 4.4). This is almost twice as low as the recurring costs, which range approximately from EUR 0.2 billion to EUR 1.7 billion. External costs accounting for almost half of the one-off costs point to a relatively larger share of activities linked to reporting of the information being outsourced. Nevertheless, these are expected to drop after the first year of preparation, accounting for about one third of recurring costs.

These costs would not, however, be incurred right after the implementation of the ESRS. In fact, large undertakings have a derogation of three years for most disclosure requirements that require information on value chains. This effectively means that EU SMEs will incur the first-year (one-off and recurring) costs only in 2027 if they're part of value chain of NFRD undertakings and in 2028 if they're part of value chain of non-NFRD undertakings. This gives both SMEs and large undertakings time to prepare. Moreover, the scope of information that can be required from SMEs by large undertakings is limited to that required from listed SMEs[10] .

In relation to the total turnover of SMEs (excluding micro undertakings) in the EU, one-off costs for SMEs can reach up to 0.02% of total SME turnover in the EU, and recurring costs could reach up to 0.03% of total SME turnover (see Figure 4.5). Of these, about 0.01% of total turnover will be paid by SMEs to external consultancies and auditors for implementation, and in the years thereafter.

[10] The ESRS for listed SMEs are still in development.

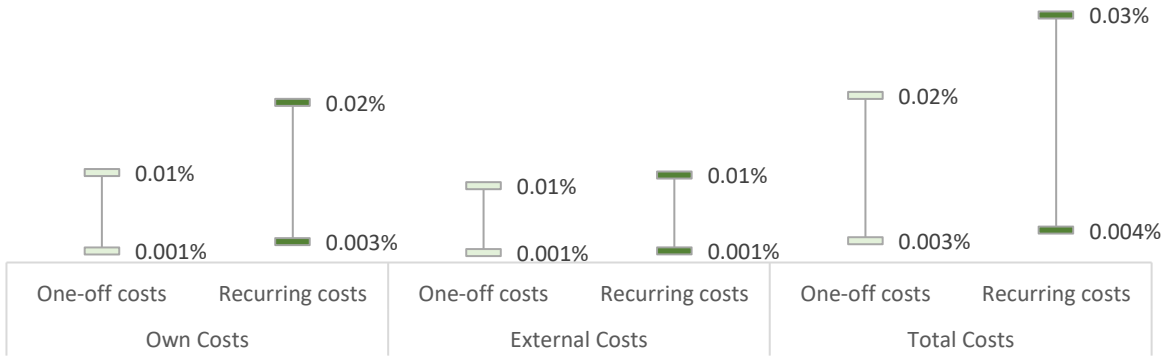
*Figure 4.4 Total administrative costs for undertakings in value chain (EUR billion)*




*Note:* Due to limited reported data, one-off costs per disclosure requirement were approximated based on costs reported by large undertakings.

*Source:* CEPS (2022).

*Figure 4.5 Total administrative costs for undertakings in value chain (% of total turnover)*




*Note:* Due to limited reported data, one-off costs per disclosure requirement were approximated based on costs reported by large undertakings.

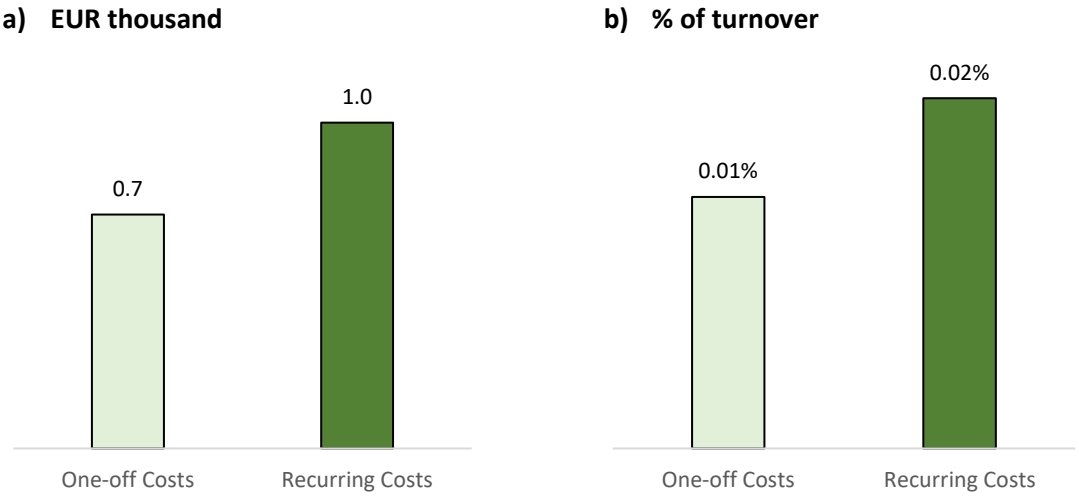
*Source:* CEPS (2022).

### *4.1.4 Incremental costs*

Incremental costs are the additional costs directly resulting from activities that regulated undertakings only perform in order to comply with their legal obligations. This effectively means that these costs would not have been incurred without the legislation. For SMEs, incremental costs amount to about half of their administrative costs, for both one-off costs (EUR 700 or about 54% of administrative costs) and recurring costs (EUR 1 000 or about 50% of administrative costs). This effectively means that only about half of the costs borne by SMEs to provide the sustainability information would have been incurred as good business practice, even in the absence of the obligation for large undertakings to report in line with the ESRS. Most SMEs that were surveyed reported that they would have to enact policy changes or introduce new policies, especially concerning data on climate and the environment.

The result is coherent with previous findings, given that the large majority of SMEs were not previously collecting or publishing sustainability data. Considering the size, resources and priorities of SMEs, as well as the complexity of the ESRS reporting requirements, this is also unlikely to change without policy intervention. Indeed, the SMEs indicated in the survey that especially the required external expertise would not have been sought in the absence of the ESRS reporting requirements.

*Figure 4.6 Incremental costs per undertaking in the value chain*

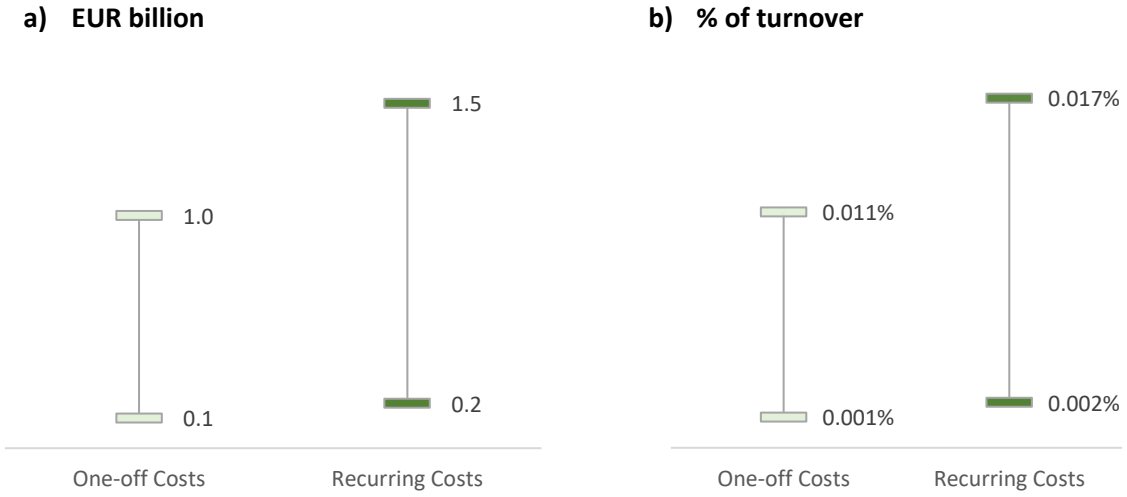



*Note:* Due to limited reported data, one-off costs per disclosure requirement were approximated based on costs reported by large undertakings.
*Source:* CEPS (2022).

Considering the total number of EU SMEs in the value chain of large undertakings (see Figure 4.7a), the total one-off incremental costs range from EUR 0.1 billion to EUR 1 billion, and the recurring costs from EUR 0.2 billion to EUR 1.5 billion. Generalising this to the wider SME population means that the additional cost of reporting sustainability data can be significant for the value chain stakeholders.

Overall, the incremental costs generated by the CSRD represent a limited share of the undertakings' turnover (see Figure 4.7b). One-off incremental expenses are expected to reach up to 0.01% of total SME turnover. Incremental expenses in subsequent years are expected to be higher, up to 0.02% of total SME turnover. This confirms that the fixed costs of reporting to large undertakings are influenced by the extent to which SMEs have been collecting such data prior to the CSRD. In most cases, it is unlikely that SMEs performed such sustainability data preparations previously.

*Figure 4.7 Total incremental costs for undertakings in the value chain*




*Note:* Due to limited reported data, one-off costs per disclosure requirement were approximated based on costs reported by large undertakings.

*Source:* CEPS (2022).

Part of the incremental costs incurred by EU SMEs could be attributed to the SFDR and CRR, as these pieces of legislation overlap with the ESRS on a number of environmental disclosures. In particular, financial institutions falling within the scope of the SFDR and CRR must report on scope 3 GHG emissions, which overlaps with disclosure requirement E1-6 (gross scope 1, 2, 3 and total GHG emissions) under the ESRS and includes data on the entire value chain.

### *4.1.5 Conclusions*

Overall, the trickle-down effect is likely to result in moderate costs for all SMEs combined. SMEs in the value chains of preparers are likely to incur internal and external costs if they are requested to provide sustainability information. Even though they are only likely to be asked for a small number of disclosure requirements, the reporting costs are still expected to be noticeable. In practice, the average cost per SME might be less, as preparers might not ask them for all the relevant requirements and might take up some of the work to prepare the information themselves. The total cost of the trickle-down effect will further heavily depend on the tiers of the value chain considered (up to a factor 10 difference).

## 4.2 Litigation cost

The first draft of the ESRS might result in indirect litigation costs for preparers, which are beyond the direct legal costs that are caused by the familiarization with the reporting standards. Increasing litigation cost can lead to reputational damages and reduced demand for products and services, which subsequently could place preparers at a competitive disadvantageous position.

Currently, litigation risk stems from climate litigation and sustainability due diligence practices (or lack thereof). Climate litigation is a result of preparers' failing to avoid or minimize adverse impacts of climate change and human rights violations, which will be revealed in their sustainability due diligence process (European Commission, 2019; Johansen & Plenborg, 2013). Sustainability due diligence is the actions of preparer to identify and address adverse human rights and climate change impacts that can be caused by its business operations. Under the ESRS 1 General Principles Appendix C, preparers are obligated to perform and report sustainability due diligence in a preparer's own undertakings and in its upstream/downstream value chain.

Although mandatory reporting standards can decrease the litigation risk, by providing concrete guidance for preparers, more comprehensive reporting can also result in greater scrutiny for some preparers and lead to increased litigation costs especially in the short-term (European Commission, 2021).

### *4.2.1 Existing litigation*

Following the Paris Agreement in 2015, the number of climate litigation cases against the private sector has been rising in the EU (Hackett et al., 2020). Increasing demand for information by their employees, customers, investors, and other stakeholders has subjected preparers' sustainability-related performance to greater scrutiny. In the absence of a reporting framework and subsequent insufficient enforcement action, sustainability reports have been used increasingly by NGOs to bring court cases against the private sector to enforce preparers to compliance. These court cases can be grouped in two broad categories:

- First, cases challenging the **accuracy and completeness of the disclosed information** with respect to national and international guidelines, that are used by the preparers to produce their sustainability information statements. Such guidelines include OECD guidelines for multinational enterprises[11], French Commercial Code[12], French Duty of Vigilance Law[13], and Dutch Civil Code[14], which in part adopt the NFRD into national law.
- Second, cases[15] directly contesting preparers' activities or performance (such as regarding failing to adhere to minimum CO2 emission reduction).

Although the increasing amount and quality of sustainability information can decrease the litigation risk, as long as the lack of enforcement by the national competent authorities persists, private stakeholders, such as NGOs, could continue to use litigation as a mechanism to enforce the private sector to comply. According to Article 1 (1) of the NFRD, preparers are obligated to disclose their environmental, social, and human-rights related policies, their outcomes, and related risks. In 2021, ESMA assessed the NFRD-related enforcement actions in the EU. A total of 711 examinations were conducted, out of which 72 required enforcement action were made (equalling 10%). In total, 68 out of 72 preparers were required a correction in their future non-financial statements. In addition, two preparers were required to issue public corrective notes and two preparers required to reissue their non-financial statements.

Enforcement actions were related to absence and/or lack of sufficient information on:

- KPIs (20%) on social and employee policies and the impact of the COVID-19 pandemic;
- Principal risks (21%) such as climate change risks;

[11] OECD guidelines for multinational enterprises are non-binding standards, which are backed by governments, for multinational enterprises, which promotes responsible business conduct consistent with applicable laws and internationally recognized standards.

[12] French Commercial Code (Code de Commerce) was enacted the NFRD in France in 2017 and it sets the information requirements which French companies must include in their non-financial reporting.

[13] French Duty of Vigilance Law, entered in force in 2017, sets the obligations under which French companies must identify and prevent risks of human rights, health and safety or environmental violations resulting from their operations or the operations of their supply chain.

[14] See "Milieudefensie et al. v. Royal Dutch Shell plc.".

[15] See "Deutsche Umwelthilfe (DUH) v. Mercedes-Benz AG" and „Kaiser, et al. v. Volkswagen AG". Both cases claim that the companies have been violating the right to climate protection by not committing to achieving carbon neutrality in the production and intended use of internal combustion engine cars.

- Description of the policies pursued by the undertaking, due diligence, and outcome of policies (18%);
- References and additional explanations for the amounts reported in the annual financial statements (4%);
- An explanation for not pursuing a certain policy (4%); and,
- Description of the issuer's business model (4%) and other issues (19%).

Most cases against the private sector brought against GHG emitters or fossil fuel producers[16] (Pouikli, 2022; United Nations Environment Programme, 2020), such as cases Milieudefensie et al.[17] versus Royal Dutch Shell plc (RDS) in the Netherlands and Notre Affaire à Tous versus TotalEnergies SE in France. In both cases, NGOs argued that the oil producers lacked the necessary strategies which will align their activities with a trajectory compatible with the 2030 climate goals of the Paris Agreement. In case of RDS, the court used RDS's 2019 sustainability report to argue that RDS's internal policies disclosed in their reporting are not consistent with their actions and climate goals of Paris Agreement. In case of TotalEnergies, the NGO's argued that TotalEnergies failed to report and mitigate the climate risks associated with its activities. Both cases still have to be concluded. RDS went to appeal process after the court's decision that Royal Dutch Shell plc was obliged to reduce the CO2 emissions by 45% by the end of 2030 (compared to 2019 emissions). In the TotalEnergies SE case, the court has yet to reach a decision in first instance.

However, increasing risk of litigation is not only a concern for direct emitters and fossil fuel producers, but also for undertakings financing and insuring these activities that can contribute to climate change. The main underlying issue behind litigation cases have been low sustainability reporting quality. In 2017, BankTrack, Greenpeace Nederland, Milieudefensie, Friends of the Earth collectively filed a complaint against ING for failure to report and commit appropriately to achieving the climate targets under the 2015 Paris Agreement. The case alleged that ING had violated environment and retail investors by failing to set targets to reduce the emission of GHG emissions from its financial products. Furthermore, the NGOs argue that ING had not reported the indirect product emissions of undertakings and processes it finances. Similarly, in 2018 a climate litigation case by Development YES – Open-Pit Mines NO[18] was filed against PZU, Poland's largest insurance company, concerning its indirect impact on climate change. The case alleged that PZU's non-financial reports lack transparency regarding its CO2 emissions and the impact of insuring the coal mining sector in Poland. Both cases went to mitigation and the financial services companies made pledges to increase their transparency in their public reporting.

Furthermore, increasing risk of litigation can also lead to increasing political costs. Preparers with increasing litigation risk can observe an adverse impact on their political ties and investor interest. Increasing litigation will bring additional legal and reputational scrutiny on the preparers' sustainability initiatives (Leuz & Oberholzer-Gee, 2006; Leuz & Wysocki, 2016).

### *4.2.2 Conclusions*

To conclude, climate litigation in the EU has emerged as a tool to leverage some more ambitious climate policies and actions in the light of a lack of enforcement action. So far litigation cases have

[16] A global overview of the climate litigation cases can be found at the Climate Change Laws of the World's global database.

[17] Co-plaintiffs included other NGOs, such as ActionAid NL, Both ENDS, Fossielvrij NL, Greenpeace NL, Young Friends of the Earth NL, Waddenvereniging, and more than 17000 citizens.

[18] Development YES – Open-Pit Mines NO is a grassroots movement working on anti-coal and anti-lignite activism in Poland.

been high-profile cases concerning mostly large undertakings, which focus on mostly low quality of reporting. The litigation risk stemming from low reporting quality could be reduced by the application of the ESRS, which will introduce more standardization, additional reporting, due diligence, and transparency. This will be further enhanced by the obligation to have the sustainability information audited.

Moreover, increased reporting obligations could also result in short-term higher litigation risk. Greater amount of disclosed information could lead to greater scrutiny on undertakings' sustainability related performance and reporting. Furthermore, since preparers need to disclose information on their entire value chain, they could be also held liable for the environmental social and governance related performance of their supply chain members. This will not only lead additional litigation risk but also increased compliance cost for preparers (for a detailed discussion on the latter see section 3.2).

However, surveyed preparers do not see an increase in litigation risk due to ESRS. The current litigation risk emerges due to the legislative void that is caused by the international agreements not being fully anticipated in national legislations. Hence, this legislative void is exploited in legal cases. Litigation results in large legal costs and potential fines, but the additionality of the costs regarding investments to reduce the emissions should be limited as the governments would sooner or later have to require the undertakings to act based on their climate commitments in the Paris Agreement.

## 4.3 Competitive position costs and benefits

The ESRS can have both indirect competitive costs as well as benefits, which are both discussed in this section.

An important indirect cost of mandatory reporting standards is the potential loss of the competitive position of preparers of sustainability reports in line with the ESRS. Previous literature underlines the disclosure of propriety (corporate sensitive) information as the main reason behind the loss of competitive position (Breuer et al., 2021; Christensen et al., 2021; Dinh et al., 2021). Until now, the competition aspect of sustainability information disclosure has been assessed only to a limited extent in the literature. Most of the previous literature has focused on the determinants of voluntarily disclose sustainability information by undertakings. Hence, the impact of mandatory sustainability reporting standards on competition are still somewhat unclear.

Proprietary (or corporate sensitive) information means information that other market participants, such as competitors, NGOs, labour unions, tax authorities, and regulators, can use. In the context of ESRS, such information can include:

- Disclosure of financial resources for the implementation of sustainability transition plans;
- Potential product profitability and potentially profitable markets (including demand and supply conditions); and,
- Information regarding the value chain.

If a preparer's business model/strategy relies on the confidentiality of disclosed information, access and usage of such information by its competitors can place the preparer at a competitive disadvantage and result in a loss of bargaining power within the value chain (Au & Tan, 2021; Bens et al., 2011; Berger et al., 2019; Christensen et al., 2019).

The following sections discuss in detail the impact of the reporting requirements and the negative spill-over effects of competitive position costs on innovation capacities.

### *4.3.1 Impact of the competitive position costs on the preparers*

ESRS's impact through competitive position costs can affect both preparers and undertakings that are themselves not subject to CSRD. As the interest by investors and public in sustainability information increases, disclosure of sustainability information can improve undertakings' reputation and access to capital. Standardised and easily accessible sustainability information will allow more efficient comparison between undertakings and can lead to competitive advantages for more sustainable undertakings. By not disclosing information, undertakings that are not subject CSRD might face reduced access to new customers and finance. For example, private SMEs, may lack the incentive and resources to report sustainability information voluntarily and eventually be placed in a competitively disadvantageous position to obtain finances.

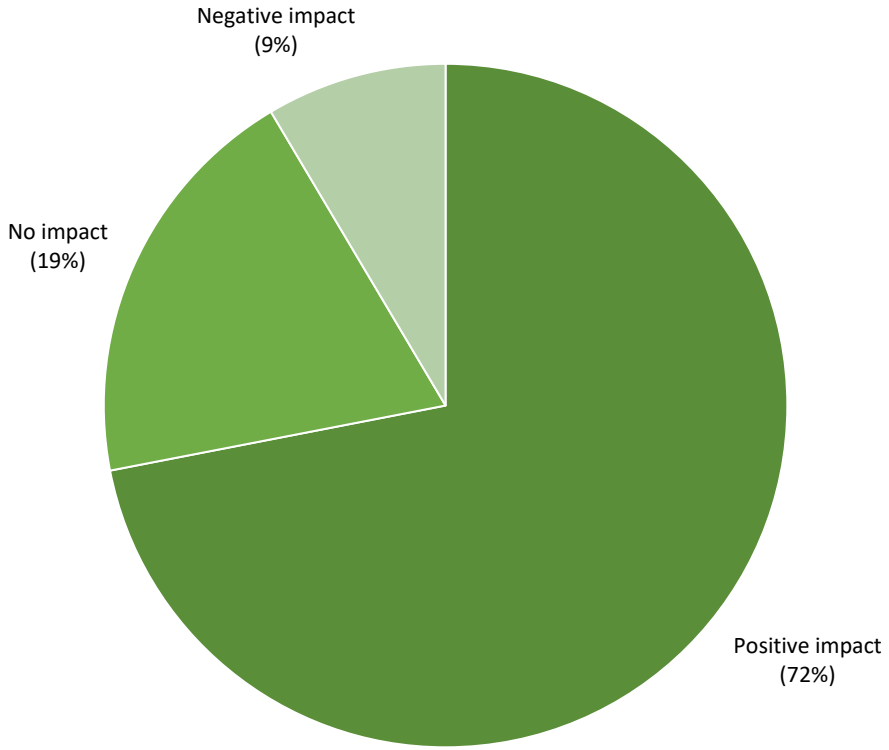
The competitive position costs for preparers can vary significantly across sectors, company size, and geographical coverage. The potential competitive disadvantage could be higher for preparers that are:

- Operating in imperfectly competitive markets (a market situation where the sellers have the market power over the prices)**.** Competitive position costs can be higher for preparers operating in niche markets with very few competitors (such as local monopolists) than preparers operating in a competitive market. Disclosing information on market-specific supply and demand conditions can create competitive disadvantageous for preparers over potential market entrants (Breuer et al., 2021)**.**
- Smaller or public SMEs, as most large preparers already disclose sustainability information even without legal obligation since they need to communicate this information with a broader set of stakeholders (Leuz & Wysocki, 2016).
- Financially constrained undertakings. Increased risk disclosure can cause a decrease in shareholder value and can increase the cost of capital for the preparers (Allen et al., 2022; Au & Tan, 2021).
- Preparers with smaller EU or non-EU competitors (latter mainly through import competition) can be affected adversely. Non-EU undertakings can use the disclosed information to understand supply and demand conditions and to enter certain EU markets (Zamfir, 2020). This effect is limited inside the EU, as all undertakings with larger activities in the EU will have to report in line with the ESRS.
- EU undertakings operating outside the EU can also be put at a competitive disadvantageous position since their main competitors are not obligated to disclose such information and can offer better pricing due to their lower assurance costs (Zamfir, 2020).

In financial reporting literature, the existence of competitive position costs due to the disclosure of propriety information has been used in many cases as the rationale for non-disclosure (Allen et al., 2022; Breuer, 2021; Feltham et al., 1992; Minnis & Shroff, 2017). However, the level of indirect effects of the first draft of the ESRS will depend on the preparers' pre-existing disclosure level. For example, undertakings that are already following voluntary reporting regimes such as the Global Reporting Initiative (GRI) could face relatively small disclosure and indirect cost increases than undertakings that do not follow a disclosure standard.

According to survey results, most of the preparers consider that the disclosure to the first set of ESRS will lead to a competitive advantage. Three quarters (76 %) of the prepares indicated that the first draft of the ESRS will lead to a competitive advantage, whereas 15 % of the preparers indicates that it will not impact their competitive position. The remaining 9 % of preparers consider that through the first draft of the ESRS their competitive position will be adversely impacted (see Figure 4.8).

*Figure 4.8 Impact of the obligation to disclose sustainability information according to ESRS on competitiveness (%)*



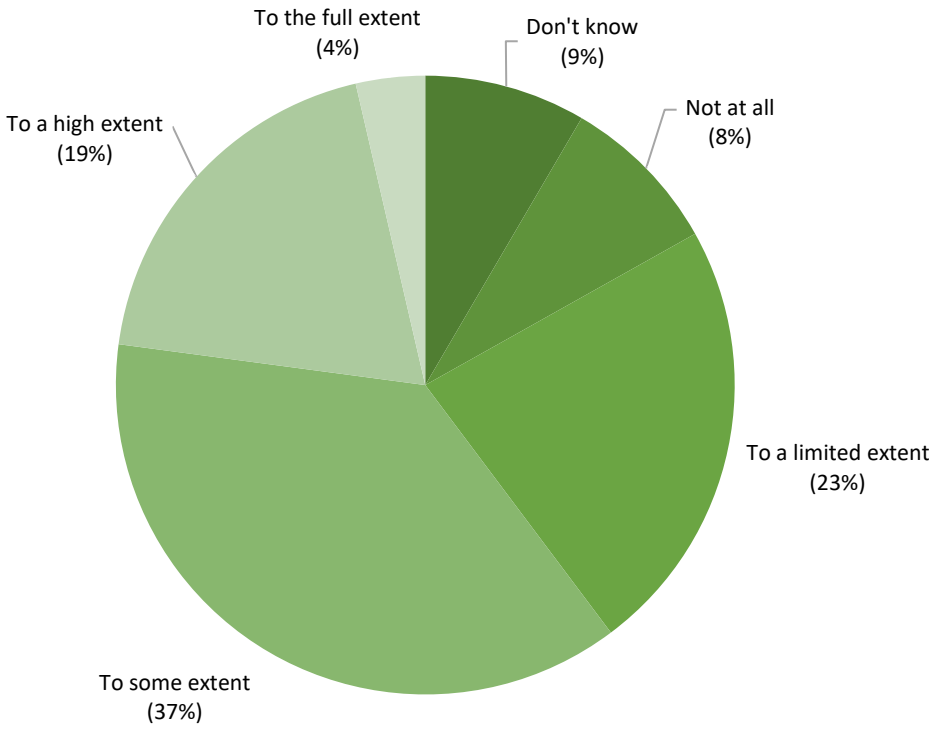

*Source:* CEPS (2022).

Surveyed preparers indicated that competitive advantages as a result of the disclosure of sustainability disclosure will be:

- Potential increased chance to win tenders and public competitions;
- Increased transparency and comparability across competitors will allow new customers and investors to be attracted; and
- Easier access to finance and lower borrowing costs.

Nevertheless, the majority of surveyed preparers (60 % to a limited or some extent) indicated that the potential impact on competitiveness will be limited (see Figure 4.9).

*Figure 4.9 To what extend to you expect ESRS to contribute to a better competitive position of your company? (%)*




*Source:* CEPS (2022).

The surveyed preparers that indicated that no effect could be observed, indicated:

- Same standards applying to their competitors;
- They are already disclosing all the required information, therefore ESRS would not result in additional reporting; and,
- Limited customer interest in additional disclosure. Some of the preparers' experience, particularly in service sectors such as financial and education, until now shows that customers do not take account of sustainability information when making their purchasing/vendor choices. Hence, they are not sure if customers would read the sustainability reports and base their future choices based on the reporting.

Surveyed preparers that indicated ESRS would lead to competitive disadvantageous cite the following arguments:

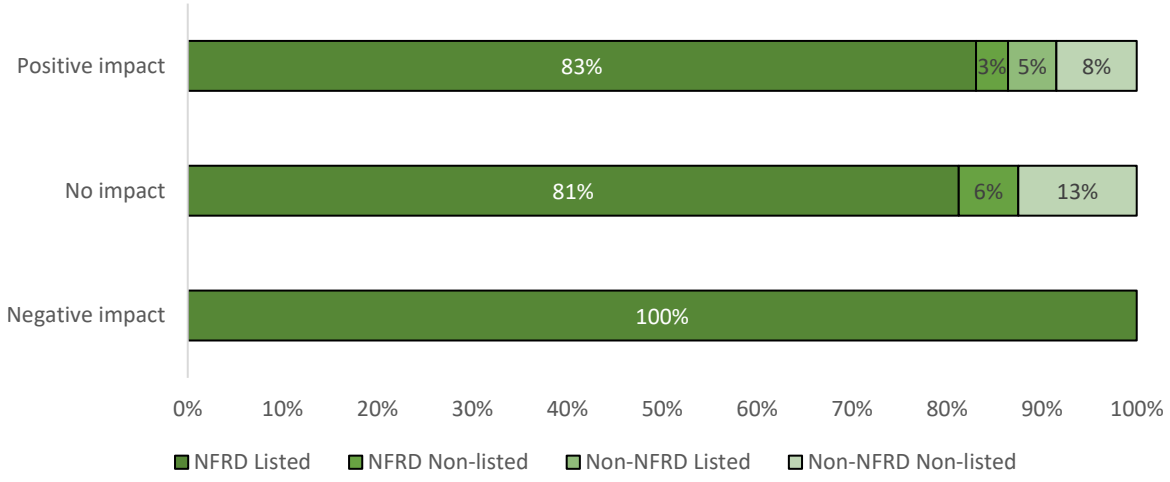
- Disclosing propriety/sensitive information on product profitability, potentially profitable markets, value chain, new processes and technologies can be used in the short-term by competitors to benchmark/imitate and reduce costs.
- Additional costs raised due to reporting activities might put preparers at a competitive disadvantage over their competitors who are not under the scope of CSRD/ESRS and could offer better pricing due to lower costs to their customers. The costs related to additional reporting requirements are considered as direct costs (see section 3.1).
- Additional reporting requirements will also result in additional administrative burden on undertakings and customers in the value chain. Survey responders indicated that additional requirements such as on the biodiversity in the value chain could lead to a disproportionately

high effort by their customers, such as farmers, whose information will be needed to assess the impact of products locally. This 'trickle-down' effect is already considered as separate cost in the respective section (see section 4.1).

Regarding sectoral impact the results show that sectors with more complex value chains are more likely to expect significant competitive disadvantages. Such sectors include manufacturing, healthcare, and agriculture. Furthermore, In contrast to the literature, survey results indicate that larger preparers are more likely to report potential competitive disadvantages than smaller preparers. The majority of smaller preparers expressed that the first draft of ESRS will lead to competitive advantages. The results across company types showcase a similar dynamic. All the preparers who indicated that the proposed ESRS would place them in a competitively disadvantageous position, are listed undertakings subject to NFRD (see Figure 4.10). Such undertakings are typically larger multinational enterprises, operating in non-EU markets.

The larger preparers that are operating in non-EU markets with large value chains are concerned that their direct costs would increase substantially due to reporting requirements. They expect that increasing direct costs would place them at a disadvantageous position over their competitors, which are not subject to ESRS and could gain a cost and pricing advantage. Smaller large preparers, meanwhile, indicate that the first draft of the ESRS would increase transparency and reporting quality, which would provide them an opportunity to engage with new investors and customers.

*Figure 4.10 Impact of the obligation to disclose sustainability information according to ESRS on competitiveness (%)*




*Source:* CEPS (2022).

### *4.3.2 Relationship between reporting regimes and competitiveness*

The first set of ESRS would require preparers to increase the specificity and level of detail of sustainability disclosure relative to what preparers currently report either voluntarily or as part of the disclosure obligation under the NFRD. Such proprietary information may include:

- Products or services;
- Value chain (incl. supply chain);
- Information about profitable markets; and,
- Sector-specific risks and opportunities.

Although there are many studies on the impact of mandatory financial reporting regimes, the research on non-financial/sustainability reporting and its impact on competition remains limited. Hence, the experience with the mandatory financial disclosure regimes could be a good indicator for the potential indirect effects of the sustainability reporting regimes. The existing literature on sustainability reporting mostly focuses on the differences between mandatory and voluntary regimes, and the mandatory regimes' impact on competitiveness. According to previous research, disclosure of sector-specific risks and opportunities is perceived by the preparers as the main source of competitive position costs (Au & Tan, 2021; Chen et al., 2022; Minnis & Shroff, 2017). Preparers are often concerned that disclosed information on opportunities can be used by their competitors and increased risk disclosure can limit their access to capital. According to the survey conducted among almost 1500 listed and private undertakings (incl. SMEs), Minnis & Shroff (2017) show that three fifths (61 %) of surveyed European private undertakings were concerned that their competitors would download their financial statements if they were publicly available and almost half (48 %) of the undertakings surveyed undertakings have downloaded financial statements of their competitors in the past. However, other studies such as Leuz (2010) report, that mandatory disclosure regimes, in comparison to voluntary regimes, can reduce the impact of disclosure of proprietary information, since all undertakings have to provide the same information.

Many undertakings, specifically listed undertakings, are already reporting sustainability information based on one or more voluntary reporting frameworks. The following key differences exist between the first draft of the ESRS and the voluntary reporting standards:

- Definition of materiality: None of the existing voluntary reporting regimes fully apply a double materiality approach such as ESRS;
- Reporting requirements for the entire value chain;
- Reporting requirements on potential challenges and competitive advantages in the sectors; and
- Reporting requirements on information on their internal processes.

In 2022, initiatives outside of the EU also emerged to standardise and harmonise corporate sustainability reporting. In the United States, the Securities and Exchange Commission (SEC) issued a proposal on the climate disclosure rule ("*Enhancement and Standardization of Climate-Related Disclosures*"). At the international level, the International Sustainability Standards Board (ISSB) released a draft presenting detailed standards for climate-related disclosures. The proposals differ mainly regarding their scope and level of prescriptiveness (The SustainAbility Institute by ERM & Persefoni, 2022).

- The first draft of the ESRS is the most prescriptive and detailed proposal with specific taxonomy criteria and metrics) out of the three. SEC and ISSB proposals are principle-based, which leave significant room for the preparers to decide, which and how the information is disclosed;
- In terms of scope, the SEC proposal is limited to climate change and the ISSB proposal includes general requirements and climate disclosure requirements, whereas the first draft of the ESRS covers all environmental, social and governance topics.

### *4.3.3 Relationship between ESRS and competitiveness*

One of the key differences between the ESRS and the existing voluntary standards is the **definition of materiality**. In contrast to international reporting standards, such as the Global Reporting Initiative (GRI), which considers all the matters material to the market, the environment, and the public, and the Sustainability Accounting Standards Board (SASB), which considers only matters influencing the undertaking's business value, the first draft of the ESRS adopts the '**double materiality**' approach and

**deems all matters related to business value, environment, and public as material**. Some of the surveyed preparers noted that the scope of double materiality is quite far-reaching and that they may have to report on issues that are not material to the undertaking, investors, and other stakeholders. They are concerned that extensive reporting requirements would not only create direct costs, but they could also lead to a competitive disadvantage over non-disclosing firms.

In contrast to international standards, ESRS requires disclosure on the **value chain**. Some of the surveyed preparers noted that the value chain in the ESRS is not very well defined and reporting on the whole value chain might not be feasible due to the large scope of value chains. Reporting on the whole value chain will require additional resources not just from preparers themselves but also from the undertakings and customers in their value chain (see section 4.1 on trickle-down effect). The additional burden on the undertakings and customers in the value chain can result in significant competitive position costs for preparers that are operating in non-EU markets and competing with undertakings that are not subject to mandatory sustainability disclosure. However, disclosure requirements that concern impacts, risk and opportunities regarding an undertaking's value chain are subject to transitional measures. For the first 3 years, if the necessary information is not available, the undertaking can provide qualitative information.

### *4.3.4 Relationship between innovation and competitiveness*

Previous studies debated the relationship between innovation and competition. Although the focus is mostly on the (potential) impact of mandatory reporting, rather than what needs to be reported under the reporting frameworks (Allen et al., 2022; Au & Tan, 2021; Breuer et al., 2021; Simpson & Tamayo, 2020; Tomar, 2021).

The impact of corporate sustainability reporting on innovation is ambiguous. On the one hand, corporate sustainability disclosure may increase innovation by:

- Removing information asymmetries between preparers and capital markets, therefore improving their access to capital; and,
- Revealing technological know-how and encouraging innovation by other preparers.

In turn, innovative activities may be hampered by extensive information disclosure:

- Preparers can learn and benchmark their peers' technologies and innovations revealed in the corporate sustainability reports, which ultimately could decrease the incentive to invest R&D and innovative activities; and,
- Due to increasing competitive position and litigation cost, smaller large undertakings and financially constrained undertakings could shift their resources from innovative activities to compliance.

Breuer et al. (2021) investigates the relationship between mandatory financial disclosure and corporate innovation in the EU. They suggest that the introduction of a mandatory financial reporting regulation decreases the corporate innovative activities by offsetting the gains from the innovation, such as profit gains, sales from innovative products and cost reductions due to process improvements. The impact is particularly significant for smaller undertakings operating in 'niche markets' with few competitors. Using Eurostat's Community and Information Surveys, they show that mandatory financial reporting measured as the number of mandated undertakings is negatively associated with corporate innovation, measured as the number of undertakings that introduce new or significantly improved products, processes, or services at the country-industry level. Although the authors conclude that evidence of negative impact on corporate innovation is consistent, they underline that net impact on the whole economy is unclear.

Tomar (2021) investigates the relationship between public company presence and import competition in the US. They suggest that non-US competitors make use of the performance and investment information disclosed in SEC-mandated disclosures to compete with US firms. Benchmarking with peers, by adopting peers' 'best practices' disclosed in the sustainability statement, can facilitate industry-wide emission reduction. However, they emphasise that benchmarking practices can also lead to an overall reduced incentive to innovate, since benchmarking can promote imitation. By imitating their competitors innovative processes and technologies, undertakings can reduce their costs and increase product profitability, which ultimately could hamper their R&D and innovation activities.

Allen et al. (2022) find 'young life-cycle' **undertakings** in the US are more vulnerable to financial reporting regulation, subsequent proprietary costs, and negative innovation consequences**.** Young life-cycle undertakings are defined by the authors as undertakings with negative operating and investing cash flows and positive financing cash flows. Such undertakings are described as start-ups and high-growth undertakings, characterised by 'substantial innovation and employment capacities'. They suggest that the reduction in innovative activities (measured as R&D intensity and the number of patent filings) is a result of the diversion of resources from innovation to compliance. The finding shows that the 'one-size-fits all' approach of reporting regulations could harm young life-cycle undertakings disproportionately. Au & Tan (2021) analyse the relationship between mandatory risk disclosure such as litigation and sustainability risk and corporate innovation in the US. Controlling for company size, they find, being subject to mandatory risk disclosure will shift undertakings investment from 'uncertain investments' such as innovation to 'less risky investments' like capital expenditure. Furthermore, they underline that financially constrained undertakings are more likely to diverge their resources from R&D and innovative activities to compliance. Similar to Allen et al. (2022), they show that indirect impact of reporting regulation may not be uniform for all type of undertakings.

Similarly, Glaeser & Omartian (2022) investigate the impact of publicly available audited financial reports[19] on import competition. Their findings suggest that foreign competitors can use the disclosed performance and investment information to compete with US undertakings such as entering or avoiding certain markets and understanding supply and demand conditions, and this can lead to lower incentives for US firms to invest in innovation activities.

### *4.3.5 Conclusions*

The ESRS can have both competitive costs as well as benefits. Most of the preparers consider that the disclosure to the first set of ESRS will deliver a competitive advantage. They indicate that they will benefit from a higher probability of winning tenders and public competitions, becoming more attractive to new customers and/or easier access to finance.

Moreover, there are preparers that do not expect any impact on competition due to ESRS. They, for instance, are already reporting sustainability information or also have competitors reporting sustainability information.

In turn, there is a minority of preparers that expect to incur competitive position costs. The main underlying reason for the costs is the disclosure of sensitive corporate information. The requirements to disclose forward-looking information such as risks and opportunities, investment plans and estimated cost and benefits of R&D and innovative activities could give competitors an advantages. Extensive information disclosures might also impact the innovative activities of the preparers. If the level of disclosure is too detailed, the benchmarking behaviour could lead to imitating competitors' processes and products, which ultimately could hamper sector-wide innovation.

[19] Proxied by increases in downloads of US financial statements by users in a foreign country.

# 5. DIRECT BENEFITS

This chapter assess the **direct benefits** associated to the First Set of draft ESRS, including cost-savings and benefits derived from possible synergies and efficiencies with the relevant EU legislation on sustainability.

## 5.1 Cost savings

Due to the standardisation of the disclosed information, ESRS will introduce cost-saving benefits for different types of stakeholders. For preparers, ESRS may potentially reduce the costs linked to the presence of multiple ad hoc information requests by different users. Such information requests from users are usually uncoordinated and they mostly need to be processed individually. Hence, they lead to significant inefficiencies for preparers. On the other hand, for users (rating agencies, investors, NGOs, etc.), ESRS can also result in cost saving benefits by reducing the cost associated with finding comparable, relevant, and adequate sustainability information.

Although, there is a significant cost-saving potential of ESRS, due to the uncertainty about the reporting standards, most of the stakeholders expect limited cost saving benefits. The survey results shows that ESRS will lead to only a 14 % reduction in costs associated with the preparation and dissemination of sustainability information. This section discusses the potential cost-saving benefits from the perspective of different stakeholders, incl. preparers, sustainability data providers and rating agencies, investors, and other users.

### *5.1.1 Preparers*

Preparers, particularly larger and listed undertakings, are currently spending significant resources on preparing and disseminating sustainability information to users, such as third-party data providers, rating agencies, financial institutions, and NGOs. Increased adequate and publicly available sustainability information would reduce the number of ad hoc information requests from different users and subsequent costs associated with them. According to the survey results, ESRS could potentially reduce up to 24 % of total administrative costs at the undertaking level. However, surveyed preparers expect that ESRS would reduce total administrative costs by only an estimated 5%[20].

By providing more comprehensive, standardised, and harmonised sustainability information, ESRS can reduce preparers' need to provide additional sustainability information to third parties. Larger enterprises receive a significant number of ad hoc requests from different users, such as investors, rating agencies, NGOs, and regulators, that are asking for the disclosure of specific information Such requests are usually uncoordinated and need to be processed individually. Information requests can be in the form of meetings, calls, questionnaires, and surveys which can easily create additional costs for preparers. Since not responding to an ad hoc request can result in reputational (such as being labelled as untransparent and/or unsustainable) or rating-related damages, preparers need to invest significant resources to answers these requests by conducting ad hoc information and data collection. Ad hoc information requests usually substitute for reporting requirements for a limited period before reporting frameworks address the changing data and information needs for the longer term. Since more comparable and reliable sustainability information will be publicly available, the number of ad hoc requests from the users and costs associated with it will be reduced in the medium term (EBA, 2021; European Commission, 2021).

Currently, listed undertakings subject to NFRD are bearing higher costs associated with ad hoc information requests than their listed peers that are not subject to NFRD. Listed undertakings subject

[20]Expected cost savings are calculated as the ratio of expected cost reduction by preparers to their total administrative costs.

to NFRD have on average EUR 21 000 as external costs (measured as the fees paid to external service providers) and EUR 69 000 as own costs (measured as labour costs to provide sustainability information). Whereas listed but non-NFRD undertakings have on average EUR 13 000 as external cost and EUR 42 000 as own cost to provide sustainability information to rating agencies and financial service undertakings (see Figure 5.1). Similar to their listed peers, non-listed undertakings that are subject to NFRD are also bearing significantly higher costs than their non-NFRD peers. Non-listed undertakings that are subject to NFRD have on average EUR 6 000 external costs and EUR 21 000 own costs. The cost of providing sustainability information to rating agencies and financial service undertakings are lowest for non-listed not subject to NFRD undertakings, with on average EUR 2 000 external and EUR 7 000t own costs.

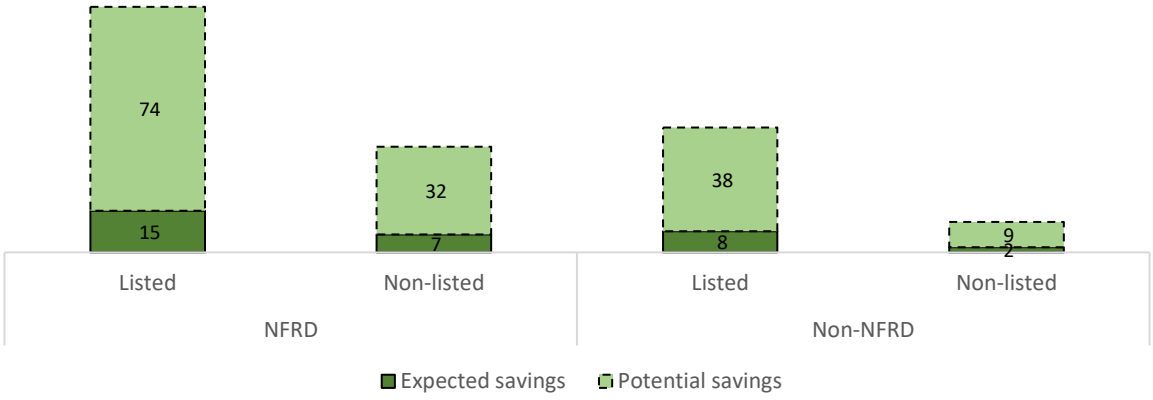
*Figure 5.1 Costs for providing sustainability information to rating agencies and financial service companies per undertaking (EUR thousands)*


*Note:* Own costs represents the labour cost spent to provide sustainability information. External costs represent the fees paid to external service providers to provide sustainability information.

*Source:* CEPS (2022).

However, according to the survey results, the majority of preparers are not expecting a significant reduction in the costs associated with ad hoc information requests. The potential cost saving which is calculated as the sum of own and external costs of providing sustainability information to users, is larger for listed undertakings subject to NFRD (EUR 90 000) than other types of preparers (see Figure 5.2). This is followed by listed undertakings not subject to NFRD with potential cost savings amounting EUR 55 000. However, expected savings (based on the self-reported expectation of preparers) are significantly lower (EUR 13 000 for listed NFRD and EUR 8 000 for listed non-NFRD). The potential cost savings for non-listed undertakings are significantly lower than their listed peers (EUR 27 000 for non-listed NFRD and EUR 9 000 for non-listed non-NFRD undertakings). The expected savings for non-listed undertakings are also lower (EUR 4 000 for non-listed NFRD and EUR 1 000 for non-listed non-NFRD undertakings).

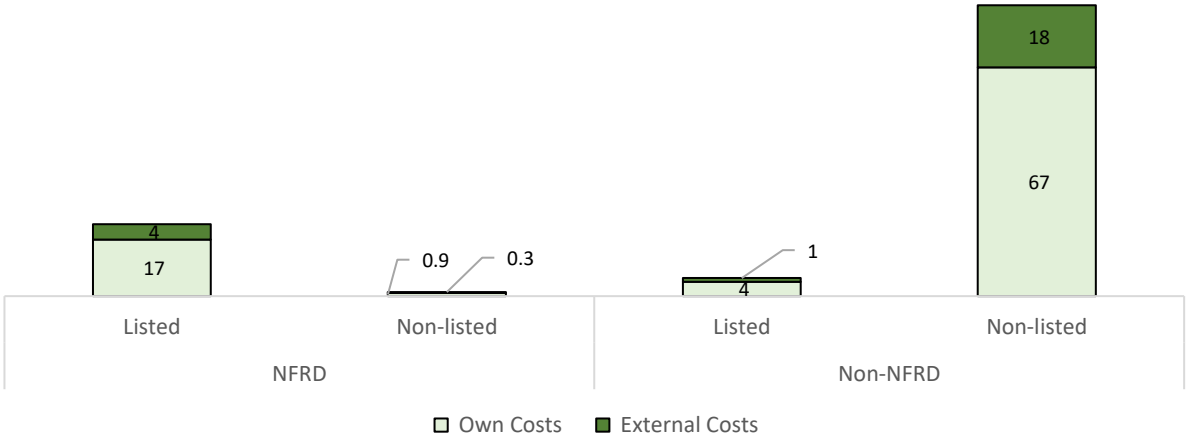
*Figure 5.2 Savings from ESRS in reduced sustainability information providing to rating agencies and financial service companies per undertaking (EUR thousand)*




*Source:* CEPS (2022).

The breakdown of total expected cost savings shows, in line with costs associated with providing sustainability information to users, that costs savings are significantly larger for own costs than external costs. The total amount of cost savings is expected to be significantly higher for non-listed undertakings, that are not subject to NFRD (EUR 14.1 million for external costs and EUR 47.4 million for own costs. See Figure 5.3). The total cost savings for listed undertakings that are subject to NFRD are expected to be EUR 4.1 million in external costs and EUR 13.9 million in own cost, followed by listed undertakings not subject to NFRD (EUR 1.2 million in external costs and EUR 4.2 million in own costs). and finally non-listed undertakings subject to NFRD (EUR 0.2 million in external costs and EUR 0.5 million in own costs).

*Figure 5.3 Total expected savings from ESRS in reduced sustainability information providing to rating agencies and financial service companies (EUR million)*




*Note:* Own costs represents the labour cost spent to provide sustainability information. External costs represent the fees paid to external service providers to provide sustainability information.

*Source:* CEPS (2022).

### 5.1.2 Sustainability data providers and sustainability rating agencies

Similar to the preparers, third-party data providers and rating agencies have been spending significant resources on collecting and verifying sustainability information. Therefore, standardised reporting will allow them to obtain more quantifiable and comparable information. The increased amount of comparable and granular information will not only reduce their costs associated with collection and verification of information, but could also increase the number of undertakings in their portfolios (for example, rating agencies can rate smaller firms/SMEs, that wouldn't need to disclose sustainability information before CSRD/ESRS).

However, surveyed rating agencies indicated that they are currently unable to indicate whether they will align their data collection and assessment methodologies according to ESRS. The majority of rating agencies are internationally active and they need to consider other national or international reporting regimes when they construct their rating methodologies. Therefore operability between ESRS and other international/national reporting standards are crucial and surveyed rating agencies expressed concerns about the interoperability between current ESRS and other international standards, such as ISSB. Increasing deviation between reporting regimes, can increase the costs for rating agencies, where a different reporting framework can result in very different and incomparable datasets.

### 5.1.3 Investors

Current sustainability disclosures lack comparability and completeness for investors to assess undertakings in an efficient way (The SustainAbility Institute by ERM, 2020). The cost savings for investors can occur either directly due to the increased amount of publicly available information, standardisation, and comparability. In the absence of standardisation, investors are spending significant resources on finding and making relevant information of different undertakings comparable (Minnis & Shroff, 2017; Christensen et al., 2021). According to the public consultation conducted by the European Commission (2021), the majority of users (59 %) said that they encounter difficulties in finding relevant information in preparers' sustainability reports. Increased publicly available information, which is standardised through ESRS, will reduce investors' cost associated with collecting and processing of sustainability information. In addition, sustainability information data portals, such as the European Single Access Point[21], can further decrease the cost for investors by making access to sustainability data easier for investors, and in turn reducing their costs associated with collecting and processing sustainability information.

Investors often rely on third-party data providers for their sustainability information. Increased publicly available sustainability information can reduce investors' dependence on third-party data providers and therefore the costs associated with it. However, potential savings for investors will depend on the global coverage data portals. Since most investors are active on a global scale, cost savings benefits through ESRS will only be limited to the EU and investors will still need to make data on EU undertakings comparable to other undertakings that are not subject to CSRD/ESRS.

In addition to ESRS's direct impact, the cost savings for investors may occur indirectly due to the cost reduction of other stakeholders, such as third-party data providers and rating agencies. As a result of ESRS, third-party data providers can face lower costs associated with the information collection and

[21] European Single Access Point (ESAP) is a proposed EU-wide digital platform containing companies' public financial and non-financial information. It aims to provide providing comprehensive and verifiable data of multiple firms for users. For more information, see Commission Communication "A Capital Markets Union for people and businesses – new action plan".

offer better pricing for their customers. Hence the potential cost-savings can be a result of the lower costs for third-party data providers.

### *5.1.4 Other users*

Other users, such as labour unions and NGOs, are not using sustainability reports as systematically as the rating agencies and investors. Depending on their field of interest, other users utilise sustainability reports to obtain more specific information and to pressurise preparers (for example, in order to realise behaviour changes). Similar to investors, other users are also facing difficulties in finding relevant sustainability information. In the absence of reporting standards, most of the preparers are disclosing vast amounts of information in different formats, which for users might be incomparable and/or irrelevant, for example, a company's philanthropic activities and activities that are not critical information to determine its impact (e.g. disclosure of paper consumption) (European Commission, 2021). Extensive reporting on such information increases the effort and cost for users associated with finding relevant sustainability information. While users in this category may benefit from higher quality and more broadly available information, their potential cost savings, however, will be relatively limited in comparison to other stakeholders due to their limited usage of sustainability reports.

### *5.1.5 Conclusions*

The ESRS can produce potential cost savings benefit for the whole economy by reducing the efforts in the production, collection and dissemination of the sustainability information. In the absence of disclosure standards, preparers face additional costs due to significant amount of ad hoc information requests from different users. Similarly, the users are spending significant resources to find comparable, relevant, and adequate sustainability information. By increasing the amount of adequate and publicly available sustainability information, ESRS can potentially reduce costs for different stakeholders. However, surveyed stakeholders said that they are currently unable to anticipate such potential cost savings, mainly due to the uncertainty over the impact of the new standards. Since ESRS will only be applicable for undertakings operating in the EU, potential cost savings for stakeholders that are globally active, such as rating agencies and investors, will also depend on the interoperability of ESRS with other national and international sustainability reporting regime.

## 5.2 Possible synergies and efficiencies

Assessing the level of synergy between the ESRS on the one hand and existing (EU and international) standards and related pieces of legislation on the other hand is key to ensuring better coherence and integration of the ESRS with the various EU policies that are related to sustainability (such as the SFDR and the Taxonomy Regulation). A high level of synergy may result in efficiency gains, as datapoints and sources of information used to comply with existing standards can be leveraged to address the new ESRS. In addition, synergies and efficiencies would ensure that investors and stakeholders gain a better and more complete picture of an undertaking's performance in relation to sustainability (Accounting for Sustainability, 2022).

As mentioned by EFRAG in the Cover Note for Public Consultation, the exposure drafts (i.e. the equivalent to disclosure requirements in the revised version of the ESRS) take existing European laws, policies and initiatives into account, given that robust, reliable and relevant sustainability information is a key element of success for a number of leading EU initiatives. It is also necessary to consider these interlinkages to prevent replications and inconsistencies. Moreover, in accordance with a direct request found in Article 19b(3) and Recital 37 of the [draft] CSRD "*sustainability reporting standards should be proportionate, and should not impose unnecessary administrative burden on companies that are required to use them. In order to minimise disruption for undertakings that already report sustainability information, sustainability reporting standards should take account of existing standards*

*and frameworks for sustainability reporting and accounting where appropriate*. […] *To avoid unnecessary regulatory fragmentation that may have negative consequences for undertakings operating globally, European standards should contribute to the process of convergence of sustainability reporting standards at global level*"

The aim of this section is thus to assess the extent to which the ESRS disclosure requirements encompass (and are in sync with) some of the most relevant laws, policies and existing frameworks on sustainability standards, in particular looking at: i) European laws and initiatives; and ii) international sustainable reporting initiatives. The assessment of the synergies is based on desk research carried out by legal specialists. The aim should be to reach a medium to high level of synergy across standards.

### *5.2.1 Standards and initiatives examined in assessment of synergies*

Before proceeding to the above-mentioned analysis, it is necessary to outline the most important laws, policies and standards compared to the ESRS from a cost perspective, in order to find possible synergies and efficiencies. To understand the significance of these other standards, it should be noted that 96% of the world's largest 250 undertakings now prepare sustainability reports (KPMG, 2020). Currently, the EU rules on non-financial reporting apply to large public-interest entities (PIEs) with more than 500 employees. This covers approximately 2 000 large undertakings and groups across the EU, including listed undertakings, banks and insurance companies. In addition, almost 10 000 other undertakings designated as PIEs by national authorities also need to publish non-financial statements (European Commission, 2022; CEPS, 2020). The proposal for a CSRD, which would amend the existing reporting requirements of the NFRD, extends the scope to all large undertakings and all undertakings listed on regulated markets (except for listed micro-enterprises).

The standards and pieces of legislation against which the ESRS were assessed were chosen according to the following criteria:

- Extent of stakeholder usage (see CEPS, 2020);
- Relevance in EFRAG documents in terms of citations in the Basis for Conclusions and Appendices; and,
- Relevance in the European panorama.

Following the first criterion, the Global Reporting Initiative Standards stand out. Under the second criterion, the International Sustainability Standards Board, the Task Force on Climate-related Financial Disclosures and the Carbon Disclosure Project questionnaires were cited numerous times. The third criterion leads to the Non-Financial Reporting Directive and its Guidelines, the Taxonomy Regulation and the Sustainable Finance Disclosures Regulation. All of these standards and initiatives are introduced briefly in the remainder of this subsection.

The **Sustainable Finance Disclosures Regulation** (SFDR) lays down harmonised transparency rules for financial market participants and financial advisers on how to integrate environmental, social and good governance factors into their investment decisions and financial advice, and on their overall and product-related sustainability ambitions. Thus, it sets out rules on disclosures. In April 2022, the European Commission adopted Delegated Regulation (EU) 2022/1288, which sets technical standards to be used by financial market participants when disclosing sustainability-related information under the SFDR. This regulation specifies the exact content, methodology and presentation of the information to be disclosed, thereby improving its quality and comparability. The requirements will now be subject to scrutiny by the European Parliament and the Council, and are scheduled to apply from 1 January 2023.

The **Non-Financial Reporting Directive** (NFRD) requires certain large undertakings with more than 500 employees to disclose relevant non-financial information to give a review of their business model, policies, outcomes, principal risks and key performance indicators (KPIs), including on environmental matters, social and employee aspects, respect for human rights, and anti-corruption and bribery issues[22]. The Commission has produced two non-binding sets of guidelines. The 2017 Guidelines help undertakings disclose relevant social and environmental information in a more consistent and comparable manner, and the 2019 Guidelines on reporting climate-related information consist of a new supplement to the existing guidelines on non-financial reporting, which remain applicable.

The **Taxonomy Regulation** aims to allow investors to know whether an economic activity is environmentally sustainable by setting common EU-wide criteria[23]. These criteria are set by Article 3 of the Regulation, according to which an economic activity shall qualify as environmentally sustainable where that economic activity: i) contributes substantially to one or more of the environmental objectives set out in Article 9 of the Regulation; ii) does not significantly harm any of these environmental objectives; iii) is carried out in compliance with the minimum safeguards set out in the Regulation; and iv) complies with technical screening criteria set up by the Commission in accordance with the Regulation. The Taxonomy Regulation modifies the SFDR and the NFRD because undertakings also have to disclose the extent to which their products are 'environmentally sustainable' under the Taxonomy Regulation. Undertakings subject to an obligation to publish non-financial information have to disclose the information required by Article 8 of the Taxonomy Regulation, i.e. they have to disclose information on the proportion of turnover, capital expenditure ('CapEx') and operating expenditure ('OpEx'), or on their green asset ratio, associated with economic activities that qualify as environmentally sustainable. The Commission has to define technical screening criteria for each environmental objective through delegated acts. A first delegated act on sustainable activities for climate change adaptation and mitigation objectives has been applicable since January 2022 (Regulation (EU) 2021/2139). This act has been modified by the Complementary Climate Delegated Act (Regulation (EU) 2022/1214), which will enter into force in January 2023. The Commission is working on a second delegated act for the remaining objectives. Another delegated act (Regulation (EU) 2021/2178) specifies the content and presentation of the information to be disclosed pursuant to Article 8 of the Taxonomy Regulation, including the methodology to be used to comply with it.

The **Global Reporting Initiative** **(GRI) standards** are a modular system of interconnected standards that can be used by any organisation, large or small, public or private, from any sector or location. This system comprises three sets of standards: i) GRI universal standards, which apply to all organisations; ii) GRI sector standards, which are aimed to be developed for 40 sectors in order to increase the quality, completeness and consistency of reporting by organisations; and iii) GRI topic standards, which contain disclosures for providing information on topics such as waste and occupational health and safety. Thanks to this structured system, stakeholders and other interested parties can inform themselves about the undertakings' impacts on the economy, environment and people in a transparent way. The GRI remains a pioneering sustainability reporting institution, and its standards are considered the world's most widely used for sustainability reporting. Indeed, two thirds of the preparers surveyed in 2020 stated that they had used the GRI standards at least to some extent to report their non-financial information.

Under the existing governance structure of the IFRS Foundation, at COP26 the Foundation's Trustees established the **International Sustainability Standards Board (ISSB)**, with the aim of developing a comprehensive global baseline of sustainability disclosures for the capital markets. It created two different exposure drafts:

[22] See also document summary.

[23] See also document summary.

- **Exposure Draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information** sets out the overall requirements for an entity to disclose sustainability-related financial information on all its significant sustainability-related risks and opportunities, to provide the market with a complete set of sustainability-related financial disclosures. The proposals require the disclosure of information about an entity's impacts and dependencies on people, the planet and the economy, when relevant to the assessment of the entity's enterprise value.
- **Exposure Draft IFRS S2 Climate-related Disclosures** builds upon the recommendations of the Task Force on Climate-Related Financial Disclosures, and incorporates industry-based disclosure requirements derived from SASB standards. It has been created as a response to the urgent need for better information about climate-related risks and opportunities for all entities, their activities and their economic sectors.

The **Task Force on Climate-related Financial Disclosures (TCFD)** recommendations are widely adoptable and applicable to organisations across sectors and jurisdictions, and are designed to solicit decision-useful, forward-looking information that can be included in mainstream financial filings. The recommendations are structured around four thematic areas representing core elements of how organisations operate: governance, strategy, risk management, and metrics and targets. These recommendations are designed to help undertakings provide better information to support informed capital allocation, and can assist investors in determining if climate risk is appropriately priced into the valuation of the entity. Support for the TCFD recommendations continues to increase around the world[24]. At present, the number of TCFD supporters stands at over 3 000 organisations from 92 countries, with a combined market capitalisation of USD 27.2 trillion. The TCFD 2021 Status Report shows the 2018–2020 Reporting for the Top 50 Companies by 2020 revenue by region, placing Europe in first place with more than two thirds (68%) average disclosure in 2020, with North America in second place at just over two fifths (42%). The report adds that Europe remains the leading region for disclosures, with its undertakings now disclosing 16 percentage points more than the next closest region (Asia Pacific).

The **Carbon Disclosure Project (CDP)** is a not-for-profit charity that runs the global disclosure system for investors, undertakings, cities, states and regions to manage their environmental impacts. Regarding corporate disclosure, the CDP created three comprehensive questionnaires on climate change (which also includes also a section on biodiversity), forests and water security, accompanied by guidance that explains each question in detail and describes what information to provide, the required format, and where to find tools or further information to formulate the answer. The CDP is in line with the TCFD recommendations and translates them into actual disclosure questions and a standardised annual format, in a comparable and consistent way. Some 13 000+ undertakings worth approximately two thirds (64%) of global market capitalisation disclosed through the CDP in 2021.

The subsections below delve deeper into the synergies found across the disclosure requirements included in the first set of draft ESRS.

### *5.2.2 ESRS 2 – General disclosures*

The objective of the ESRS 2 disclosure requirements is to cover general topics of cross-cutting nature, thus valid for all sustainability matters an entity reports on, regardless of the sector it operates in. In particular, the requirements prescribe disclosure on several categories: i) the basis for preparation of the sustainability statements (BP); ii) the undertaking's governance and organisation in relation to sustainability matters (GOV); iii) its strategy and material impacts, risks and opportunities (SBM); iv) its

[24] For an overview, see the 2021 Status Report of the TCFD.

management of impacts, risks and opportunities (IRO); and v) its policies, targets and actions. These information categories are key to ensuring a better understanding of how sustainability affects the undertaking's development, performance and position, and to providing proper contextualisation of the topical disclosures.

As is the case for all ESRS, those of general nature have also been developed by drawing from the principles and requirements of EU laws and initiatives and other international standards and frameworks – in particular the NFRD and its implementation guidelines, the SFRD and IFRS S1, but also the GRI and TCFD, as per Recital 37 of the [draft] CSRD. In this context, several synergies between the ESRS and all the comparison standards could indeed be identified. However, nuances appear when looking more closely at the specific categories.

The two disclosure requirements related to the basis for preparation (BP) have relatively lower synergies with the other frameworks, mainly because those information requirements are not mentioned (or only to a very limited extent) by other standards. However, disclosures in relation to specific circumstances (ESRS BP-2) are fully aligned with IFRS S1 standards. Similarly to ESRS, IFRS also give guidance on reporting when facing estimation uncertainty, changes in a metric or target, or material prior period errors. Along the same lines, although with less detail, GRI standards also refer to the accuracy principle, requiring the undertaking to indicate which data has been estimated, and to explain all the underlying assumptions, techniques and limitations of the estimates.

Standards on governance (GOV) have the most synergies with the comparison standards (such as GRI, IFRS S1, NFRD, TCFD and CDP). All require disclosures on how the undertaking handles material impacts, risks and opportunities related to sustainability matters via its governance and the role of its management. Specifically, the ESRS fully encompass other frameworks when it comes to disclosures on the roles and responsibilities of management, how management is informed about and addresses sustainability-related matters, and on the integration of sustainability strategies and performance in incentives schemes. There are a few cases where the synergies are not so strong, which is mainly due to the relatively higher number of nuances required by the ESRS. This is the case, for instance, for disclosures on an entity's risk management and internal control system, where the ESRS not only require information on its scope, main features and components, but also on the risk assessment approach (including the risk prioritisation methodology) and how its findings are integrated, the main risks identified (actual and potential) and their mitigation strategies, and a description of the periodic reporting of the findings to the entity's management.

Standards on strategy (SBM) entail synergies with all of the comparison standards, as all prescribe reporting on the sustainability-related impacts, risks and opportunities in relation to the entity's strategy and business model(s) (albeit to different extents). Stronger interlinkages exist with the GRI (which was considered the main source of inspiration when drafting some of the disclosure requirements), IFRS standards and European Commission Guidelines. For example, all three frameworks require a description of the undertaking's business model and key value chains, the general strategy in the context of its sustainability reporting and the extent to which stakeholders' expectations inform sustainability-related decisions. When it comes to the specific disclosure on interactions between material impacts, risks and opportunities and the strategy and business model (ESRS SBM-3), the ESRS are aligned with the other frameworks, even though not all frameworks follow a double materiality approach (as defined in ESRS 1 Chapter 3). Thus, ESRS disclosures yield a more complete picture of the impact and financial materiality of the undertaking.

Standards on the management of impacts, risks and opportunities (IRO) have a relatively high number of overlaps, especially with IFRS S1, GRI and CDP standards (to a lesser extent also TCFD). In particular, IFRS S1 share a similar approach with ESRS to identifying the potential material sustainability-related risks and opportunities. Both refer to own disclosure requirements as a starting point for the materiality assessment. As mentioned above, some of the requirements of other comparison standards do not take into account both sides of double materiality (e.g. the GRI mostly takes the side

of socio-environmental impacts, while IFRS mainly take financial impacts into account), which lowers the degree of interlinkages and results in ESRS having a more complete assessment of the material impacts, risks and opportunities.

Lastly, the ESRS cross-cutting content disclosures (CCRC) are fully in line with other comparison frameworks. Specifically, the ESRS require disclosures on the policies adopted to manage material sustainability matters, the targets set to reach the policy objectives, including systematic monitoring of the progress, and the actions and resources planned in relation to the policy and targets. All comparison standards follow similar requirements, albeit to different extents. The TCFD, for instance, has metrics and targets as one of its core elements, and recommends disclosures on the metrics used to assess risks and opportunities in relation to the entity's strategy and risk management approach. Similarly, IFRS also include disclosures on metrics and targets to enable users to have a better understanding of the entity's performance and progress towards its goals and policy objectives. The level of information and detail required by IFRS is congruent with the ESRS requirements.

### *5.2.3 ESRS E1 to E5 – Environment*

**ESRS E1 – Climate change.** This draft standard covers disclosure requirements related to three different areas: Climate change mitigation, which relates to the undertaking's endeavours to hold the increase in the global average temperature, as laid down in the Paris Agreement, and concerns mainly GHG emissions; Climate change adaptation, which relates to the undertaking's process of adjustment to actual and expected climate change; Energy, which covers all types of energy production and consumption.

Given the broad range of topics covered by the standard, ESRS E1 is the environmental standard that has the highest level of synergies and efficiencies with the other standards analysed. A strong interlinkage exists with the CDP questionnaire on climate. The two regimes are nearly perfectly aligned, asking for the same disclosures characterised by a very similar methodology and specificities.

A medium to high level of synergy exists with the GRI standards. For instance, a very similar (albeit not perfectly equivalent) disclosure to under E1-2, E1-3, E1-4 can be found under GRI 3-3 on material topic (and GHG emissions can be considered as such), according to which the undertaking has to disclose its policies, targets and actions taken to manage the topic and related impacts. Disclosures related to energy consumption are asked under GRI 302 on energy, while the information to disclose under GRI 305 presents high to medium overlap with E1-6.

ESRS E1 covers the entirety of IFRS S2 and TCFD, but the interconnections' strength with these other two standards vary depending on the specific disclosure requirement, ranging from low to very high. The low connections with IFRS S2 and TCFD are explained by the multiple additions that characterise ESRS E1, such as: clearer reference to alignment with limiting global warming to 1.5°C (i.e. transition plan); locked-in emissions more developed than the corresponding concept of legacy assets; concept of policies more developed in ESRS to address both strategy and risk management processes; inclusion of taxonomy KPIs; more details regarding targets; impacts taken into consideration on top of risks and opportunities; and more detailed application guidance for physical and transition risks identification and assessment.

Regarding the relationship with the Taxonomy Regulation, there are low to medium synergies with the disclosures related to Articles 10 and 11 of the Regulation, which explain when an economic activity shall qualify as contributing substantially to climate change mitigation, and with those related to some technical screening criteria indicated by Commission Delegated Regulation (EU) 2021/2139. Therefore, an overlapping of the necessary data collection is conceivable.

ESRS E1 also presents strong synergies with the NFRD and its guidelines when it comes, for instance, to policies related to climate change mitigation and adaptation, gross Scopes 1-2-3 and total GHG emissions and potential financial effects from material physical risks, material transition risks and climate-related opportunities.

It also covers several SFDR Principal Adverse Impact (PAI) indicators, in particular: Indicator 4 in Table 2 of Annex on investments in undertakings without carbon emission reduction initiatives; Indicator 5 in Table 1 of Annex 1 on share of non-renewable energy consumption and production; Indicator 5 in Table 2 of Annex 1 on breakdown of energy consumption by type of non-renewable sources of energy; indicator 6 in Table 1 of Annex 1 on energy consumption intensity per high impact climate sector; indicator 1 in Table 1 of Annex 1 on scope 1 GHG emissions; Indicator 2 in Table 1 of Annex 1 on carbon footprint; Indicator 1 in Table 1 of Annex 1 on total GHG emissions; and Indicator 3 in Table 1 of Annex 1 on GHG intensity of investee undertakings.

It should be added that, in some cases, the identified synergies are to some extent limited by the number of details requested by the ESRS E1 standard, compared with other standards analysed.

**ESRS E2 – Pollution.** This draft standard sets out disclosure requirements related to the pollution of air, water and soil; substances of concern; most harmful substances; and enabling activities in support of the prevention, control and elimination of pollution.

While there are only six disclosure requirements under ESRS E2 on pollution, most of them will be new to undertakings, above all to those that do not have to comply with specific targets because of legal requirements, such as the reporting framework under the Industrial Emissions Directive. There are no specific or direct interlinkages with IFRS, TCFD or NFRD. However, it should be noted that in some disclosure requirements, ESRS E2 cross-references with ESRS 2, which contains synergies with IFRS, TCFD and NFRD (see above). Therefore, an indirect (albeit limited) connection exists.

ESRS E2-4 presents strong interlinkages with the SFDR framework in relation to air pollution, covering several SFDR PAIs, i.e. Indicator 1 in Table 2 of Annex 1 on emissions of inorganic pollutants; Indicator 2 in Table 2 of Annex 1 on emissions of air pollutants; and Indicator 3 in Table 2 of Annex 1 on emissions of ozone-depleting substances.

Regarding the relationship with the CDP, it should be noted that while there is not a specific questionnaire on pollution, water pollution is mentioned in the CDP water questionnaire, which can support (albeit slightly) the disclosure requested under E2-4 on pollution of air, water and soil and E2-6 on potential financial effects from pollution-related impacts, risks and opportunities.

The GRI is the standard that has more synergies with ESRS E2, above all regarding ESRS E2-1, ESRS E-2 and ESRS E-3. There are no perfect equivalent disclosures within the GRI, but according to GRI 3-3, for each material topic (and pollution can be considered as such) the undertaking has to describe its policies or commitments, actions taken to manage the topic and related impacts and the effectiveness of the actions taken, including goals, targets and indicators used to evaluate progress. For the other pollution ESRS, the level of connection with the GRI remains at a low to medium level.

ESRS E2 presents low to medium synergies with disclosures related to Article 14 of the Taxonomy Regulation, which explains when an economic activity shall qualify as contributing substantially to pollution prevention and control. Therefore, an overlapping of the necessary data collection is conceivable.

It should be added that the synergies identified are to some extent limited by the number of details and the overall granularity characterising the ESRS E2 standard, compared with the other standards analysed.

**ESRS E3 – Water and marine resources.** This draft standard covers disclosures on two sub-topics: water (related to the undertaking's relationship with water in its upstream and downstream value

chain, in terms of impacts, risks and opportunities and how it effectively addresses these issues) and marine resources (related to the undertaking's activities that cause or contribute to impacts either through the use of ocean-based resources, discharges and emissions to the environment which end up in the oceans, or activities located in maritime areas).

ESRS E3 presents very strong synergies with CDP disclosures, given the existence of a specific water questionnaire. More precisely, it can be observed that by combining several questions from the CDP questionnaire, this standard requires the disclosure of very similar information on policies (ESRS E3-1), measurable targets (ESRS E3-2), action plans and resources (ESRS E3-3), water management consumption (ESRS E3-4) and potential financial effects from water and marine resources-related impacts, risks and opportunities (ESRS E3-5). The two disclosures are nearly perfectly aligned, given that all the disclosure requirements of ESRS E3 are covered by the CDP questionnaire.

Strong interconnections also exist with the GRI standards, in particular with the result of the combination of GRI 3 on material impacts (and water and marine resources can be considered as such) and GRI 303 on water and effluents, which asks for very similar disclosures related to policies, targets, action plans and resources and water consumption.

Strong synergies also exist between the SFDR PAIs and ESRS E3-1 and E3-4. More specifically, similar disclosures are requested under: Indicator 6.1 and 6.2 in Table 2 of Annex 1 (water usage and recycling); Indicator 7 in Table 2 of Annex 1 (investments in undertakings without water management policies); Indicator 8 in Table 2 of Annex 1 (exposure to areas of high-water stress); and Indicator 12 in Table 2 of Annex 1 (investments in undertakings without sustainable oceans/seas practices).

There are no specific or direct interlinkages with IFRS, NFRD or TCFD (with the exception of ESRS E3-2 on targets, characterised by a low connection with the TCFD on metrics and targets, which affirm that organisations should describe their key climate-related targets such as those related to water usage, without further specifications). However, it should be noted that in some disclosure requirements, ESRS E3 cross-references with ESRS 2, which contains synergies with IFRS, NFRD and TCFD (see above). Therefore, an indirect (albeit limited) connection exists.

ESRS E3 presents low to medium synergies with disclosures related to Article 12 of the Taxonomy Regulation, which explains when an economic activity shall qualify as contributing substantially to sustainable use and protection of water and marine resources. Therefore, an overlapping of the necessary data collection is conceivable.

**ESRS E4 – Biodiversity and ecosystems.** This draft standard sets out disclosure requirements related to the undertaking's relationship with terrestrial, freshwater and marine habitats, ecosystems and populations of related fauna and flora species, including diversity within species, between species and of ecosystems and their interrelation with many indigenous and local communities.

ESRS on biodiversity and ecosystems present low to medium synergies with other standards (few exceptions of high synergies with the GRI and CDP). This is because the topic is currently evolving, and the majority of the disclosures are new and require extensive data collection. As a consequence, there are no specific or direct interlinkages with IFRS, NFRD or TCFD (with the exception of ESRS E4-3 on targets, characterised by a low connection with the TCFD on metrics and targets, which affirm that organisations should describe their key climate-related targets such as those related to land use, without further specifications). However, it should be noted that in some disclosure requirements, ESRS E4 cross-references with ESRS 2, which contains synergies with IFRS, NFRD and TCFD (see above). Therefore, an indirect (albeit limited) connection exists.

High connections exist between some SFDR PAIs and ESRS E4-2. In particular, this disclosure requirement covers four SFDR PAIs, i.e. Indicator 11 in Table 2 of Annex 1 on investments in

undertakings without sustainable land/agriculture practices; Indicator 12 in Table 2 of Annex 1 on investments in undertakings without sustainable oceans/seas practices; Indicator 14 of Table 2 of Annex 1 on natural species and protected areas; and Indicator 15 in Table 2 of Annex 1 on deforestation. Moreover, ESRS E4-5 covers Indicator 22 in Table 2 of Annex 1 on land artificialisation.

Low to medium interlinkages exist with the CDP system. It should be said that a specific questionnaire on biodiversity does not exist. Nevertheless, synergies can be detected by combining questions from the forest questionnaire with those present under sector 15 of the climate change questionnaire. For instance, the combination of questions C15.2, C15.6 and F5.1 of the CDP questionnaires results in a disclosure which is similar to the one asked under ESRS E4-2 on policies related to biodiversity and ecosystems.

Some strong synergies exist between the GRI standards and ESRS E4-2, 3 and 4. There are no perfect equivalent disclosures within the GRI, but according to GRI 3-3 for each material topic (and biodiversity can be considered as such) the undertaking has to describe its policies or commitments, actions taken to manage the topic and related impacts and the effectiveness of the actions taken, including goals, targets and indicators used to evaluate progress. Therefore, the two standards ask for very similar disclosures.

Finally, regarding the Taxonomy Regulation, ESRS E4 presents low to medium synergies with disclosures related to Article 15 of the Taxonomy Regulation, which explains when an economy activity shall qualify as contributing substantially to protection and restoration of biodiversity and ecosystems. Therefore, an overlapping of the necessary data collection is conceivable.

**ESRS E5 – Resource use and circular economy.** This draft standard covers disclosure requirements related to resource use and circular economy. It has to be used to evaluate the undertaking's transition to a circular economy (i.e. an economic system whereby the value of products, materials and other resources in the economy is maintained for as long as possible, enhancing their efficient use in production and consumption) and to describe the actions taken to maximise and maintain the value of the resources, products and materials by creating a system that allows for renewability, long-life optimal use or re-use, refurbishment, remanufacturing, recycling and biodegradation.

ESRS E5 presents very strong synergies with the GRI standards. Regarding ESRS E5-1, 2 and 3, there are no perfect equivalent disclosures within the GRI. Nevertheless, according to GRI 3-3 for each material topic (and resource use and circular economy can be considered as such) the undertaking has to describe its policies or commitments, actions taken to manage the topic and related impacts and the effectiveness of the actions taken, including goals, targets and indicators used to evaluate progress. Therefore, the two standards require disclosures that are nearly 100% aligned. Moreover, E5-4 (resource inflows) and E5-5 (resource outflows, which includes information on waste) are deeply inspired – respectively – by GRI 301 on materials and packaging (in particular, GRI 301-1 on materials used by weight or volume, GRI 301-2 on recycled input materials used and GRI 301-3 on reclaimed products and their packaging materials) and by GRI 306 on waste (in particular, GRI 306-3 on waste generated, GRI 306-4 on waste diverted from disposal and GRI 306-5 on waste directed to disposal).

On the contrary, there are no specific or direct interlinkages with NFRD, IFRS, CDP or TCFD (with the exception of ESRS E5-2 on targets, characterised by a low connection with the TCFD on metrics and targets, which affirms that organisations should describe their key climate-related targets such as those related to waste management, without further specifications). However, it should be noted that in some disclosure requirements, ESRS E5 cross-references with ESRS 2, which contains synergies with IFRS, NFRD, CDP and TCFD (see above). Therefore, an indirect (albeit limited) connection exists.

A medium connection exists with the SFDR PAIs, given that two PAIs are covered under E5-5, (Indicator 9 in Table 1 of Annex 1 on hazardous waste ratio, and Indicator 13 in Table 2 of Annex 1 on non-recycled waste ratio).

Finally, regarding the Taxonomy Regulation, ESRS E5 presents low to medium synergies with disclosures related to Article 13 of the Taxonomy Regulation, which explains when an economy activity shall qualify as contributing substantially to transition to a circular economy. Therefore, an overlapping of the necessary data collection is conceivable.

It should be added that the identified synergies are limited to some extent by the number of details requested by the ESRS E5 standard, compared with the other standards analysed.

### *5.2.4 ESRS S1 to S4 – Social*

**ESRS S1 – Own workforce.** This draft standard covers disclosure requirements related to a number of areas, such as policies related to an undertaking's own workforce; processes for engaging with its own workers and workers' representatives about impacts; processes to remediate negative impacts and channels for an undertaking's own workers to raise concerns; targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities; actions on material impacts on an undertaking's own workforce, and approaches to mitigating material risks and pursuing material opportunities related to its workforce, and effectiveness of those actions and approaches; characteristics of the undertaking's own employees; characteristics of non-employee workers in the undertaking's own workforce; training and skills development indicators; health and safety indicators; work-life balance indicators; adequate wages; social protection; compensation indicators (pay gap and total compensation); employment of people with disabilities; collective bargaining coverage and social dialogue; as well as work-related incidents and complaints, and severe cases of human rights issues and incidents. Thus, the range of topics covered by ESRS S1 is very broad.

The highest level of synergy was observed between ESRS and the SFRD standards, as the ESRS S1 – Own workforce references the SFRD Regulation (Regulation (EU) 2019/2088) extensively.

Synergies with other standards, such as the NFRD and its 2017 and 2019 guidelines, the Taxonomy Regulation and GRI are moderate, mainly due to a relatively higher number of nuances required by the ESRS. Observed synergies mainly relate to a common reference to the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles Reporting Framework. Further, all ESRS S standards are coherent and in sync with each other, given that clear links have been ensured and the preparers do not need to collect extra information when they can rely on the information already collected for other chapters of the S standards.

**ESRS S2 – Workers in the value chain.** This draft standard covers policies related to value chain workers; processes for engaging with value chain workers about impacts; processes to remediate negative impacts and channels for value chain workers to raise concerns; targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities; as well as actions on material impacts on value chain workers and approaches to mitigating material risks and pursuing material opportunities related to value chain workers, and effectiveness of those actions.

The highest level of synergy was observed between the ESRS S2 workers in the value chain and the SFRD standards, given that ESRS S2 references the SFRD Regulation extensively. Other synergies identified with the GRI and Taxonomy Regulation are merely due to the common reference to the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles Reporting Framework.

**ESRS S3 – Affected communities.** This draft standard covers policies related to affected communities; processes for engaging with affected communities about impacts; channels for affected communities to raise concerns; targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities; as well as actions on material impacts on affected

communities and effectiveness of those actions, and approaches to mitigating material risks and pursuing material opportunities related to affected communities and effectiveness of those actions.

The highest level of synergy was observed between the ESRS S3 – Affected communities and the SFRD standards, as ESRS S3 refers extensively to the SFRD Regulation.

There are a few cases in which synergies are not so strong, and this is mainly due to a relatively higher number of nuances required by the ESRS. Any synergies between ESRS S3 and the Taxonomy Regulation as well as the GRI are primarily related to their common reference to the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles Reporting Framework.

**ESRS S4 – Consumers and end-users.** The draft standard covers policies related to consumers and end-users; processes for engaging with consumers and end-users about impacts; processes to remediate negative impacts and channels for consumers and end-users to raise concerns; targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities; as well as actions on material impacts on consumers and end-users and approaches to mitigating material risks and pursuing material opportunities related to consumers and end-users, and effectiveness of those actions.

The highest level of synergy was observed between the ESRS S4 – Consumers and end-users and SFRD standards, given that ESRS S4 refers extensively to the SFRD Regulation.

Other synergies identified with the GRI and Taxonomy Regulation are merely due to the common reference to the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles Reporting Framework.

### *5.2.5 ESRS G – Governance*

Given that governance in relation to sustainability is addressed via the general standards (see Section 5.2.2), ESRS G1 provides information on the undertaking's business conduct in general terms, thus not limited to sustainability topics (as per Recital 44 of the CSRD). In particular, ESRS G1 disclosure requirements focus on information related to: i) business ethics and corporate culture (including anti-corruption and anti-bribery); ii) political engagements of the undertaking (including lobbying practices); and iii) payment practices in respect to business partners. The importance of these information specifications relies on the belief that a lack of conduct and anti-competitive behaviour may hamper the efficient allocation of resources and value creation and reduce incentives to supply new or better products at competitive prices.

Most of the synergies are with GRI standards. This is mainly due to the fact that other standards and frameworks considered in this analysis ask for information about the entity's governance mainly in relation to sustainability, which is covered by the general ESRS disclosures (see Section 5.2.2). Disclosure requirements on corruption and bribery (G1-3 and G1-4), political engagement and lobbying activities (G1-5) and management of the relationship with suppliers (G1-2) are all fully covered by the GRI framework, thus entailing similar costs of disclosure. Disclosure requirements on corporate culture and business conduct polices (G1-1) encompass GRI standards to a large extent and, to a relatively smaller extent, SFDR standards as well. On the contrary, disclosure requirements on payment practices (G1-6) have lower levels of synergy with the comparison frameworks. The reasons behind weak synergies are mainly related to the greater amount of information or nuances requested by the ESRS. These nuances are, however, necessary to ensure the comparability and completeness of information.

### *5.2.6 Conclusions*

Our analysis has found a medium to high degree of synergy between the ESRS and the comparison frameworks examined, especially when taking into account the general disclosure requirements (ESRS 2), those related to governance (ESRS G) and, to some extent, those related to the environment (mainly climate change – ESRS E1). Cases of relatively limited synergy stem mainly from the higher degree of nuances outlined in the ESRS. This extended granularity is often needed to ensure a level of standardisation of information reported by each undertaking and more accurate monitoring of indicators over time.

The added value of the ESRS framework rests, based on the above analysis, in its completeness. While the focus of several of the comparison standards is, to some extent, quite narrow, the ESRS requirements manage to capture all perspectives of sustainability (e.g. social and environmental aspects, sustainability in relation to the governance of the entity, its strategy and business model and its policies, actions and targets).

*Box 4. Costs and benefits of ESRS aligned sustainability reporting in XBRL format*

This box assesses both the one-off and recurring costs incurred when transforming sustainability ESRS aligned reporting from PDF into eXtensible Business Reporting Language (XBRL) format, and the benefits that this transformation will bring to users of sustainability reporting data, specifically ESG rating providers. The details of the methodology employed to estimate the total cost and benefits of XBRL reporting are explained in Annex 2.

**XBRL taxonomy**

XBRL taxonomy facilitates the machine reading (and standardisation) of sustainability reporting as detailed in the ESRS. While a cost is associated with standardising reporting, benefits can be obtained for organisations that analyse this data to produce ratings and indicators that other financial market participants and other users can use. The time spent on extracting data from non-standardised formatting will be reduced. The benefits in terms of cost savings that follow from this efficiency gain depend on the 'level of detail' that is encompassed in the XBRL reporting requirements. Conversely, time spent, and costs made, on translating reporting into XBRL also depend on the level of detail. Currently, three different levels of disclosure are under consideration, which are all assessed in this cost-benefit analysis:

- **Level 1 – chapter and table level:** represents the simplest format with detailed tagging only for relevant tables and text bloc**k** tagging for chapters of complete disclosure requirements.
- **Level 2 – data point level**: includes selected data points that need to be individually tagged.
- **Level 3 – maximum granularity level**: represents the most granular level of detail whereby disclosure requirements are broken down to the maximum extent.

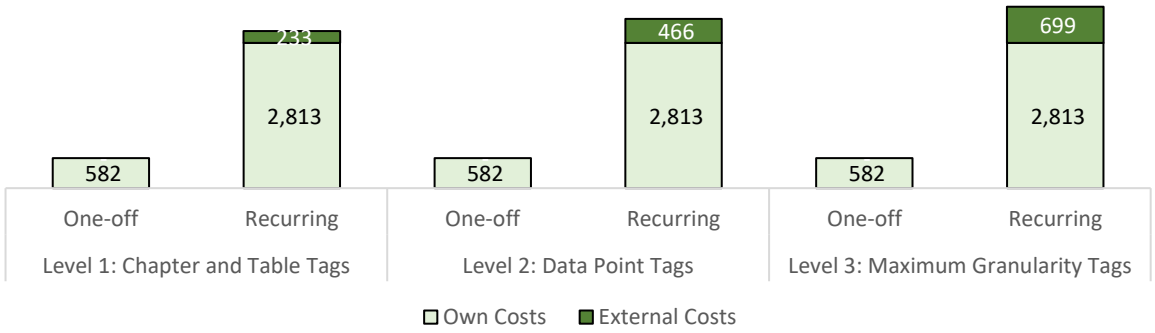
**Cost per preparer**

An EU undertaking will likely incur an initial cost in the first year of XBRL sustainability reporting (i.e. a one-off cost) in addition to the yearly cost (i.e. recurring cost). The one-off cost consists entirely of the undertaking's own costs, namely those of training personnel in XBRL for sustainability reporting. The recurring cost consists of both own and external costs. Recurring own costs consist of the costs incurred for the hours spent translating reporting into XBRL format. Recurring external costs are those that follow from having to purchase the software necessary for reporting in XBRL.

The initial cost is the same regardless of the required level of detail in XBRL, and is estimated to be around EUR 582 per undertaking (see Figure 5.4). This follows from the assumption that training costs are incurred to train staff in XBRL for sustainability reporting purposes, and that these costs will not be affected by the level of detail in which the undertaking ultimately reports.

The recurring cost consists of a fixed, external cost that remains the same for all levels of detail, and represents the yearly licence paid for software to standardise sustainability reporting. The own cost part of the recurring cost is the variable element, representing the hours spent on reporting in XBRL, and increases with the level of detail in XBRL that is required. The average recurring cost per undertaking of translating sustainability reporting into XBRL ranges from EUR 3 000 to EUR 3 500 (see Figure 5.4). The undertaking's own costs are estimated to range from EUR 233 to EUR 698 for levels 1 to 3. On the whole, level 3 reporting detail increases the total cost by approximately 15%, from EUR 3 000 to EUR 3 500.

*Figure 5.4 Costs per preparer of translating sustainability statement into XBRL (EUR)*

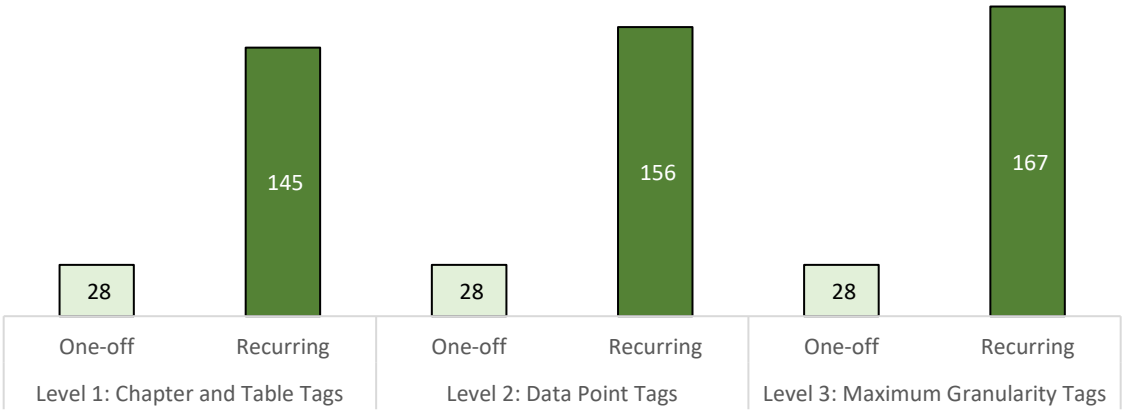



*Source:* CEPS (2022).

### Total costs

The total one-off cost for translating reporting into XBRL is approximately EUR 28 million initially for all levels (see Figure 5.5). Total EU costs of XBRL reporting increase with the required level of reporting detail in XBRL. As such, the total recurring cost ranges from EUR 145 million to EUR 167 million. Indeed, the estimated costs are little affected by the level of detail in the reporting. This is explained by the software costs, which form the main cost component. These are independent from the level of detail in the reporting.

*Figure 5.5 Total EU costs of translating sustainability statement into XBRL (EUR million)*




*Source:* CEPS (2022).

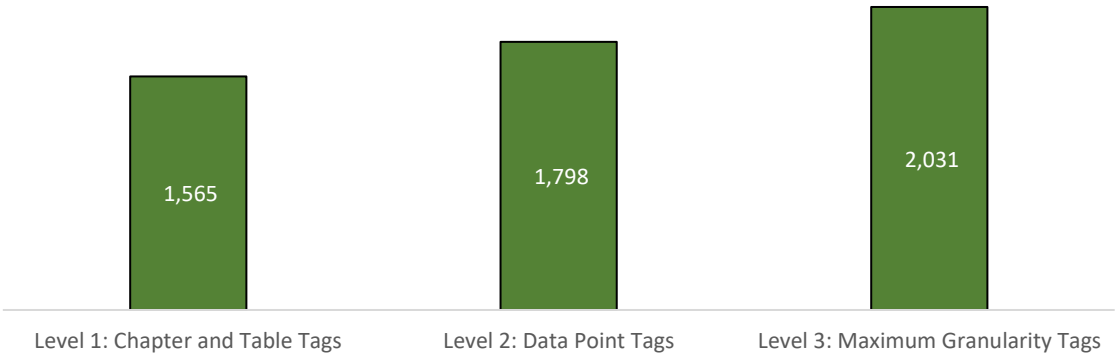
### Incremental costs

Incremental costs are costs that EU undertakings incur purely as a result of the new reporting requirements, and as such did not incur before. For example, an undertaking that already reports in XBRL will not incur incremental costs for the purchase of XBRL software, whereas one that did not report in XBRL will incur these costs.

The incremental cost per undertaking increases based on the required level of reporting detail in XBRL (see Figure 5.6). For level 1 tagging it is estimated to be EUR 1 565, increasing to up to EUR 2 031 for level 3 tagging. As a share of total costs (one-off cost plus recurring), incremental costs make up just under a half.

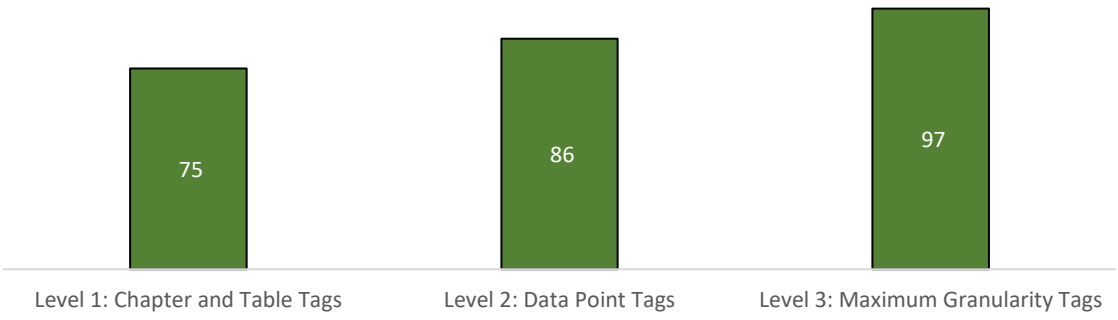
Multiplying the incremental cost per undertaking by the total number of EU preparers, total incremental costs for EU undertakings amount to EUR 75 million for level 1 tagging, rising to EUR 97 million for level 3 tagging (see Figure 5.7). This is because of the increased time spent on translating non-financial reporting into XBRL format for a more granular level of detail in XBRL.

*Figure 5.6 Incremental costs per preparer of translating sustainability statement into XBRL (EUR)*




*Source:* CEPS (2022).

*Figure 5.7 Incremental total EU costs of translating sustainability statement into XBRL (EUR million)*




*Source:* CEPS (2022).

**Benefits per ESG rating provider**

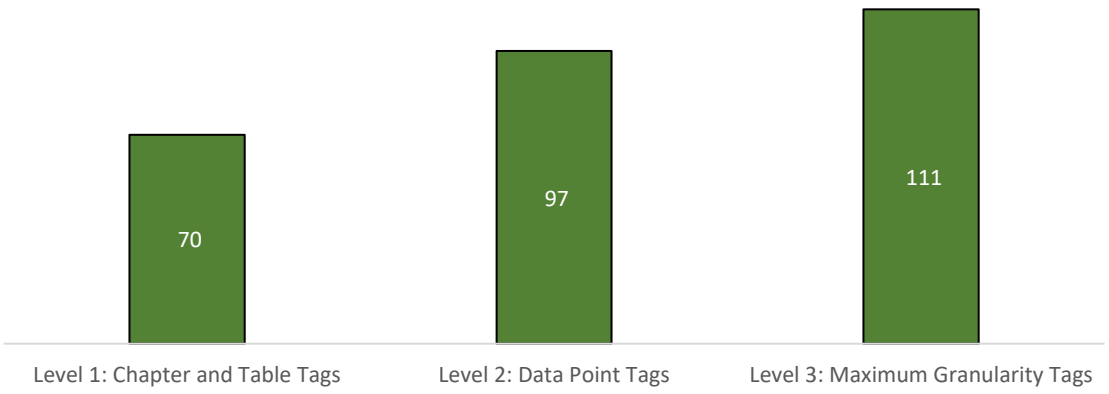
The benefits to undertakings from reporting sustainability data are potentially wide-ranging. In essence, sustainability data becomes more accessible and machine readable, allowing data collection to become more efficient and be carried out by a larger audience. This currently benefits undertakings working with this data, which are ESG rating providers. In the future, as new use cases are discovered and the audience for this data increases, the benefits are expected to increase. For now, while such use cases are not yet underway, the quantification of benefits is limited to ESG rating providers. These rating providers are assumed to obtain efficiency gains that translate into lower costs; a cost reduction that they are not expected to price through to their customers, which are mostly investors, due to the modest size of the cost reduction.

Given that data collection and processing are responsible for only part of the costs an ESG rating provider incurs, an efficiency gain in the range of say 5% to 10% does not translate into a large reduction in overall costs. See Annex 2 for an exact breakdown of the methodology employed to calculate cost savings.

That being said, cost savings increase as the required level of detail reported in XBRL increases. The highest cost saving is obtained from the most granular tagging (level 3) at EUR 111 000 per ESG rating provider (see Figure 5.8). Cost savings do not grow linearly, as the marginal utility of easily accessible data drops as more data becomes available. In fact, level 3 granularity of XBRL reporting might exceed the current level of data granularity now used by ESG rating providers, and thus bring limited efficiency gains (of course, in the future this level of data might be used for new purposes).

Whereas savings represent a larger percentage of costs in level 3 XBRL reporting, the growth in savings is not as large as the growth in costs. This is because undertakings do not currently use level 3 detail for their sustainability ratings.

*Figure 5.8 Cost saving per ESG rating provider (EUR thousand)*



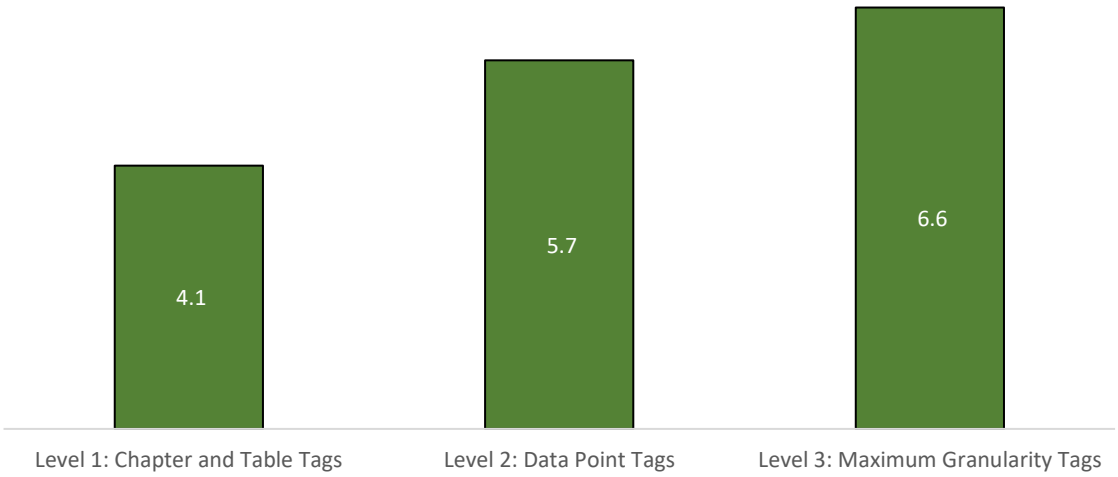

*Source:* CEPS (2022).

**Total cost savings for ESG rating providers**

On an EU scale, the cost savings for ESG rating providers range from EUR 4.1 million to EUR 6.6 million per annum for levels 1 to 3 respectively (see Figure 5.9). Estimated cost savings are limited, first because the savings obtained follow from efficiency gains in the data collection carried out by ESG rating providers; data collection that is only part of the total costs ESG rating providers incur. Second, other possible cost savings may come from future use cases of XBRL reported sustainability data, which are currently unknown and can therefore not be calculated.

Limitations aside, what can be said is that the ESG market is expected to grow rapidly in the EU due to increased ESG data demand. As a result, cost savings are expected to grow across the EU in the coming years.

*Figure 5.9 Total cost savings for ESG rating providers in the EU (EUR million)*




*Source:* CEPS (2022).

In addition to ESG rating providers, other types of organisations, including financial market participants and NGOs, might make use of the sustainability information in XBRL. The cost savings have not been estimated, as there is too much uncertainty about the amounts concerned. Moreover, the estimates for the ESG rating providers consider only the savings, not the potential benefits from better quality data collection.

**Conclusion**

Translating ESRS reporting into XBRL format imposes costs on EU undertakings, but also introduces benefits to ESG rating providers and other users. The costs incurred relate to the yearly costs of licence software, training staff in the use of XBRL reporting in a sustainability context, and the labour hours following from reporting in XBRL format. The cost savings amount to time saved in data processing as a result of XBRL reporting. Total EU cost savings depend on the level of detail in XBRL formatting. While benefits increase when a higher level of reporting detail in XBRL is required, so too do the costs borne by those required to report.

# 6. INDIRECT BENEFITS

This chapter aims at assessing the **indirect benefits** deriving from the First Set of draft ESRS. In particular, behavioural changes and improved sustainability.

## 6.1 Behavioural changes

The sustainability reporting requirements under the CSRD and the reporting in line with the ESRS are likely to change the behaviour of at least some of the undertakings. These behavioural changes in the undertakings can include increased i) awareness on sustainability matters; ii) improvements in internal processes and procedures; iii) changes of policies, risk strategies, and business model of the undertaking; and, iv) revisions in the value chain. This section covers the assessment of how the behaviour of undertakings changes as a consequence of the first set of draft ESRS.

The expected impact of the ESRS is assessed based on a combination of desk research and responses from the various stakeholders in the survey and interviews.

### *6.1.1 Changes in behaviour due to CSRD and ESRS*

The CSRD expands the scope of undertakings with an obligation to report non-financial or sustainability information. Currently, all large undertakings and all listed undertakings (except for micro undertakings) need to report. The CSRD will introduce reporting requirements that are more detailed, and that will require following reporting standards based on mandatory EU sustainability (European Commission, 2022).

The behavioural changes due to CSRD and ESRS are likely to vary between the preparers as well as the undertakings in the value chain. There are various factors influencing the expected behavioural changes, including the current existing sustainability reporting. Indeed, the undertakings currently preparing non-financial or sustainability statements under the NFRD or preparing voluntarily are likely to experience changes through more comprehensive reporting, compared to those undertakings that will start preparing sustainability information under the CSRD.

Undertakings that were previously not reporting are facing larger changes, as they will have to implement the reporting structures from scratch. The use of standards could further contribute to changes in behaviour if accompanied by clear guidance.

The SMEs in the value chain of preparers may also change behaviour with sustainability information to be provided. The extent might vary depending on multiple factors such as company size, role in the value chain or previous behaviour. The standards might therefore have an impact, but the scale of the impact could vary depending on the effect of reporting requirements under the CSRD on the undertaking.

### *6.1.2 Changes in behaviour expected based on NFRD and other disclosure requirements*

The NFRD introduced mandatory reporting for large undertakings with more than 500 employees. The Directive was amended in order for undertakings to be aware of and able to inform EU citizens of the impact their activity has on the environment and society. It also tries to prevent, to manage and to mitigate potential negative impacts of their activity on value chains. Collecting this information is valuable for society at large as it supports the possibility to audit and guide undertakings. It makes it possible for staff, customers, investors and other stakeholders to assess the non-financial performance of undertakings (NFRD, 2014).

Certain literature argues that mandatory issuer disclosure contributes to policies in favour of undertakings, shareholders, suppliers and customers. It is only by making reporting mandatory that managers can vouch for accurate disclosure and implement optimal policies (Fox, 1999). Literature looking at the impact of reporting requirements on corporate behaviour indicates that an important aspect is the formulation of the reporting requirement. If the definitions are clearly formulated, it is likely that the additional requirement will improve corporate transparency (Ho, 2017). What is also argued is that – in the case of the study – ESG disclosure might have limited efficiency in addressing policy objectives (Jebe, 2015).

However, there are also signs of the limited impact of reporting requirements on changes in corporate behaviour. Reporting requirements alone might not be sufficient to incentivise additional measures (ECCJ, 2019). There are also studies showing that undertakings will over time adopt standards. The adoption may however not lead to increased efficiency for the undertakings (Arcot, et al., 2010). Reporting requirements can lead to a conflict between the internal culture, in the case of this study a bank, and the reporting standards (Dumay & Dai, 2017). Nevertheless, evidence shows that comply or explain corporate governance codes are preferred for non-financial reporting than broad-brush reporting and voluntary disclosure (Ho, 2017).

When undertakings decide to incorporate their own published information on non-financials in management decisions, it has the capacity to generate sustainable value at board level and employee level in the company (Maas et al., 2016). Moreover, this corporate sustainability information has the potential to generate opportunities, push for further innovation and be of competitive advantage for undertakings (Porter & Kramer, 2006).

Certain behavioural changes have been observed with the introduction of the NFRD, however only to a limited extent. More specifically, a study evaluating the NFRD found increasing intra-undertaking awareness regarding non-financial information. In order to prepare the non-financial statement, it is necessary that departments cooperate. This led to a change in behaviour for certain undertakings now experiencing more cross-unit communication. It is worth noting that those undertakings that already prepared non-financial statements on a voluntary basis did not report any change in their cross-unit cooperation. Hence, these undertakings in most cases already published information on environmental and human rights aspects, which is the main information demanded from customers and suppliers (de Groen et al., 2020).

Indeed, it is not necessarily regulation that leads to non-financial reporting and behavioural changes. For example, non-profit organisations such as the CDP facilitate corporate reporting on the environmental goals defined by COP 26. In their report the undertakings show the value and behavioural impact of an undertaking setting its own target. Some of their members have already decreased their environmental impact, both directly and through their value chain.

CEPS (2020) also found that fewer than half of the undertakings in the scope of the NFRD expressed an impact on corporate due diligence policies and long-term practices. One reason explaining the less than half uptake, is that an important part of those participating in the study had the same or similar policies in place prior to the implementation of the NFRD and were therefore unable to see a change *ex post*. Looking at the policy impact on whether new policies were adopted consequent to the NFRD, showed a very limited change, with a large majority expressing that there was no policy change adopted as a result of performing non-financial reporting. It was only in a very large minority of the cases (less than 10 %) that new policies were adopted.

The CSRD also has an objective to try and even push further for corporate behavioural changes. Announced as a part of the Green Deal (European Commission, 2019), the review of the NFRD really tries to facilitate sustainable investments. The aim of this change is to address the issues that are related to the duty of care of company directors, to include sustainability in corporate strategies, to

define sustainable targets based on scientific proof, and to include due diligence on undertakings' environmental and human rights impact.

The extent of the behavioural change depends largely on the treatment of the topic by the executive and non-executive boards as well as shareholders. The reporting itself can contribute to raising awareness among the key decision-makers. Through legal enforcement and verification of the information there might be legal liability in raising the profile of sustainability among the executive board. The decision-makers in the undertakings might further be stimulated by internal or external stakeholders who are better informed about the sustainability impact of the undertaking concerned.

The involvement of external undertakings and especially assurance providers in the preparation of the sustainability statements is likely to trigger additional changes in the behaviour of preparers, particularly if these external undertakings are of large scale. Hence, these undertakings can support or encourage undertakings to implement appropriate procedures in place to prepare the sustainability statements as well as sustainability policies. This can also have a further trickle-down effect on undertakings in the value chain of preparers.

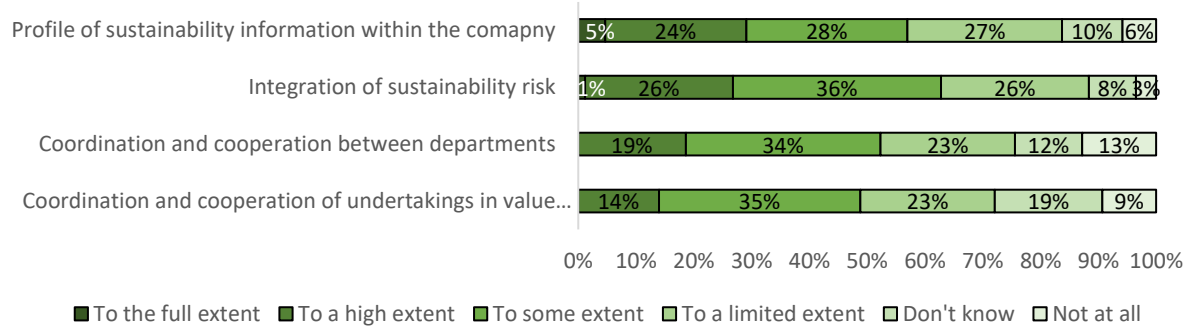
Ethical behavioural changes tend to be observed more in societies that have low power distance and in group collectivism, that are future oriented striving for avoidance of uncertainty. However, these do not support change by themselves and demand policymakers to set up the necessary tools and mechanisms in order to ensure that the implementation of reporting standards is effective. Societies that do not fulfil the same characteristics will in most cases require further enforcement mechanisms, in order to overcome their reluctance towards the broader picture (Zengin-Karaibrahimoglu & Cangarli, 2015).

Reporting standards on sustainability topics have the capacity to impact undertakings' views on externalities such as pollution. The disclosure requirement can have economic consequences and thus lead to reputational damage. This would imply internalising negative externalities which would push firms to adopt CSR and sustainability reporting (Hart, 2009).

### *6.1.3 Impact of the sustainability reporting within an undertaking*

The following section assesses the expected impact of the first set of the draft ESRS; i) on the profile of sustainability in information within the undertaking; ii) on the integration of sustainability risk in the non-financial reporting; iii) on the coordination and cooperation between departments within an undertaking; and iv) on the coordination and cooperation of undertakings in the value chains of preparers. The section discusses how preparers, users, value chain undertakings, assurance providers and other stakeholders expect corporate behaviour to change (see Figure 6.1).

*Figure 6.1 Impact of sustainability on corporate behaviour*




*Source:* CEPS (2022).

### 6.1.4 Raising the profile of sustainability information within the company

The large majority of preparers in the sample indicated that the first draft of the ESRS is expected to raise the profile of sustainability information within their organisation. They expect the members of the executive board of directors to become further involved. While the board will have more information available on how the undertaking is performing on different sustainability aspects, it will also have to be more informed on the legal obligations under the CSRD/ESRS, assurance activities, and potential questions from users of the sustainability statements.

The collection and preparation of the statement as well as the enhanced importance of the sustainability information to the management is likely to be reflected in a general rise of the profile of sustainability information within the organisation.

Only a fraction of respondents expressed that it would not lead to any change. These undertakings are in general already preparing a sustainability statement in line with one of the existing reporting standards. The executive boards of these undertakings tend to be more involved, considering that the sustainability of their activities is often of strategic importance or a business interest.

With the need to provide information to preparers, the undertakings in their value chain are also expecting to witness an increase in the profile of sustainability information.

### 6.1.5 Contribution to better integration of sustainability risks and opportunities in strategy

Most of the preparers in the sample expect the standards to have a moderate or large impact on the integration of the risks and opportunities in their corporate strategy. A very small minority of the preparers even expect the information to change the profile of sustainability in their organisation to the fullest extent. More integration of the reporting is likely to influence the business model of the undertaking. Actors expressing a more limited effect on the awareness within the undertaking from the standards is generally due to an already existing reporting.

The expected outcome from standards is a better understanding and more effective measures used for the evaluation of the ESG impact of the undertaking. This information is not only useful internally but can also be used as a measure to benchmark the performances of the preparer against other peers. Reporting the sustainability information enables stakeholders and the community to assess the preparer's performance.

The undertakings in the value chain of preparers indicate that the ESRS are likely to raise the profile of sustainability information in their organisations.

### 6.1.6 Contribution to better coordination and cooperation between departments

A majority of preparers in the sample expect there to be better coordination between departments within the organisations due to the ESRS. Hence, in order to prepare the sustainability statement there is often the need for various departments in the organisation to collaborate. This improvement mostly applies to undertakings where sustainability reporting was not previously carried out or only to a limited extent.

However, there are also many that do not expect a notable change as they are often already publishing non-financial information and have already benefited from strengthened cooperation as a consequence of this.

There are also some preparers that argue that the cooperation between departments might decrease. Indeed, if there is currently already intense communication between departments on the preparation of the sustainability information, this might become less with the standardisation of the indicators, leaving less room for interpretation and thus a lesser need for communication between departments.

This is especially relevant for undertakings that currently report comprehensively on sustainability following a principle-based standard or not following a standard at all.

The undertakings in the value chain of preparers indicate that they expect it will create further incentives to cooperate between departments. However, given their limited size it is very common that departments cover more responsibilities and a good cooperation between departments exists.

### *6.1.7 Contribution to better coordination and cooperation in the value chain*

The majority of the preparers in the sample indicated that they expect the draft of the first set of ESRS to lead to better coordination and cooperation between undertakings in the value chain. Dialogue with the undertakings in the value chain of preparers is expected to be deepened. This benefit would be part of the trickle-down effects.

The increased information that would be shared would also increase trust between the undertakings involved in the value chain, thus supporting collaboration. Moreover, preparers, undertakings in the value chain and others are likely to get a better overview of the value chain. The information on the undertakings might lead to inclusion of sustainability aspects in the selection of suppliers and the preparers (in combination with the undertakings in the value chain) might set clear objectives to engage in reporting and reduce the transition period. For example, the use of the ESRS can facilitate the initiation of specific reduction targets for the value chain (e.g. energy, waste, etc.).

The benefit will very much depend on the importance of the value chain, which varies greatly across sectors. Certain sectors where the value chain is of limited importance have limited need for standards to obtain a full understanding of the sustainability information of the undertakings in the value chain. In other sectors with more complex value chains with more actors or multiple layers, the standards could potentially contribute to better coordination, though many preparers have questions about the possibility to implement the standards effectively beyond the first tier of undertakings in their value chain. However, there are sectors that might not see the same effect as they might already be obliged to report similar non-financial or sustainability information or their ESG impact might be low in general.

### *6.1.8 Expected changes revisions and adoption of internal policies*

In addition to the different specific factors impacting corporate behaviour, it is important to understand how the reporting standards impact specific corporate policies. The policies in question are related to the environment, climate, social, employee, fundamental rights, and anti-corruption and bribery matters.

The large majority (69 %) of the preparers responding to the survey indicated they expect the first draft of the ESRS to lead to new internal policies or revision of existing policies. Almost one third (30 %) of respondents indicate an expected change in all policy areas, while nearly a tenth (8 %) did not expect to observe any changes to internal policies following the introduction of the standards.

The main trigger for a policy change is expected to come from employees, customers, investors, and other stakeholders, rather than the ESRS. However, the reporting of additional information on sustainability might help these stakeholders to push undertakings to become more sustainable.

Turning to the policy changes by area, the large majority indicated that they expect the environmental policies to change. About one third expects to revise existing policies on their own initiative, while another one fifth said that they would either revise or create new environmental policies at the request of large undertakings.

Similarly, the large majority of preparers in the sample indicated that they are expecting policy changes with regard to climate. More than one third of all preparers indicated that they expect to make changes

at their own initiative, while only a small share indicated that they would be making revisions based on requests from large undertakings. Only a small minority indicated that they are not expecting any policy changes with regard to climate. The remaining preparers, about one fifth, did not indicate an expectation about internal climate policies.

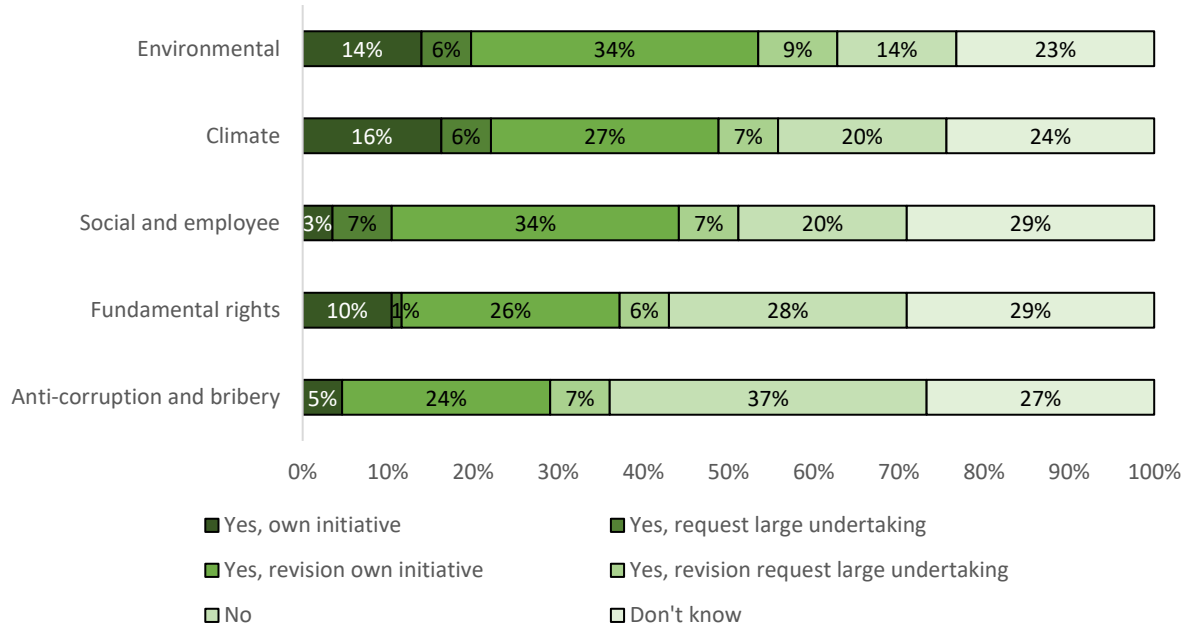
A small share of the preparers in the sample are expected to make policy changes at own initiative concerning social and employee policies. In addition, more than one third of the preparers indicated that they will make revisions at their own initiative following the ESRS disclosure requirements. Moreover, about one-fifth of preparers expect that there will not be changes due to the introduction of the ESRS. More than a quarter of the preparers further indicated that they do not know whether the new requirements would impact their internal social and employee policies.

Only a minority of the preparers in the sample are likely to introduce or make changes to their fundamental rights policies in response to the introduction of the ESRS.

A similar share of the preparers in the sample indicated that they expect to introduce or make changes to their existing anti-corruption and bribery policies. Indeed, about one third of preparers indicated that they would see new or changes made to their policies, with a majority of these being done due to internal initiatives. Moreover, more than one third of respondents indicated that they expect that there will not be any new policies or changes to existing policies.

The differences across areas are well explained by the status-quo and focus of the ESRS. Indeed, many preparers already have policies in place on fundamental rights and anti-corruption matters, while the environment and climate objectives have been introduced more recently and the policies are likely to see quite a lot of changes as the net zero targets influence the activity of preparers across the EU. The smaller large undertakings are those expecting larger effects, especially on environmental matters.

*Figure 6.2 Expected changes and adoption of internal policies*




*Source:* CEPS (2022).

### *6.1.9 Expectations to adopt due diligence processes*

In the General Principles of the ESRS (ESRS 1, 2022), due diligence reporting is defined as a process that is performed to identify, track, prevent, mitigate and remediate adverse impacts linked to the operations, the products or the services of the preparers. ESRS reporting does not extend or modify the role of governance bodies, rather it informs on the due diligence assessment procedure with regard to material impacts, risks and opportunities. Due diligence is performed to cover and mitigate human rights and environmental impacts (e.g. GHG emission or corruption). In order to give a full image of the activities of the undertaking, the due diligence process also includes activities carried out by undertakings in the value chain of the preparer. The draft ESRS includes a segment on the due diligence process. Only when an undertaking is unable to perform its due diligence on the entire value chain because of its complexity, can it estimate the information using internal and external information.

In addition to the current ESRS, a new Directive on corporate sustainability due diligence (CDD) was adopted by the European Commission in February 2022. The objective of the CDD is to encourage sustainable and responsible corporate behaviour as well as raise the profile of human rights and environmental considerations. An important number of the undertakings in the scope of the CSRD, are also covered by the CDD. More specifically, EU limited liability undertakings with more than 500 employees and a net turnover of over EUR 150 million at global level or EU limited liability undertakings active in strategic sectors with more than 250 employees and a global net turnover exceeding EUR 40 million (European Commission, 2022). The latter is, except for the sectoral limitation, very similar to the scope requirements in the CSRD[25].

Preparers were explicitly asked about due diligence processes regarding environmental issues, social issues, anti-corruption issues and fundamental rights issues. A more general observation indicates that the large majority of the preparers (80 %) indicated to change their current due diligence process in one of the four areas. On top of expecting change in at least one area, two-fifths of respondents expect a change in all four areas (41 %). Only a very small share of preparers (5 %) expect there to be no adoption or change to their current processes. The remainder are unable to predict the effect expected by the standards. In addition to the four issues mentioned above, respondents had the possibility to mention whether there are any other issues on which changes to the due diligence process are expected following the introduction of the ESRS. Less than one-tenth of respondents expressed that there would be changes to other due diligence processes than those explicitly mentioned.

Following the general observations, more specific observations can be made in each of the four areas.

The majority of the preparers (70 %) indicated that they expect changes to the due diligence process on environmental issues. Less than one-fifth (16 %) expect there to be no change in the due diligence processes, and a slightly smaller share of the preparers (14 %) were unable to predict whether new environmental due diligence processes would be adopted. The trend is similar in the supply chain, where the large majority of respondents expressed an expected change to the due diligence processes on environmental issues, with less than one-sixth expressing that they do not expect any change.

Social issues have a similar outcome to the one on environment among preparers, with more than two-thirds of the preparers (69 %) indicating that they expect to see changes in the due diligence. The main difference between the two are more uncertainty on whether there will be changes to social issues, with almost one-fifth of respondents (17 %) indicating that they did not know whether the standards will lead to a change. The remaining preparers do not expect any impact. For the supply chain more than half expect a change in the processes. One-third of the respondents indicate no

[25] Under the CSRD, companies meeting two of the three following criteria are required to report under the CSRD; annual revenue above EUR 40 million; total assets above EUR 20 million; and more than 250 employees.

expected change on social issues, while the remainder are uncertain of the impact of the ESRS on the due diligence process on social issues.

On anti-corruption issues more than two-fifths of the preparers (44 %) expect changes. Nevertheless, an almost similar share (40 %) expect there to be no change in the due diligence processes. The remainder did not know whether it will cause a change. Observing the responses from the value chain, two-thirds of the respondents of the supply chain expect changes to the due diligence procedure on issues related to anti-corruption. The remaining one-third are not expecting changes.

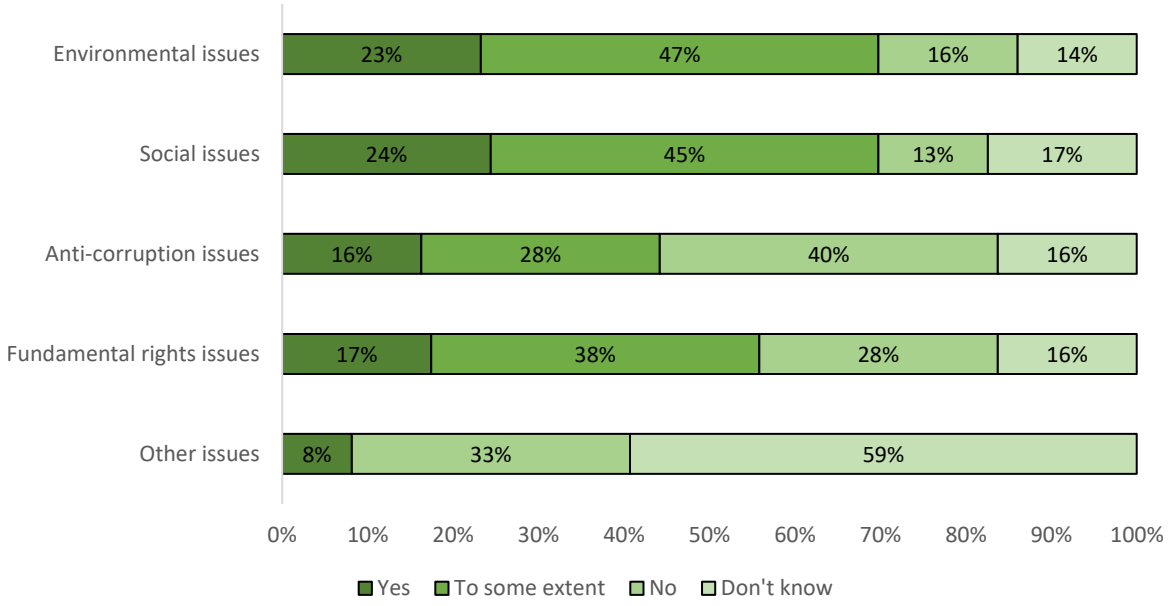
Fundamental rights issues see more than half of respondents (55 %) expecting to adopt new processes or change processes. However, almost one-third (28 %) indicated that they do not expect the new standards to lead to any change and the remainder were unable to say whether there would be a change or not. More than two-thirds of supply chain respondents expect to see changes to their due diligence processes tied to anti-corruption. The remaining third expect things to remain as they currently are.

Finally, less than one-tenth (8 %) of preparers expect there to be changes to processes other than those explicitly mentioned. The other issues on which preparers believe changes will be observed are related to risk management, legal compliance, adjusted materiality processes, value chains, governance, and ethics and policies. The large majority, representing more than half of the preparers that participated in the survey (59 %), were unable to predict changes to other due diligence processes. The remainder expect no change.

The differences observed in expected adoption of new due diligence procedures could partially be explained by those already including due diligence procedures in specific areas of their current reporting. Adding standards can therefore be expected to only have a limited impact on the due diligence.

Respondents falling under the CDD and requested to report following the ESRS standards highlighted the importance of ensuring that the two are aligned, in order not to be overburden by reporting requirements.

*Figure 6.3 Expected changes to the due diligence processes*




*Source:* CEPS (2022).

### *6.1.10 Conclusions*

To conclude, on the expected behavioural impact of the first set of ESRS, a general consensus between preparers, undertakings in the value chain, assurance providers and users that responded to the survey emerges. They all expect that there will be many behavioural changes as a result of the introduction of the ESRS. Most of the preparers indicated that the profile of sustainability reporting in their undertaking is likely to be raised. Most of these undertakings also expect internal cooperation between departments and external cooperation in the value chain to improve. A smaller share of preparers indicated that they have already made changes to their internal policies and/or due diligence processes.

There is also a general consensus among the various consulted stakeholders that the behaviour of preparers will change in various areas. In general, most of the changes expected are related to the environment and to a lesser extent social aspects. The more stable areas of fundamental rights and anti-corruption are likely to lead to fewer changes in internal policies.

Looking at the various types of undertakings covered by the CSRD, most of the changes are expected in the policies of the smaller large non-listed undertakings. These undertakings often do not have any tradition of reporting sustainability information.

*Box 5. Types of ownership of undertakings required to report in line with ESRS*

The costs and benefits for individual undertakings depend largely on the size, sector, current level of reporting, as well as the type of undertaking. The scope of the CSRD is larger than the NFRD, expanding the reporting obligation to an estimated 48 000 large undertakings. The undertakings covered are primarily various types of non-listed undertakings. This box takes a closer look at those types, particularly as the benefits of reporting sustainability information in line with the ESRS requirements might be different for some of these undertakings. For example, for a publicly listed undertaking the potential benefits from disclosing sustainability information are larger than for a similar fully family-owned undertaking which does not need to raise capital.

Looking at the undertakings in the scope of CSRD, around 2 000 undertakings are required to report under the NFRD obligation following the definition in the NFRD. This group mostly consists of undertakings with either listed stocks or bonds on EU-regulated exchanges (81 %). The remaining undertakings are insurance undertakings or credit institutions without shares listed on EU regulated markets.

Looking at the ultimate owner of large undertakings that need to report in line with the ESRS under the CSRD and not already covered under NFRD are mostly non-listed undertakings. The CSRD would require around 46 000 additional undertakings to report. Indeed, most listed undertakings have more than 500 employees and their subsidiaries are excluded from the scope of both NFRD and CSRD. An ultimate owner is the majority owner, which is at the end of an ownership chain of a group of entities. The ultimate owner is not majority owned by any other EU entity.

More specifically, almost 44 % of the large undertakings reporting under the CSRD are entities which themselves have dispersed ownership (see Table 6.1). Meaning that they have several smaller shareholders, none of them individually holding more than 50 % of the shares. These undertakings represent more than half (52 %) of the assets and turnover of all large undertakings. By definition, this group consists entirely of EU-domiciled undertakings (i.e. the parent entity is EU domiciled). Furthermore, for the most part, these undertakings do not have listed securities (41 % of all preparers). The share of total assets and turnover represented by these non-listed undertakings is disproportionally low (15 % and 28 % respectively). Conversely, the small number of undertakings with listed shares and bonds (less than 1 % of all preparers) represents a disproportionally large share of assets (41 %) and turnover (17 %). Undertakings which only have shares listed represent 2 % of all preparers, while also accounting for 5 % of assets and 7 % of turnover. Undertakings with only listed bonds play the smallest role among undertakings with dispersed ownership, constituting less than 1 % of preparers and comparable amounts of assets and turnover.

Around one fifth of all additional undertakings covered under the CSRD (17 %) are owned by other undertakings. The share of assets (24 %) and turnover (17 %) owned are larger compared to the number of undertakings concerned. In addition, around 8 % of the undertakings owning these CSRD-eligible undertakings are EU-based. These are non-limited liability undertakings. The largest type of owners of these undertakings are non-financial corporations, owning around 14 % of the eligible undertakings. This group owns a disproportionate large share of assets (18 %) and turnover (17 %) of all large undertakings under CSRD.

Other types of undertakings (i.e. financial corporations, banks, insurance corporations, private equity firms and venture capital firms) together constitute around 3 % of total ownership. In terms of assets and turnover owned, these types of owners respectively own 1 % or less of undertakings in the scope of CSRD, except for banks which own around 4 % of turnover. Not accounting for private equity firms (only 4 % in the EU), the majority of these preparers are owned by EU entities.

Non-corporately owned preparers represent 29 % of all CSRD eligible undertakings without a reporting under the NFRD. These undertakings represent a sizeable shares of assets (17 %) and turnover (22 %). Furthermore, this group is almost three-quarters European (74 %). The largest group of owners of non-corporately owned preparers are named individuals and families (20 % of all owners). This group owns a significantly smaller share of the assets (7 %) and turnover (13 %), while consisting mostly of European individuals (72 %). There are also a significant number of public authorities (4 %), foundations (3 %), and pension funds (2 %) among the owners. In terms of assets and turnover, public authorities own a larger share of both assets (8 %) and turnover (5 %), while foundations (2 % of assets and 3 % of turnover) and

funds (2 % of assets and <1 % of turnover) own significantly smaller shares. Public authorities and foundations ultimately owning large undertakings are mainly EU domiciled (88 % and 93 % respectively), while the opposite is true for funds (34 % EU). Only a small minority of the undertakings are owned by employees (<1 %), representing ownership of assets and turnover in a similar range.

The remaining ultimate ownership is currently unknown for around 10 %, constituting smaller shares of both assets (7 %) and turnover (7 %)

*Table 6.1 Ultimately owned large undertakings in scope of CSRD by type of ownership*

| Type of ownership | Undertakings by ultimate owner type | | | | *% of EU-27 origin* |
|---|---|---|---|---|---|
| | Number | % of preparers | % of total assets | % of total turnover | |
| Large corporations with disperse ownership | 21 035 | 44% | 52% | 52% | *100%* |
| Large corporations with disperse ownership with shares listed | 1 039 | 2% | 5% | 7% | *100%* |
| Large corporations with disperse ownership with bonds listed | 84 | <1% | 1% | <1% | *100%* |
| Large corporations with disperse ownership with shares and bonds listed | 400 | <1% | 31% | 17% | *100%* |
| Large corporations with disperse ownership without securities listed | 19 512 | 41% | 15% | 28% | *100%* |
| Subsidiaries of corporations | 8 022 | 17% | 24% | 19% | *8%* |
| Non-financial corporations | 6 684 | 14% | 18% | 17% | *0%* |
| Financial corporations | 486 | 1% | 1% | <1% | *37%* |
| Banks | 393 | <1% | 4% | <1% | *51%* |
| Insurance corporations | 345 | <1% | 1% | <1% | *69%* |
| Private equity firms | 100 | <1% | <1% | <1% | *4%* |
| Venture capital firms | 14 | <1% | <1% | <1% | *93%* |
| Other non-corporate owners | 13 660 | 29% | 17% | 22% | *74%* |
| One or more named individuals or families | 9 617 | 20% | 7% | 13% | *72%* |
| Public authorities, states, governments | 1 869 | 4% | 8% | 5% | *88%* |
| Foundations and research institutes | 1 312 | 3% | 2% | 3% | *93%* |
| Mutual and pension funds, nominees, trusts, and trustees | 783 | 2% | <1% | <1% | *34%* |
| Employees, managers, directors | 79 | <1% | <1% | <1% | *N/A* |
| Unknown ownership | 4 959 | 10% | 7% | 7% | *N/A* |
| **Total** | **47 676** | **100%** | **100%** | **100%** | ***63%*** |

*Note:* The percentages of preparers, total assets and turnover presented in the table above are for all undertakings in scope of CSRD.

*Source:* CEPS (2022) elaboration based on CEPS (2021) and Orbis Europe.

## 6.2 Improved sustainability

Apart from behavioural consequences following ESRS implementation (see Section 6.1), this section explores how the publicly available information on an undertaking's social, environmental and governance policies can lead to improved sustainability. The results presented in this section are based on desk research.

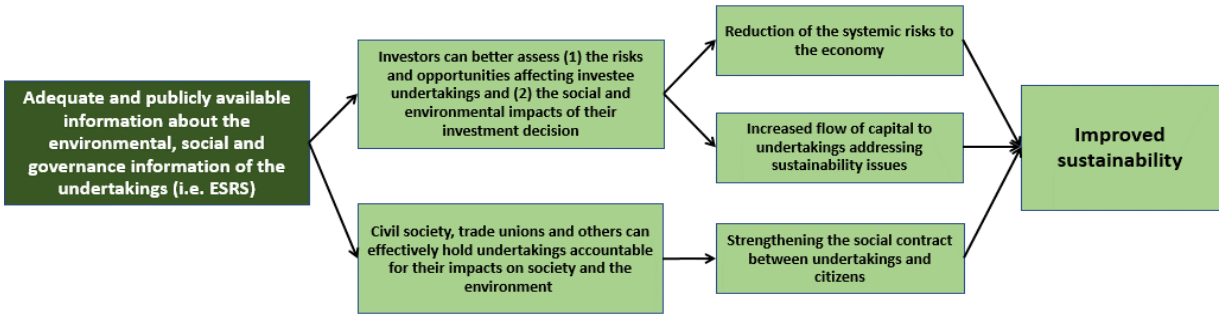
### *6.2.1 Approach*

The European Commission's impact assessment accompanying the proposal for a CSRD puts forward three main channels for improving EU non-financial reporting at the least possible cost. The potential of the European Single Market could be better exploited to contribute to the transition towards a fully sustainable and inclusive economic and financial system in accordance with the European Green Deal and the UN Sustainable Development Goals. These three channels are:

- Channel 1 – The reduction of systemic risks to the economy resulting from the fact that many investment decisions currently do not take adequate account of sustainability-related risks and opportunities;
- Channel 2 – Increased capital flows to undertakings and activities that address social and environmental problems, meaning that fewer resources are allocated to undertakings and activities that exacerbate such problems;
- Channel 3 – Making undertakings more accountable for their impacts on society and the environment, thereby strengthening the social contract between undertakings and citizens.

The achievement of the objective of improved sustainability through the elaboration of reliable, comparable and relevant non-financial (i.e. sustainability) information leads – according to the impact assessment – to two main results. First, investors will be able to take sufficient account of the risks and opportunities that affect investee undertakings stemming from sustainability matters, and of the social and environment impacts of their investments. Second, civil society, trade unions and others will effectively be able to hold undertakings to account for their impacts on society and the environment. If investors take sufficient account of the risks and opportunities that affect investee undertakings, and of the social and environmental impacts of their investments, then systemic risks to the economy will be reduced and capital flows to undertakings that address social and environmental problems will increase. If civil society, trade unions and other parties can effectively hold undertakings to account for their impacts on society and the environment, then the social contract between undertakings and citizens will be strengthened (see Figure 6.4).

*Figure 6.4 Overview of the channels contributing to improved sustainability*




*Source:* Based on the figure included in the Impact Assessment SWD/2021/150 final.

This section follows these three channels and explains how the ESRS, which cover a broad range of issues including environmental, social and governance information, can improve sustainability. The resulting indirect benefits following ESRS implementation are mainly assessed qualitatively, since the quantitative data available from primary and secondary data sources on sustainability impacts is extremely limited.

### *6.2.2 Limitations*

Even though the indirect benefits are assessed qualitatively, the results from our desk research are not comprehensive enough to assess all of these indirect benefits. The grey and academic literature analysing the linkages between sustainability reporting and societal benefits is still under-developed because the mandatory reporting requirements are recent, and most indirect benefits are not yet visible to society. Further research is necessary to establish clear effects of such disclosure. This is mainly due to the time lag between the implementation of sustainable practices and their results. In the last decades, there has been increasing demand from stakeholders for corporate sustainability reporting. However, most undertakings were not obliged to disclose sustainability information, and previous reporting standards failed to provide a sufficiently integrated approach.

Overall, the positive societal impacts of sustainability reporting take longer to be seen and are not quantifiable in monetary terms. Additionally, there are uncertainties around the medium and long-term impacts, especially because the realisation of these benefits is conditional on several factors such as investor and consumer preferences (La Torre et al., 2020). Even with the double materiality perspective, there is a risk that undertakings continue to prefer financial accountability over environmental and social accountability, especially because the economic benefits of green investments take longer to manifest themselves (La Torre et al., 2020).

Most of the existing literature focuses on environmental indirect benefits, because there have been mandatory and non-mandatory reporting requirements on the matter for a longer period of time. Furthermore, climate change mitigation is one of the most important issues currently threatening the stability of the financial system and one of the main drivers behind the CSRD. Thus, academic literature mainly looks at the linkages between sustainability reporting and climate change, centring on the reduction in GHG emissions.

Nevertheless, it is reasonable to assume that the ESRS will not only lead to environmental benefits but will also bring improvements in social and governance areas. This can, for example, be deduced from the COVID-19 pandemic, which highlighted undertakings' exposure to non-financial risks. This is particularly important for undertakings whose business models depend on the movement of people and goods[26]. Until now, investors mainly focused on environmental information (especially information related to climate change), while social information had less importance in the investment process. The COVID-19 pandemic has, however, accelerated the demand for social and governance-related information (Kell, 2020; Reynolds, 2020; Nemoto, 2020). It is thus reasonable to expect that, in the future, investors will require substantially improved and expanded reporting about social (and governance) risks. The European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) have already issued guidelines considering the sustainability risks of investments in light of the COVID-19 aftermath. These guidelines stress the importance of social and work-related matters. In addition, several studies suggest that the pandemic has already fostered the growth of sustainable investments. For example, according to a 2020 survey conducted by JP Morgen, more than half (55%) of investors expected the pandemic to promote sustainable investing in the next three years, as opposed to just over a quarter (27%) expecting a negative impact and nearly a fifth (18%)

[26] See European Commission, Impact Assessment SWD/2021/150 final, Annex 12.

remaining neutral (JP Morgan, 2020). Another author described the pandemic as a 'baptism of fire' for sustainable investments. Overall, the pandemic has contributed to an increased awareness of social and worker-related issues and their relationship with the health of the economy. If COVID-19 truly fosters the growth of sustainable investments, there will also be an increasing demand for adequate information related to social and worker-related issues.

### *6.2.3 Channel 1 – Reduction of systemic risks to the economy*

This subsection presents the first channel through which ESRS may contribute to sustainability, namely the reduction of systemic risks to the economy. It depicts the financial systemic risks arising from undertakings' actions. Additionally, it explains the importance of accounting for sustainability-related risks in investment decisions, and how ESRS facilitate this.

The European Central Bank (ECB) has identified climate change as one of the major sources of systemic risk in the financial system. In particular, climate change-related risks have the potential to become systemic, if markets are not pricing the risks correctly. The economic impacts of the climate crisis are expected to be extensive, worsening inequalities that already exist and accelerating the disruption of the entire financial system. Equally, risks related to water stress, biodiversity loss, resource scarcity and human rights controversies can have a major impact on the economy. Indeed, systemic risks pose a particular challenge to the economy and its financial system.

Businesses benefit society by contributing to financial stability and fostering economic growth. However, they are often confronted with social and environmental challenges that can create financial risks to society (i.e. negative externalities). Since ESRS are based on the concept of double materiality, the standards not only assess the financial impact of the undertaking but also its impact on the environment and on society more broadly. Sustainability reporting thus represents an opportunity to discourage negative externalities. Even though these externalities are difficult to quantify – unlike financial matters – the detailed and granular ESRS framework allows for better comparability of the societal and environmental impacts of different undertakings facilitating corporate accountability.

In turn, corporate accountability activates the fight against climate change and may lead to a more sustainable future. Generally, both the 2015 Paris Agreement on Climate Change and the European Green Deal underline the importance of controlling corporate behaviour and its impact on environmental issues. Furthermore, as mentioned in the proposed CSRD – Recital 2[27], the disclosure of relevant, comparable and reliable sustainability data by undertakings is an important prerequisite for meeting the goals set by the Commission's Action Plan on financing sustainable growth. This Action Plan strives to reorient private capital towards sustainable investments in order to achieve sustainable economic growth, to mainstream sustainability into risk management (including the integration of sustainability in credit ratings) and to foster transparency and long-termism in financial and economic activity. Under the latter category, the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) have all recommended strengthening the disclosure of sustainability factors to facilitate investor engagement. Investors, after all, pay attention to ESG scores[28].

[27] See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189

[28] See, for example, https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/why-esg-is-here-to-stay; PwC (2021), Global Investor Survey, https://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting/2021-esg-investor-survey.html.

*Box 6. The importance of accounting for climate change-related risks in investment decisions*

In order to understand the consequences of climate-related risks, supervisors, central banks and research institutes are refining several stress-testing exercises. A study conducted by Gourdel, Monastrelo, Dunz, Mazzochetti and Parisi (2022) examines the double materiality of climate change risks in the euro area. More specifically, the study presents a stress-testing framework to depict the consequences of different climate change scenarios on the financial system. The authors compare three scenarios for economic activities:

1) The orderly scenario
2) The disorderly scenario
3) The current policy (i.e. the hothouse world)

Each of the possible scenarios describes a way in which carbon tax is introduced, resulting in three possible trajectories of carbon pricing across scenarios (pricing provided in USD 2010 per ton of CO2). The orderly transition (scenario 1) relies on the immediate and progressive increase in carbon pricing, promoting transition to a low-carbon economy. The disorderly scenario (scenario 2) represents a late and sudden rise in carbon pricing, requiring a sharper emission decline to meet the Paris Agreement. The hothouse world scenario (scenario 3) is based on policies currently in use, i.e. low carbon tax equal to approximately USD 13 per ton of carbon.

In their conclusions, the authors find that an orderly transition (scenario 1) decreases carbon emissions (12% less in 2040 compared to 2020), while supporting economic growth. The disorderly transition (scenario 2), threatens the euro area's economic and financial stability and can cause GDP to shrink by 12.5% by 2050 compared to the orderly transition. Further, the orderly transition represents a short-term cost to economic growth, but this cost is nevertheless limited (0.3% lower economic growth than in the two other scenarios by 2025) and brings in strengthened economic stability over the long term. All in all, the orderly scenario outperforms the hothouse world (scenario 3) and the disorderly scenario already in 2030. The disorderly scenario could lead to a 2.8% decrease in real GDP compared to an orderly scenario already by 2035. Finally, the hothouse world would lead to a 4.7% decrease in real GDP by 2040 compared to an orderly transition. This would be caused by higher physical risks.

Gourdel et al. (2022) underline the importance of undertakings' engagement in achieving an orderly transition and healthy economy in the future. According to these authors, undertakings' expectations about climate policies and climate impacts are the main factor in achieving a low-carbon transition. In estimating the role of undertakings' expectations regarding climate impact in the transition process, they find two crucial results. First, when undertakings assume an early introduction of a high carbon tax and internalise the different carbon price scenarios in their net present value (NPV) assessment, the economic decarbonisation and energy transition could happen significantly faster compared to the case with no anticipation. More precisely, if undertakings expand their policy anticipation in their NPV assessment up to 20 years, it could result in 20% fewer emissions from 2035 compared to scenarios with no anticipation. Second, the credit in the initial phase of simulation is higher if undertakings consider longer investment horizons. This happens because the current prices of green investments are still comparatively high, and not very profitable in the short term. Nevertheless, these benefits manifest themselves in the long term.

The above studies show that undertakings and their behaviour play a central role in fighting against climate change and the systemic risks arising from it. Therefore, it is essential that climate change-related financial risks are fully reflected in asset valuation. This can only happen if investors have access to adequate information such that they can consider sustainability risks in their decisions. ESRS aim to collect data that is relevant, comparable, reliable and usable, allowing investors to take adequate account of sustainability-related issues.

The CSRD not only targets listed but also non-listed undertakings. For the latter, it is especially important for suppliers of larger (listed) undertakings to be compliant with the ESRS, because these larger undertakings might insist that all suppliers guarantee a supply chain that conforms to the ESRS. In addition, undertakings compliant with the ESRS might get better conditions when negotiating loans, or might have more possibilities of finding new financing avenues, such as green bonds. More generally, most private fund providers (from private equity to debt and beyond) are evaluating ESG risk factors, and it is therefore important for non-listed undertakings to at least have a narrative on how they have included environmental, social and governance factors in their day-to-day business. In any case, the negative externalities discussed above apply to both listed and non-listed undertakings, and it is only through the efforts of all undertakings alike that systemic risks can be mitigated.

Through the incorporation of ESRS into undertakings' reporting requirements, investors and financial institutions are able to look at sustainability-related risks and opportunities in their investment and financing decisions (sustainable investments and green ways of financing, respectively). As a result, systemic risks that can threaten financial stability are mitigated by making the reporting undertakings themselves more sustainable.

Erataly and Cortes Angel (2022) explore whether undertakings incorporating ESG into their corporate culture actually reduce their systemic risks in a stock market context. The authors conclude that undertakings with higher ESG ratings face up to 7% lower systemic risk contribution and exposure compared to undertakings with lower ESG ratings. In the same vein, Cerqueti et al. (2021) find that the relative market value loss of high ESG ranked funds is lower than the loss experienced by low ESG ranked counterparts. It follows that these findings will be even more pronounced when the ESG ratings are based on the ESRS.

These insights show that policy actions at the EU level are needed to avoid systemic risks reducing the stability of the financial system. The proposed ESRS have the ability to mitigate the systemic social and environmental risks that are threatening financial stability as they facilitate corporate accountability. After all, ESRS allow investors to account sufficiently for sustainability-related risks. A systemic transition towards a greener economy will already benefit the financial and economic markets and reduce systemic risks in the foreseeable future.

### *6.2.4 Channel 2 – Increasing the flow of capital to undertakings that address sustainability risks and opportunities*

Insufficient availability of relevant, reliable, comparable and usable sustainability information not only contributes to systemic financial risks but also hinders the capacity of the financial system to channel investments effectively towards undertakings that actually address sustainability issues. If investors do not have adequate information about the sustainability performance of an undertaking, then naturally they cannot take such information into account when making investment decisions. This subsection explores this problem further and explains how ESRS could contribute indirectly to increasing the flow of capital towards sustainable undertakings and potentially disadvantage undertakings exacerbating sustainability issues.

In 2014, the EU introduced the NFRD to improve access to sustainability information and allow investors to incorporate this information into their investment decisions. While the NFRD brought some success and encouraged sustainability-related behavioural changes at the undertaking level, it had multiple shortcomings. First, the NFRD only covers large undertakings with more than 500 employees. However, labour intensity is not a good measure of carbon intensity (Schütze & Stede, 2021). Indeed, the NFRD likely omits numerous polluting undertakings. Second, Monciardini, Mähönen and Tsagas (2020) criticise the NFRD for its low quality and comparability of non-financial statements, and claim that the current level of reporting is not sufficient to understand and undertaking's impacts on the environment and society as a whole. In 2019, ESMA analysed 937 non-financial statements to assess compliance with the NFRD, and consequently underlined the importance of urgently enhancing

some of the important aspects of non-financial disclosure, especially the disclosure of risks related to environmental matters and climate change. Third, ESMA highlighted that the majority of reporting undertakings fail to explain the relevance of their key performance indicators (KPIs) and how they were prepared. Some other scholars have criticised the NFRD for not providing sufficient information about what should be reported and how, thus leaving the decision to individual undertakings and Member States. This may increase the fragmentation of reporting practices because individual undertakings choose to disclose different information, or to disclose at a different level of detail (Ohnesorge & Rogge, 2021).

According to the Commission, there is a need for EUR 480 billion worth of additional investments to meet the 2030 climate and energy targets[29]. The 2018 Action Plan on financing sustainable growth and the 2021 sustainable finance strategy underline the importance of the private sector in financing the sustainable and fair transition by navigating capital flows towards undertakings addressing sustainability issues[30]. However, according to the 2018 Bloomberg Sustainable Business and Finance Survey[31], nearly half (48%) of European investors believe that obtaining consistent and comparable historical data about the sustainability performance of different undertakings is a big challenge. As indicated by the International Monetary Fund, the lack of a consistent methodology and the low comparability of non-financial information are among the biggest challenges investors face when incorporating sustainability information into their investment decisions[32]. This shows that investors are currently unable to channel their funds efficiently towards undertakings addressing sustainability issues, even when they have the intention to do so.

Further, some ESG investment funds currently fail to carry out in-depth screening of the kind and variety of Corporate Social Responsibility (CSR) due diligence processes enforced by the undertakings. Frequently, the examination only requires undertakings to confirm that they adopt some form of CSR activities, without investigating the details of specific policy topics. There is a need for the harmonisation of criteria, such that the sole presence of a CSR due diligence tool is no longer sufficient, but rather a more specific screening should be conducted[33]. That way, investors will be provided with the information necessary to make an informed investment decision.

The ESRS have the potential to address these shortcomings in several ways. First, the ESRS cover a broader range of reporting undertakings compared to the NFRD – the proposed CSRD 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, often include a reporting template and should be reported in a machine-readable manner. Finally, assurance

[29] European Commission (2021), *Strategy for financing the transition to a sustainable economy*.

[30] See https://finance.ec.europa.eu/publications/renewed-sustainable-finance-strategy-and-implementation-action-plan-financing-sustainable-growth_en#action-plan and https://finance.ec.europa.eu/publications/strategy-financing-transition-sustainable-economy_en. Mentioned in https://www.ceps.eu/ceps-publications/a-critical-look-at-the-esg-market/.

[31] *The Sustainability Imperative: Business and Investor Outlook 2018*, Bloomberg Sustainable Business & Finance Survey.

[32] International Monetary Fund (2019), *October 2019 Global Financial Stability Report*.

[33] Ibid.

of the reported sustainability information is required. All of these characteristics ensure that the reported data is relevant, comparable, reliable and usable.

Even if many investors do not use the sustainability reports directly, they are very much dependent for their investment decisions on the information provided to them by credit rating agencies (CRAs). Credit ratings allow investors to assess the quality of their investments and the risks associated with them. While credit ratings are not the only deciding factor in an investment process, they are widely used in the evaluation of an investment (Gonzalez, 2004). CRAs mostly rely, with regard to sustainability-related topics, on the information provided to them by the undertakings. A study conducted by ECB researchers investigates how the CRAs in the euro area include and communicate climate-related risks in their rating reports. The paper points to significant differences in methodologies and disclosure practices across CRAs and asset classes. The authors consequently recommend three areas for improvement regarding climate change-related disclosures:

- The extent to which the effect of material climate change is incorporated into credit ratings should also be disclosed. The authors underline the relevance of disclosing the magnitude of adjustments to the credit rating arising from climate change risk. This means that users should understand the weight that climate change risk has in the credit rating.
- CRAs should include a clear explanation about the methods and models used to determine an undertaking's exposure to climate-related risks.
- Greater transparency should be targeted, with regard to both the definition and the assessment of the individual climate change risk factors.

Section 5.1 indicated some uncertainty as to whether or not CRAs would align their assessment methodologies with the ESRS. The reason given is that most CRAs operate internationally, while the ESRS are only applicable at the EU level. Nevertheless, Section 5.2 has concluded on the synergies between the ESRS and the international reporting standards. Additionally, the granularity of the ESRS acts as an answer to many of the improvements suggested by the ECB. Thus, even though the CRAs may not adjust their assessment methodologies immediately, the detailed sustainability information provided by the ESRS could become important (and requested by investors) in the future. However, this benefit is contingent on developments in other reporting standards and on the alignment of international reporting standards with the ESRS.

There is evidence that undertakings that pay attention to ESG principles perform more strongly over the longer term (Friede, et al., 2015). Further, the analysis of ESG factors provides an additional level of risk analysis that helps to identify potentially material exposures. The ESRS can hence be considered to have the potential to mitigate risks (see also subsection above) (Henisz & McGlinch, 2019).

As explained above, the ESRS aim to collect data that is relevant, comparable, reliable and usable, while the proposed CSRD obliges a significantly higher number of undertakings to disclose sustainability information. The comparison of environmental, social and governance standards will be significantly enhanced, allowing investment undertakings to make better informed decisions. In particular, the implementation of the ESRS could foster the European Green Deal by ensuring that there is an increased flow of capital towards undertakings that address social, governance and environmental problems. Public disclosure on the basis of the ESRS (whether or not through the CRAs' reports) will allow investors to better assess the value of their investments and to effectively channel their investments towards undertakings addressing sustainability issues. As an added bonus, this increased capital flow towards green undertakings provides an answer to stakeholders' growing demands to invest in such undertakings. Green or sustainable undertakings are moreover attractive due to their reduced risk potential and their higher equity returns.

Moreover, it is important to note that the implementation of the ESRS could not only increase the flow of investments towards sustainable undertakings but also potentially disadvantage undertakings that exacerbate societal and environmental problems. Without adequate sustainability information from

undertakings there is a misallocation of capital and too many resources flow towards undertakings that have negative sustainability impacts constraining the ability to meet the objectives of the European Green deal and the UN Sustainable Development Goals[34]. The ESRS have the potential to mitigate this issue. Since investors will have access to adequate data about the sustainability performance of undertakings, they can better ensure that they do not support undertakings with negative sustainability impacts[35].

### 6.2.5 *Channel 3 – Strengthening the social contract between undertakings and citizens*

This section explains the last important indirect benefit of the ESRS in the context of improved sustainability, namely the strengthening of the social contract between undertakings and citizens. If undertakings report sustainability information that is relevant, comparable, usable and reliable, it allows civil society, trade unions and other stakeholders to hold undertakings accountable for their societal impacts, thereby increasing trust in business and strengthening the social contract between undertakings and citizens. This has positive impacts on the efficient functioning of the social market economy[36].

Improved comparability of sustainability statements would not only benefit investors and CRAs but also employees, consumers, policymakers and civil society organisations, as they all can better monitor the sustainable behaviour of undertakings. ESRS implementation will put pressure on undertakings to identify, prevent and alleviate their negative environmental, social and governance impacts in order to maintain their good reputation. Additionally, increased transparency strengthens citizens' trust in business. Literature indicates that consumers (at least those who are well informed about sustainability matters) these days seek information that is less price-oriented. According to Eurobarometer (2020), nearly all EU citizens (94%) indicate that environmental protection is important to them. Additionally, consumers care about other sustainability issues such as employee treatment and compliance with social norms, and approximately two thirds (69%) of EU adults wish that undertakings were more transparent about their business practices. Furthermore, the COVID-19 pandemic has further contributed to the awareness of sustainability principles[37]. If citizens, NGOs and other stakeholders do not have access to the relevant sustainability information of undertakings, they cannot make informed decisions, and hold the undertakings accountable even if they have the intention to do so.

Literature has found a link between sustainability reporting (after the implementation of the NFRD) and corporate accountability (La Torre et al., 2020), even though many improvements are still necessary. The understanding of accountability used by La Torre, Sabelfeld, Blomkvist and Dumay (2020) builds on the assumption that undertakings have responsibilities that go beyond the contractual duties with their shareholders. In particular, undertakings have a duty to mitigate the negative externalities that they impose on the environment and society. Therefore, undertakings should be held

[34] See Impact Assessment SWD/2021/150 final, Annex 12.

[35] See Impact Assessment SWD/2021/150 final, Section 4.

[36] See Impact Assessment SWD/2021/150 final, Section 4.

[37] See Impact Assessment SWD/2021/150 final, Annex 12.

accountable for their impact on society, and this is maintained through corporate accountability. The authors identify four main factors limiting corporate accountability:

- First, reported non-financial information is often not sufficiently reliable or comparable. According to the 2020 public consultation conducted for the European Commission's impact assessment, the large majority (84%) of stakeholders believed that low comparability of reported information is a problem, compared with only 3% who did not perceive it as problematic[38]. Without sufficient comparability, the value of information from any undertaking is significantly decreased. A different study revealed that inconsistencies in the data reporting methodologies could lead to substantially different conclusions when assessing the same group of undertakings (Kotsantonis & Serafeim, 2019).
- Second, undertakings often report information that consumers find irrelevant. There are numerous reasons behind this, among others: (i) the failure to provide information that is sufficiently detailed and tailored to users' needs; (ii) the failure to report negative and positive sustainability impacts in an equal manner; (iii) the failure to explain linkages between financial and non-financial information of undertakings; (iv) the fact that undertakings fail to explain how they decide on which information to report; and (v) the failure to provide forward-looking information, which many end-users value more than historical data[39].
- Third, there are a lot of undertakings that are still not reporting. NGOs, trade unions and other stakeholders wishing to hold undertakings accountable claim that a lot of undertakings are currently not reporting any sustainability information, even though their societal impacts may be significant. As explained above, the NFRD does not include large non-listed undertakings and hence fails to incorporate some undertakings with significant sustainability impacts. According to the public consultation conducted for the 2021 European Commission impact assessment, the large majority (87%) of organisations believed that the scope of the NFRD should be expanded[40].
- Fourth, it is hard for end-users to find non-financial information even when it has been reported. The reasons behind this are numerous. First, a lot of undertakings reporting sustainability information report information that is irrelevant to users (such as philanthropic activity, or indicators that are not relevant to assessing an undertaking's most important impacts) alongside the relevant information. This increases the volume of sustainability reports and makes it more challenging to find the relevant information. Second, the information reported is often not adequately digitalised, hindering access to the information. Third, relevant information is not provided centrally in one location. Undertakings often distribute their information to different publications, and therefore some users have difficulties in finding it.

The ESRS have the potential, at least to some extent, to resolve these issues. The first and the second of the four problems identified could be resolved by the proposed ESRS, given that these standards strive to collect data that is relevant, comparable, reliable and usable. The mandatory nature of the disclosure under the CSRD potentially solves the third problem, while the requirement to digitally tag[41] the non-financial information in order to facilitate its searchability and usability could take care of the fourth reported issue.

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[38] See Impact Assessment SWD/2021/150 final, Annex 12.

[39] See Impact Assessment SWD/2021/150 final, Annex 12.

[40] Ibid.

[41] Preparers are obliged to digitally tag sustainability information to foster its usability and searchability. See Impact Assessment SWD/2021/150 final, Annex 17 for more details.

Even despite the hiccups in non-financial reporting under the NFRD (and, hence, potential hiccups related to ESRS implementation), La Torre et al. (2020) emphasise the importance of accountability-driven sustainability reporting practices, and underline the importance of ensuring high levels of accountability. Greater accountability leads to greater trust in the workplace. Increased trust will lead to greater employee engagement. As reported in Section 6.1, most stakeholders indicated that the obligation to disclose according to ESRS would lead to a movement towards increased social due diligence, and would likely lead to revised policies in this area. This would benefit employees. There is evidence in the literature suggesting that implementation of CSR activities is linked to higher employee satisfaction. If sustainability reporting motivates undertakings to engage in socially responsible activities, this can increase the motivation and productivity of their employees by instilling a sense of purpose. For example, randomly selected employees of one Australian bank reported stronger satisfaction and motivation after receiving bonuses in the form of donations by their undertaking to local charities, compared with their co-workers who were not chosen for the charity donation initiative (de Neve et al., 2018). Job satisfaction is associated with a lower employee turnover rate, and competent employees are more likely to work in an undertaking with a good reputation that treats employees fairly. Additionally, employees identifying with the principles of their undertaking achieve better results and behave loyally. Sustainability reporting increases the transparency between the undertaking's management and its employees, which can lead to employee satisfaction and well-being.

Greater accountability not only leads to increased employee trust and engagement, but also contributes to a greater sense of social fairness, strengthening the social contract between citizens and businesses. Corporate accountability maintains exactly that businesses should be held responsible for the impact of their actions on society and the environment. The ESRS provide civil society with the tools to hold undertakings accountable for their sustainability impacts.

### *6.2.6 Conclusions*

The implementation of the ESRS has the potential to deliver a crucial element in achieving a timely and orderly low-carbon transition, and in preventing the systemic risks arising from late transformation. Unlike other important reporting standards, the ESRS aim to collect data that is relevant, comparable, reliable and usable; digitally accessible; and mandatory for a large number of undertakings. In this way, the ESRS correct the shortcomings of the NFRD. Having adequate and publicly available data about the sustainability performance of undertakings is important for investors as well as trade unions and society more broadly. It allows investors to take environmental and social risks into account when making an investment decision and, similarly, it allows citizens and trade unions to hold undertakings accountable for their societal and environmental impacts. Proper implementation of the ESRS will most likely lead to improved sustainability, and the following three indirect benefits can be achieved: a reduction in systemic risks to the economy; increased capital flows to undertakings addressing sustainability issues; and the strengthening of the social contract between undertakings and citizens. All of these benefits strengthen the potential of the single market to contribute to the European Green Deal.

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# 7. CONCLUSIONS

This report has assessed the costs and benefits of the first set of draft ESRS for the different stakeholder groups, including preparers, SMEs that are part of the preparers' value chain, investors, NGOs, trade unions and society at large. This is challenging as the costs are visible and tangible and measurable in the short term, while the benefits of the ESRS are intangible and non-measurable, and thus will only become evident in the medium to long term. Therefore, the conclusions concerning the measurable costs and benefits need to be treated with caution, as benefits are underestimated in quantitative terms.

The direct costs, both in terms of administrative and assurance, are likely to be the main costs of the ESRS. These costs are likely to increase from the current ones under the NFRD and voluntary reporting. However, in the first year of reporting, undertakings are likely to incur a one-off administrative cost that is similar in size to the recurring administrative cost. NFRD listed undertakings face around EUR 287 000 for one-off costs and EUR 320 000 for recurring ones. These costs are quite evenly spread between inhouse and external costs. The costs will be phased in gradually depending on the transition period for disclosure requirements. The most burdensome requirements will be those related to the environment that are technical in nature, including DR 1-6 on reporting GHG emissions and DR E1-9 on reporting the financial effects from material physical and transition risks, and climate-related opportunities. In particular, NFRD-listed undertakings will face the highest average incremental costs in absolute terms. However, relative to undertakings' turnover and operating costs, NFRD-listed undertakings would face the lowest share of administrative and assurance costs. Similarly, the assurance costs are expected to increase significantly due to more comprehensive coverage. Reasonable assurance costs are likely to be more than twice as high as the costs for limited assurance.

Turning to indirect costs, the ESRS, specifically the requirement to report information on undertakings in the value chain, is likely to have a trickle-down effect. This effect is likely to be noticeable, considering the large number of undertakings potentially affected, as well as the likely need to rely on external expertise to prepare the information required (thus increasing the costs). However, the precise impact is currently difficult to establish due to the uncertainty over the tiers of the value chain affected, as well as the preparers' approach towards their request (coverage of disclosure requirements and assistance). Although the consulted stakeholders did not consider litigation risk and the related costs a particular issue, ongoing litigation activities and enforcement actions show that it might become one in future (e.g. reporting quality and climate change action). Similarly, most consulted stakeholders were not or only to a limited extent concerned about the impact on their competitive position, mostly because their competitors would also be subject to the same requirements. Nevertheless, some preparers, especially those that are active outside the EU, are concerned about the disclosure of sensitive corporate information (e.g. forward-looking information, value chains, etc.). Moreover, information that is too detailed limits the potential benefit and therefore discourages sector-wide innovation.

The main benefits of the CSRD are derived from a larger group of non-listed large undertakings disclosing sustainability information. The ESRS is expected to contribute more comprehensive and higher quality sustainability information to this. The sustainability information further becomes comparable across all large EU undertakings that are expected to report in line with the ESRS. Even though investors deem more comprehensive, standardised and comparable sustainability information very important for their investment decisions, the coverage limited to EU undertakings significantly limits the direct benefits to investors, who typically invest globally , as they generally expect to have to rely on alternative sustainability standards and rating agencies covering undertakings globally.

Since ESRS will only be applicable to undertakings operating within the EU, potential cost savings benefits for stakeholders that are globally active, such as rating agencies and investors, will depend on the interoperability of ESRS with other national and international sustainability reporting regimes. In

this respect, it is advisable that the possible synergies and efficiencies of the ESRS with other frameworks be considered as a medium to high priority. This is especially true for the general disclosure requirements, governance and – to some extent – the environmental aspects of the ESRS. More limited synergies are generally identified in areas where an additional level of granularity is found in the new standards, set up to ensure both a level of standardisation and better monitoring of reporting undertakings.

Although the main benefits are likely to be for ESRS users there are also significant potential benefits for the preparers. Many of them already provide *ad hoc* sustainability information to sustainability rating agencies, financial institutions and other stakeholders. The preparers, as well as the rating agencies, expect only a fraction of the potential savings will be realised based on the current draft. This is confirmed by most parties responsible for these requests, which indicates that caution should be exercised if committing to any change in their approach.

The application of the ESRS is also expected to lead to many behavioural changes, especially in those undertakings that are not currently reporting sustainability information. Most of the preparers are likely to see the profile of sustainability reporting in their undertaking to increase. Most of these undertakings also expect the internal cooperation between departments and external cooperation in the value chain to improve. A smaller share of preparers already indicates that they are making changes to their internal policies and/or due diligence processes. There is also consensus among the various consulted stakeholders that preparers' behaviour will change in various areas. In general, changes related to the environment (and to a lesser extent, social aspects) are the most anticipated. The more stable areas of fundamental rights and anti-corruption are likely to lead to fewer changes in internal policies.

The ESRS is expected to positively impact sustainability at corporate level and for society as a whole. The new standards have the potential to lead to a low-carbon transition while also preventing systemic risk arising from the late transition to more sustainable activities. The new standards also solve the shortcomings of the NFRD. It ensures that more adequate sustainability information is accessible to investors, trade unions and society at large. This ameliorates decision making for investors and ensures the accountability of preparers to trade unions and to wider society. Three indirect benefits are identified, specifically reduced systemic risk to the economy, increased capital flows to undertakings addressing sustainability issues, and the strengthening of the social contract between undertakings and citizens. All these elements put together contribute towards the development of a single market that will help to achieve the ambitious goals of the European Green Deal.

Because of the triggered behavioural changes, the ESRS would also contribute to improvements in sustainability. These benefits include the increased sustainability of production processes and products, as well as greater employee satisfaction. The impacts on fundamental rights and anti-corruption and bribery matters are likely to be limited. However, the potential sustainability benefits are dependent on context. To achieve the desired sustainability objectives they must be combined with other measures to reach their maximum potential.

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# LIST OF ABBREVIATIONS

| Abbreviation | Description |
|---|---|
| AIFM | Alternative investment fund manager |
| BAU | Business as usual |
| CAPEX | Capital expenditures |
| CBA | Cost-benefit analysis |
| CDP | Carbon Disclosure Project |
| CEPS | Centre for European Policy Studies |
| $CO_2$ | Carbon dioxide |
| CRD IV | Capital Requirements Directive |
| CRR | Capital Requirements Regulation |
| CSDDD | Corporate Sustainability Due Diligence Directive |
| CSR | Corporate social responsibility |
| CSRD | Corporate Sustainability Reporting Directive |
| EBA | European Banking Authority |
| ECB | European Central Bank |
| EIOPA | European Insurance and Occupational Pensions Authority |
| ESBS | Eurostat Structural Business Statistics |
| ESG | Environmental, social and governance |
| ESMA | European Securities and Markets Authority |
| FMPs | Financial market participants |
| FTE | Full-time equivalent |
| G-SII | Globally significantly important institution |
| GDPR | General Data Protection Regulation |
| GHG | Greenhouse gas |
| GRI | Global Reporting Initiative |
| GVS | Global value chain |
| IBIP | Insurance-based investment product |
| IDR | Investor Disclosure Regulation |

| Abbreviation | Description |
|---|---|
| IFRS | International Financial Reporting Standards |
| ILO | International Labour Organization |
| IORPs | Institutions for Occupational Retirement Provision |
| ISBB | International Sustainability Standards Board |
| ISCO | International Standard Classification of Occupations |
| KPI | Key performance indicator |
| LLC | Limited liability company |
| NACE | Nomenclature des Activités Économiques dans la Communauté Européenne (Nomenclature of Economic Activities) |
| NFRD | Non-Financial Reporting Directive (2014/95/EU) |
| NGO | Non-governmental organisation |
| O-SII | Other significantly important institution |
| OPEX | Other operating expenditures |
| PAI | Principal adverse impact |
| PEPP | Pan-European personal pension product |
| PIE | Public interest entity |
| SASB | Sustainability Accounting Standards Board |
| SCM | Standard Costs Model |
| SDG | Sustainable Development Goal |
| SEC | US Securities and Exchange Commission |
| SEF | Social Entrepreneurship Fund |
| SFDR | Regulation on sustainability-related disclosures in the financial services sector |
| SME | Small and medium-sized enterprises |
| TCFD | Task Force on Climate-related Financial Disclosures |
| TEG | Technical Expert Group |
| UCITS | Undertaking for collective investment in transferable securities |
| VECA | Venture capital fund |

# ANNEX 1. IDENTIFICATION OF UNDERTAKINGS IN THE VALUE CHAIN

A number of ESRS require undertakings falling within the scope of the CSRD to disclose information concerning the sustainability matters of undertakings that are part of their value chain, even if these undertakings do not fall directly within the scope of the CSRD themselves (the so-called trickle-down effect), which could be the case for non-listed SMEs. Therefore, an estimation of the number of undertakings that are part of the value chain of undertakings falling within the scope of the CSRD was conducted, in order to then calculate the costs arising from such requirements. Indeed, estimations are required as most undertakings do not publish a list of the undertakings in their value chain, nor do the available databases provide this information. This annex provides the detailed methodology adopted to estimate the number of undertakings in the value chain.

### *Number of SMEs in the value chain*

Estimating the number of affected SMEs is complicated for several reasons. First, most non-listed SMEs do not disclose the list of undertakings in their value chain. Simultaneously, there is no undertaking-level trade-flow database that would allow the mapping of existing value chains. Second, value chains vary across sectors. For example, the manufacturing value chain would typically include more stages and actors compared to the financial services value chain, due to the different nature of final product (good v service). Third, value chains differ across sectors, which challenges attempts to generalise the value chains for large undertakings. Each value chain is unique and depends on many factors (corporate strategy, country, size, ownership, etc.).

To date, there is no literature on estimating the number of EU SMEs that are part of a value chain. The closest methodological approach to mapping global value chains (GVCs) was developed by Todeva and Rakhmatullin (2016). Their paper, prepared for the Joint Research Centre of the European Commission, provides the most detailed guidance thus far on mapping GVCs using company-level data. The authors rely on the Orbis database for top-down GVC mapping of an established industry sector. In particular, they study the biopharma industry. However, their approach can be used to map the model value chain for all sectors. This paper follows a similar approach in order to identify the number of EU SMEs in value chains.

The methodology developed by Todeva and Rakhmatullin models the GVC for a selected sector based on two main assumptions:

- The market structure of the multinational enterprise (MNE) is representative of the typical GVC in a selected sector due to its multiproduct and multi-technology nature.
- Diversification of production along the value chain happens predominately among large and very large firms.

Their methodology consists of four main steps:

**Step 1:** identification of the core industry boundaries. These can be sector or technology specific depending on the area of interest.

**Step 2:** construction of the comprehensive company-level dataset covering all enterprises within the identified industry boundaries.

**Step 3:** categorisation of enterprises in core value groups through clustering analysis of large and very large enterprises that are part of MNEs.

**Step 4:** visualisation of the industry value chains through network analysis.

This paper uses an approach inspired by Todeva and Rakhmatullin, but there are several prominent differences. First, EU-based vertically integrated groups (VIGs) are analysed, instead of focusing only

on MNEs. This allow the scope to be broadened to different sectors, while preserving the logic that VIGs can be used to identify typical value chains. Second, diversification of the production along the value chain is assumed to happen among small, medium and large undertakings, rather than only large undertakings. This is necessary to align the focus of the model to the needs of this report. Micro undertakings are omitted, assuming that they rarely form part of the GVCs that will be consulted by preparers.

The estimation of the number of SMEs in the value chain is based on company-level data. The database used is the same as that which estimated the number of undertakings in the scope of the NFRD, CSDR and other non-financial reporting regulations (CEPS, 2021). This database can be used to determine the total number of undertakings and their financials (total assets, turnover and number of employees) for various subgroups considered for the analysis (listed v non-listed, part of a group or standalone, undertakings already in the scope of the NFRD v those in the scope of the CSRD).

This paper's methodology to identify the affected SMEs comprises four steps:

**Step 1**: **identification of representative EU vertically integrated groups.** While it is impossible to identify all VIGs, a representative sample is constructed based on the EU Industrial R&D Investment Scoreboard of enterprises that invest the most in R&D. These undertakings are representative of VIGs, as vertical integration is characterised by high levels of R&D investment (Lee, 1994). Furthermore, sector K (financial and insurance activities) is excluded[42] due to the overlap with the SFDR provisions. This is because under the ESRS, large parts of value chain reporting for undertakings in the financial sector would come from the undertakings they invest in, as the latter are considered part of the value chain. This will overlap with the SFDR provisions, which already require undertakings in the financial sector to report sustainability information on their investments.

**Step 2: identification of typical characteristics of sampled EU VIGs**. Based on the company-level data on the undertakings with the most R&D investments, typical characteristics of the sampled EU VIGs are identified. Characteristics identified include the NACE sectors present in the VIG, and financials such as total assets, turnover, number of employees, geographical location, number of subsidiaries, etc. of both the parent and subsidiaries.

**Step 3: identification of undertakings in value chain of large undertakings**. The typical characteristics of the sampled VIGs identified in the previous step are extrapolated for the large undertakings falling within the scope of the CSRD and transposed onto the entire population of EU undertakings to determine the share of turnover of undertakings in the value chain. This results in an extensive dataset of all undertakings active in the EU with a sub-sample of EU undertakings that could be part of a value chain.

**Step 4: estimation of the minimum and maximum number of SMEs in the value chain**. The typical characteristics of the sampled VIGs, such as the distance from the parent organisation, are used to determine the sequence of the value chains. The minimum values are obtained assuming a short sequence of the value chains, and the maximum values are obtained assuming a full sequence of the value chains. The number of affected SMEs is estimated by relying on the average turnover per company of different size.

[42] Additionally, the dataset of the Top 1 000 R&D companies did not contain any companies in sectors T, U, M or R. Sectors T and U were excluded as they were not deemed to be relevant in the context of this study. Sectors M and R were approximated based on the data for sectors P and I respectively, due to similarities in the underlying activities.

The methodology described above was complemented by a sensitivity analysis that tested different scenarios:

**Baseline scenario** estimated the number of affected SMEs based on the assumption that preparers will reach out to all tiers within their value chain. Additionally, the value chains were modelled based on the company structure of groups including subsidiaries of all sizes.

**Optimal scenario** estimated the number of affected SMEs based on the assumption that preparers will reach out to all tiers within their value chain. Additionally, the value chains were modelled based on the company structure of groups including only SME subsidiaries.

**Scenario 1** estimated the number of affected SMEs based on the assumption that preparers will reach out only to the first tier within their value chain. Additionally, the value chains were modelled based on the company structure of groups including only SME subsidiaries.

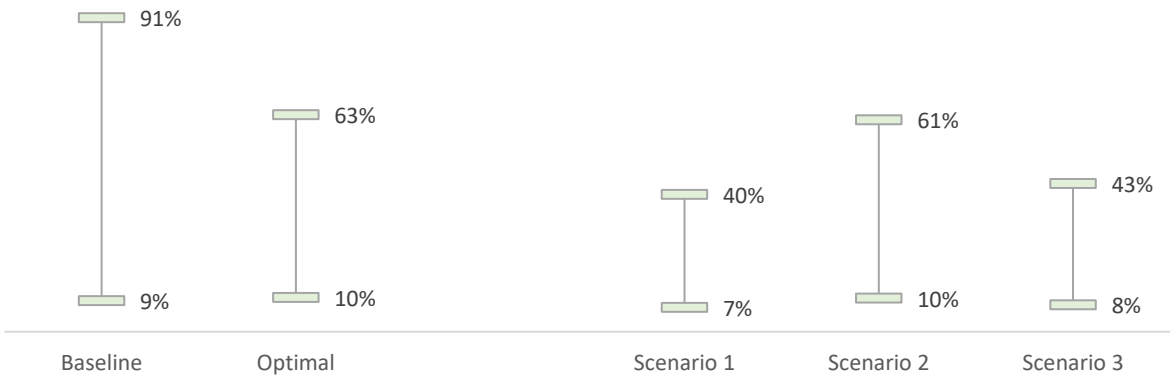
**Scenario 2** estimated the number of affected SMEs based on the assumption that preparers will reach out only up to the fifth tier of their value chain. Additionally, the value chains were modelled based on the company structure of groups including only SME subsidiaries.

**Scenario 3** estimated the number of affected SMEs based on the assumption that preparers will reach out only to undertakings upstream in their value chain. This means that downstream sectors such as wholesale and retail; transportation and storage; and professional, scientific and technical services were not considered.

As expected, the baseline scenario results in the largest range of affected SMEs. Between 9% and 91% of all EU SMEs would be considered affected according to the baseline scenario (see Figure A.1). Under the optimal scenario the maximum number of affected SMEs is reduced by almost one third – to 63%. Assumptions underlying this scenario are the most plausible given the first set of draft ESRS. Therefore the output of the optimal scenario was used in the estimation of the trickle-down effect.

If large undertakings only reach out to the first tier in their value chain, the number of affected SMEs would further decrease, ranging from 7% to 40% of all EU SMEs. In turn, limiting the number of tiers to five would not produce a significant impact – the range of SMEs would remain almost the same as under the optional scenario. This is in line with the economic expectation that SMEs are usually the last point in the value chain, or in other words not many SMEs have long value chains of their own. Finally, considering only the upstream value chain would also reduce the range of affected undertakings.

*Figure A.1 Range of affected SMEs under different scenarios of the sensitivity analysis*




*Source:* CEPS (2022).

# ANNEX 2. ASSUMPTIONS ON COST-BENEFIT ANALYSIS OF XBRL TRANSLATION OF ESRS REPORTING

This annex details the methodology applied in the calculation of both costs and benefits that follow from translating sustainability (i.e. non-financial) reporting into the XBRL format. Cost estimates are based on a combination of input from a survey conducted amongst EU preparers (firms that will be required to disclose under the ESRS), interviews and desk research (see Table A.*1*).

Table A.1 Overview of cost and benefit components of the cost-benefit analysis

| Costs | Benefits |
|---|---|
| Licensing XBRL software | Time savings that follow from standardisation and machine-readability of sustainability reporting data |
| Training staff in translating sustainability reporting to the XBRL format according to ESRS | |
| Investing person hours in translating sustainability reporting into XBRL | |

*Source:* CEPS (2022).

### *Costs of XBRL translation*

First, the costs related to changing from a regular sustainability reporting format (e.g. PDF) to standardised XBRL reporting are estimated. The steps taken in completing this estimation are as follows:

1. First, the cost of XBRL software is estimated. Based on survey input, 94% of preparers expect to opt for paid XBRL software. The cost of such software is estimated to be EUR 3 000, based on interview input.
2. Second, the cost of training staff in the use of XBRL to report in the ESRS format is estimated. Per preparer, one employee is expected to be trained in the use of XBRL in the ESRS format. This person is expected to receive eight hours of training, provided by a trainer well versed in both the use of XBRL and the specifics of the XBRL format used in the ESRS.
3. Third, the person hours spent on translating the sustainability reporting into XBRL are estimated. For the three levels of detail (1 to 3), the hours required are estimated to be 7.2, 12.8 and 19.2. These estimates are based on survey input. The cost of a person hour is assumed to be EUR 36.4, according to Eurostat data[43].
4. Fourth, the previous estimates are combined to find the total cost of XBRL reporting per undertaking. Consequently, the total cost per undertaking is translated into total EU cost by multiplying the average cost per undertaking by the number of EU undertakings required to disclose (i.e. EU preparers).

The costs are broken down into one-off costs and recurring costs. Recurring costs are further broken down into own (i.e. internal) and external recurring costs. One-off costs consist solely of training costs, given that once the training investment is made, the knowledge is present in-house and will not recur.

[43] Retrieved from Eurostat (EUR 29.1), dataset *Labour cost levels by NACE Rev. 2 activity [LC_LCI_LEV__custom_3289815]* on 1 September 2022 and multiplied by 1.2 to account for overhead costs.

Recurring costs consist of licensing and person-hour costs. Licensing costs are recurring since the licence for the XBRL software is paid on a yearly basis. Person-hour costs are recurring since sustainability reporting is done on an annual basis, and the person hours required to translate into XBRL therefore recur annually as well. Licensing costs are considered external recurring costs, while the person-hour costs are considered own recurring costs.

The last part of the costs exercise concerns the estimation of incremental costs. Incremental costs are those costs that follow directly from the new XBRL reporting requirements, and were not incurred before. For example, a company that already pays for XBRL software (e.g. for purposes other than XBRL reporting in the ESRS context) incurs the cost for the software in general, but this will not be an incremental cost since it was already incurred before the introduction of the XBRL reporting requirement. Based on the survey input, a quarter of the undertakings concerned do not license XBRL software and will thus incur the incremental cost of licensing XBRL software.

The cost of training staff in the use of XBRL in the ESRS context and the person hours required annually to report in XBRL along ESRS are considered incremental for all undertakings concerned. This follows from the assumption that no undertaking currently reports in XBRL along the ESRS that have yet to be finalised, and that these two costs are therefore incremental for all undertakings concerned.

For all splits, i.e. one-off, recurring, own, internal and incremental, EU totals are calculated by multiplying the undertaking average by the number of undertakings (47 676) concerned.

### *Cost savings of XBRL translation*

The second step in the discussion of the methodology is the cost savings that a shift to XBRL reporting enables. Before diving into the details of the benefit estimation, it is important to point out the assumed beneficiaries of XBRL reporting.

The estimation assumes that the benefits of XBRL reporting accrue to ESG rating providers. This follows from the assumption that ESG rating providers are currently the foremost users of sustainability reporting data. They will therefore benefit from efficiency gains in the collection and analysis of the sustainability data that a shift towards XBRL reporting facilitates. The costs they incur in collecting and analysing sustainability data will decrease. The decrease, as will be shown, is however limited. This follows in the first place from the fact that data collection and analysis are only part of the costs that ESG rating providers incur, and that while the benefits of XBRL reporting are tangible, they do not remove or even halve those costs. As the cost benefits of XBRL reporting are therefore modest for ESG rating providers, they are not assumed to price through the cost savings to their customers, and cost savings (benefits) therefore accrue solely to ESG rating providers.

Once implemented, new use cases of XBRL-reported sustainability data may be discovered, and new users of that data may arise. Logically, the benefits of reporting in XBRL increase with number of uses and users. The current estimation should therefore be treated as a minimum, seeing that the potential benefits can be far greater, but cannot be estimated at this point in time.

The steps taken in estimating the benefits of reporting sustainability data in XBRL format are as follows:

1. First, estimates for the global ESG data market are found, specifically those of Opimas research, which states that total global spending on ESG data was USD 782 million in 2021 (EUR 616 million at 2021 exchange rates[44]).

[44] USD/EUR = 1.18 (2021 average according to Eurostat).

2. Second, the total global costs incurred by ESG rating providers are calculated. A profit margin of 20% is assumed on sustainability ratings activities[45]. As such, total costs incurred by ESG rating providers are EUR 492 million.

3. Third, the share of costs attributable to reporting on the activities of EU firms is estimated. The share of EU firms of total firms on which ESG data is reported is assumed to be 17%[46]. Total costs that follow from reporting on EU firms are therefore EUR 84 million.

4. Fourth, the average cost per ESG rating provider is estimated. Assuming that all undertakings that collect data on EU firms are also present in the EU, and that the number of ESG rating providers (or similarly, ESG data providers) in the EU is 59[47], the average cost per undertaking is EUR 1.4 million.

5. Lastly, average savings per undertaking are calculated by applying a cost saving of 5% for level 1 detail, 7% for level 2 detail and 8% for level 3 detail. These percentages are based on survey results, interviews and desk research. The marginal gains decrease as the level of detail increases, especially as level 3 detail includes information that is currently not necessarily used by ESG rating providers and therefore would not reduce their current costs as much. In the future, new uses of level 3 detail data may arise, and further benefits may flow from that. The cost savings per firm per level of detail are specified in the table below (see Table A.2).

Table A.2 Average cost savings per undertaking (EUR)

| Average cost savings per undertaking per level of detail (EUR thousand) | |
|---|---|
| **Level 1** | 70 000 |
| **Level 2** | 97 000 |
| **Level 3** | 111 000 |

*Source:* CEPS (2022).

From these assumptions and sources, the undertaking- and EU-level costs are calculated. Unlike for costs, the benefits are not further divided into one-off, recurring or incremental, as they are all recurring and entirely incremental.

[45] MSCI, the largest ESG rating provider, notes a 20% profit margin on its sustainability activities in its 2021 annual report (page 5).

[46] For MSCI, EU firms make up 15% to 20% of its indices. Refinitiv, another big ESG rating provider, states that EU firms account for 18% of firms on which it reports ESG data.

[47] As reported by ESMA (2022).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