EU Newsletter #2 Sustainability Reporting

March 2022

This is the second publication of our Sustainability Reporting Newsletter. We believe this will help you drive your sustainability agenda forward.

2021 could be called the year of sustainability reporting and the trend has accelerated in 2022. Sustainability regulations are gradually coming into force, starting from the 2021 reporting period (Taxonomy and SFDR). Preliminary prototypes on the European Sustainability Reporting Standards (ESRS) were published by EFRAG under CSRD Directive in the first months of 2022. The remainder of 2022 should set the ground for the SEC requirements on climate disclosures. There's also an expectation that the ISSB will issue its first standards by the end of 2022.

This means that, starting 2025, the new regulations will apply to approximately 49 000 businesses across the EU, including non-listed companies.

Companies still have some time to get their sustainability reporting ready, particularly in view of the more demanding reporting requirements.

Enjoy your reading

Olivier Schérer
Partner PwC

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Agenda

Editorial

The growing awareness of the climate emergency and stakeholders' increased sensitivity to environmental and social issues have called into question the relevance and viability of our economic models. On 28 February, the Intergovernmental Panel on Climate Change (IPCC) has published its latest report entitled "Climate Change 2022: Impacts, Adaptation and Vulnerability" (--> here) which highlights that effects of climate change are more severe than previously thought.

It is clear that a fundamental environmental and social transformation must be achieved over the next decade, and sustainability reporting has a central role to play in the transition at hand. Stakeholders across the board agree on the need to develop sustainability reporting standards that are of equal quality to financial reporting standards. Given the various sustainability reporting initiatives that have been launched, a convergence of reporting standards will be critical going forward.

A necessary convergence of sustainability reporting standards drawing on Europe's experience and integrating its specificities

While global standardisation certainly has many advantages for companies, particularly international groups, Europe has an imperative to retain its sovereignty in such a strategic area for the Union's economy and its companies.

International standards are needed because sustainability issues are global. Companies need consistency – and therefore a common set of sustainability reporting standards – to operate internationally. The ISSB's initiative aims to develop global standards, in the perspective of financial materiality of sustainability risks, including climate risks, that could affect investors.

Meeting the challenges of transition set out by the European Green Deal does, however, require implementing regional public policies, including sector-based regulations.

Sustainability reporting needs to be aligned with these regulations so that companies can communicate with stakeholders about their related levels of compliance and performance. It should be noted that these regulations are highly technical and reflect the ambitions and priorities of the various authorities.

This means that compatible standards are needed at the global and European levels to ensure both international consistency and alignment with regional public policies. In particular, this requires defining common concepts, taking account differing priorities and establishing equivalences that allow for interoperability among standards.

Adapting governance and resources to the challenge of interoperability

Working together to build interoperable standards is the main challenge. Given its ambitions and the significance of its existing and draft regulations, Europe must be in a position to contribute substantially to international standards. The right conditions must be created to make this happen, in particular through a governance system and an organisational model that foster interactive collaboration both at the operational and the decision-making levels.

The process of standardising sustainability reporting also requires mobilising financial and human resources to meet the ambition of developing internationally recognised standards of high quality. It is essential for Europe to allocate resources that are compatible with its targets and comparable to the resources that will be implemented at the international level.

CSRD : current status of the political negotiations

Overview

With its comprehensive proposal for the Corporate Sustainability Reporting Directive (CSRD), the European Commission (EC) is aiming for a paradigm shift in sustainability reporting. The political negotiations have been going on for some time and are now entering the decisive phase, as an agreement at European level is being sought. The proposed amendments concern, among other things, the timeline and controversial topics such as the scope of application, international consistency of reporting standards and external assurance requirements.

Upcoming trilogue negotiations

Since the EC published its legislative CSRD proposal in April 2021, the European Parliament and the Council of the EU have been working on numerous amendments. Even though work on the proposal is proceeding, the parties are still far from each other on several key points. Trilogue negotiations between the Parliament, the Council and the EC are envisaged after the Parliament and the Council each reach an agreement with an aim of reaching a consensus during the French presidency of the Council by June 2022 at the latest.

The coming months will thus be marked by political negotiations with major implications for corporate reporting in the EU. The main challenge for companies at the moment is to analyse and understand what these implications mean for them.

Timeline

Regarding the timeline, there is currently broad support for a postponement. The EC's proposal provides for first-time application for financial years beginning on or after 1.1.2023 (with SME-reporting starting three years later). This is an ambitious timeline, given that sustainability reporting is to be based on Sustainability Reporting Standards, which EFRAG is currently tasked with developing. While there seems to be an approval for a general one-year postponement in the Parliament, the Council supports a phased approach, extending the timeline by one year for large listed undertakings and even two years for non-listed undertakings and groups.

A later first-time application would give companies more time to implement the necessary process and system adjustments – a necessary foundation for bringing sustainability reporting on a par with financial reporting.

Scope of application

A very controversial issue on which there is currently no sign of agreement is the scope of application. The EC's proposal provides that the new sustainability reporting requirements are mandatory for all undertakings listed on EU-regulated markets (including SMEs, but excluding micro-undertakings) and for all large undertakings and large groups. The counterproposals comprise:

- Expansion of the scope to companies established outside the EU but operating in the EU in order to create a level playing field for EU companies. However, this proposal raises concerns.
- Regarding proportionality for SMEs, views are diverging. On the one hand there is support for

protecting them from an excessive administrative burden. On the other hand, there is a risk that companies outside the CSRD scope might see their access to market funding limited due to investors' increased focus on ESG. Consequently, proposals range from the expansion of the scope to non-listed SMEs active in so-called high-risk sectors to its reduction by removing any reporting requirements for SMEs (even if listed).The Council wants to further clarify how the standard for SMEs will be simpler.

- Removing the exemptions for subsidiaries if they are included in the parent entity's consolidated sustainability report. This is a crucial point for many companies. Some stakeholders are in favour of such a removal, in particular if the subsidiary is a PIE or if the parent entity is outside the EU.

International consistency of reporting standards

Many stakeholders demand international consistency of sustainability standards. The focus here is on consistency with those reporting standards that are being developed by the newly created International Sustainability Standards Board (ISSB) under the umbrella of the IFRS Foundation. At the same time, European reporting standards are expected to integrate the double materiality principle and to enable investors to assess compliance with the SFDR and the EU Taxonomy. Given this background, Commissioner Mairead McGuinness recently stated that international standards will be a "floor, not a ceiling". On this matter, both Council and Parliament have maintained the original proposal, with the reporting standards to be adopted with a delegated regulation, whereby the Commission must "take into account developments with regard to international standards".

External assurance

The EC's proposal provides for an obligation to have the content of the new sustainability report subject to an assurance engagement performed by the statutory auditor (initially with limited assurance). This was meant to improve the reliability of the information and to foster interconnectivity of financial and sustainability reporting going forward. Member States were given the option to allow other providers to assure sustainability reporting.

One of the controversial issues in this respect is whether to prohibit the statutory auditor from performing a combined audit of financial and sustainability reporting. At present, a majority in Parliament seems to favor prohibiting the statutory auditor from providing assurance over the sustainability reporting. The company would therefore have to engage a different auditor or an independent conformity assessment body.

The Council supports a clarification that Member States may allow assurance over sustainability reporting to be provided by a different auditor than the one of the financial statements. Furthermore, the Council favors the idea of creating an "opt-in" regime, whereby not all auditors become sustainability auditors.

Statutory auditors already accredited are automatically accredited to provide assurance on sustainability reporting, provided they acquire the knowledge through their continuing education. Future auditors instead have to opt in, i.e., decide whether to accredit for providing sustainability assurance, and thus not be subject to sustainability-related training requirements.

The Council also proposes that six years after the entry into force of the CSRD, the transition to an assurance engagement with reasonable assurance should take place.

Next steps

- Finalisation of subject to approval by the Parliament and the Council, which is expected during the French presidency of the Council by June 2022.
- Followed by the transposition of the CSRD into national law by EU Member States and the adoption of the reporting standards by the EC.
- First-time application currently expected for financial years starting 1.1.2024 at the earliest.

Find out more

- Council: compromise text on the CSRD proposal as of 18.2.2022 (--> here); confirmed by the Council during its meeting on 24.2.2022 (--> here)
- Committee on Legal Affairs: draft report on the CSRD proposal as of 16.11.2021 (--> here)
- Amendments to the draft report of the JURI as of 14.12.2021 (--> here and --> here)
- Final opinions of the European Parliament's Committees: ECON (--> here), ENVI (--> here), DEVE (--> here), EMPL (--> here), ITRE (--> here)

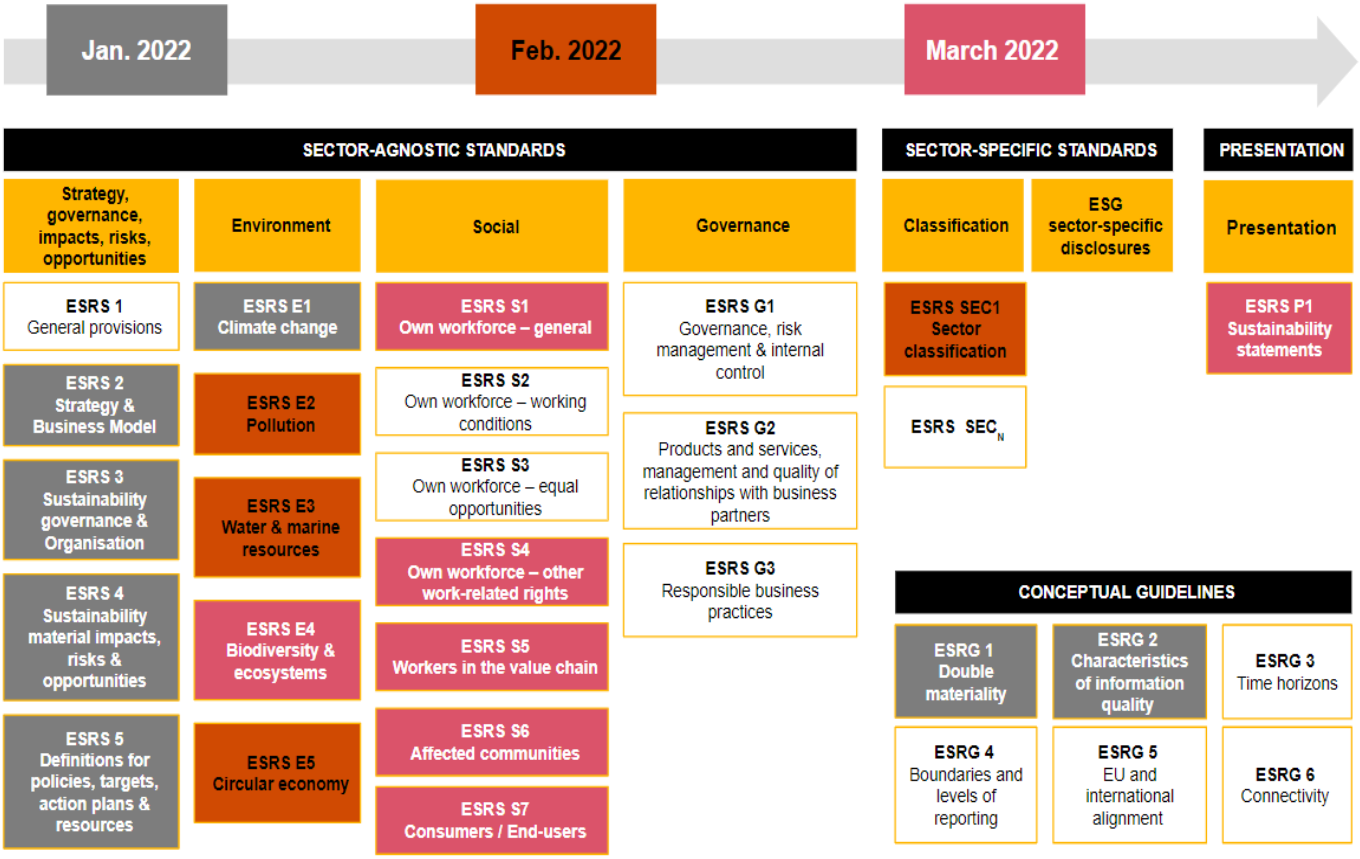
Update on the Standard Setting Process

EFRAG Update

EFRAG recently published batches of Working Papers of the European Sustainability Reporting Standards. Batch 1 was published on 20 January 2022, including a cover note and seven standards, while Batch 2 was published on 18 February 2022 including a cover note and three standards. Additional working papers respectively on ESRS SEC1 Sector classification standard and mostly social-related standards were also published at the end of February 2022 and early March 2022. Publications are available on the EFRAG's website (--> here)

By publishing the working papers EFRAG is following its tradition of being transparent and informative about the actual status of its work. At the same time, they emphasise that the published working papers are going to be subject to an extensive review process and as a result might be subject to changes relating to structure and content which will not be open to public consultation.

Following the publication, a structured review process has been implemented consisting of an internal review by the Project Task Force, a review by the Expert Working Groups and a financial consensus discussion before the draft standards will be handed over to the EC. In parallel to the review process, the Project Task Force is finalising the remaining working papers that will be published in the upcoming weeks.



The proposed disclosure requirements provide valuable insights for the stakeholder but will also be an immense challenge for the preparer regarding data availability, data sources and the respective processes.

The cross-cutting standards (ESRS 1 to 5) address disclosures on matters that are crucial to the relationship between the company's sustainability matters and its strategy and business model, its governance and organisation, and its materiality assessment.

The conceptual guidelines are disclosed within ESRG 1 and ESRG 2. ESRG 1 "Double materiality" provides guidance on the double materiality assessment considering impact and financial materiality. ESRG 2 "Characteristics of information quality" explains the requirements of comparability, verifiability, and understandability as well as the definition of forward-looking and retrospective information, and the Tone-of-the-top concept.

ESRS E1 "Climate change" has been updated in comparison to the version published on 24 September 2021. The disclosure requirements are challenging and in addition to scopes 1, 2 and 3's greenhouse gas emissions and its intensity, they reflect the requirements of the EU Taxonomy with regard to climate mitigation and climate adaptation, as well as financial exposures to physical and transition risks.

For more details, please refer to the articles "EFRAG's updated climate prototype standard" (--> here) and "EFRAG's cross cutting standards and conceptual guidelines" (--> here).

ESRS E2, E3, E4 and E5 are all sector-agnostic environmental standards. The disclosure requirements contain challenging subject-matter disclosures within the fields of pollution, water and marine resources, biodiversity and ecosystems and circular economy. The standards are structured in a manner that requires the reporter to incorporate the cross-cutting standards and conceptual guidelines from batch 1 into each material area. In addition, they reflect the requirements of the EU Taxonomy with regard to the subject-matter as well as financial exposures to physical and transition risks.

ESRS SEC 1 "Sector classification" defines 14 sector groups and 40 sectors. The sector classification standard was created by identifying, mapping and analysing the NACE classification system together with reference to additional economic activities as described in the EU-Taxonomy. This was done to create a comprehensive and pragmatic sector classification. Each sector will have an individual standard with specific sector related disclosure requirements and will come in addition to the ESRS agnostic standards.

ESRS P1 "Sustainability Statements" provides the basis for the presentation of sustainability reporting within the management report in accordance with article 19a and 29a of the CSRD.

ESRS S1 "Own workforce – general" sets out the disclosure requirements for undertakings to report on how they affect their own workforce - both positive and negative impacts - with regard to working conditions, equal opportunities and other work-related rights. It is related to ESRS S4 "Own Workforce - Other Work-Related Rights" which is specific to work-related rights, (e.g., collective bargaining and freedom of association, social dialogue, freedom from child labour, privacy at work…). Disclosures for upstream and downstream 'value chain workers' are covered in ESRS S5.

Disclosure requirements for undertakings to report on both how they affect local communities – in both positive and negative ways – through their own operations and their upstream or downstream value chain and on business risks and opportunities related to their impacts and dependencies are covered in ESRS S6 for local communities and ESRS S7 for consumers and end-users.

Besides the standard setting process, on 10 March 2022 EFRAG announced the composition of its Sustainability Reporting Board, which is is responsible for all sustainability reporting positions of EFRAG including technical advice to the EC on draft EU Sustainability Reporting Standards and amendments to the Standards. The Chair of the EFRAG Sustainability Reporting Board will be appointed following the nomination by the EC, a process that is expected to be finalised before the summer.

On 10 March 2022, EFRAG also announced the next steps to complete its governance reform by the target date of end of March:

- Publication of the final due process procedures on EU Sustainability Reporting Standard Setting and the related feedback statement
- Appointment of EFRAG Sustainability Reporting TEG
- Recruitment of technical staff to support the sustainability reporting standard-setting work.

ISSB Update

In November 2021, the IFRS Foundation announced the establishment of the ISSB, and also released two prototype standards - one on the general requirements for disclosure of sustainability-related information, and the other on climate-related information. Read our In depth publication (--> here) which includes a summary of the prototype standards.
The plan is still to consult on the Exposure Drafts in the first half of 2022, with a view to finalise the sustainability standards by the end of 2022. This would be in parallel to the work of EFRAG on European sustainability standards.

SEC Update

The US Securities and Exchange Commission (SEC) is currently considering proposed rule amendments to enhance disclosures regarding issuers' climate-related risks and opportunities. Originally expected in October 2021, the SEC commissioners and staff have acknowledged the delay in the proposal timing and, while the revised target was 'late 2021/early 2022', a proposal could be expected late this quarter or early next quarter. The delay is notably due to discussions about including reporting on scope 3 emissions.
Public statements by SEC Chair, Gary Gensler, about the proposal have mentioned the following:

- Climate disclosures are likely to be mandatory.
- Climate disclosures might be required within Form 10-K and for FPI.
- Both qualitative and quantitative disclosures might be required.
- Certain industry-specific disclosures might be required.
- Companies might need to support advertised environmental claims.
- Fund names such as 'green' or 'low-carbon' might be subject to new regulation.
- Rules might be 'inspired by' the Task Force on Climate-Related Financial Disclosures (TCFD) Framework.

While working on new climate disclosure requirements, the SEC's Division of Corporation Finance has reiterated the importance of its existing 2010 interpretative guidance regarding disclosure related to climate change (--> here). In September 2021, it also published a sample letter of staff comments that the Division might issue to companies regarding climate-related disclosures (--> here).

Next steps

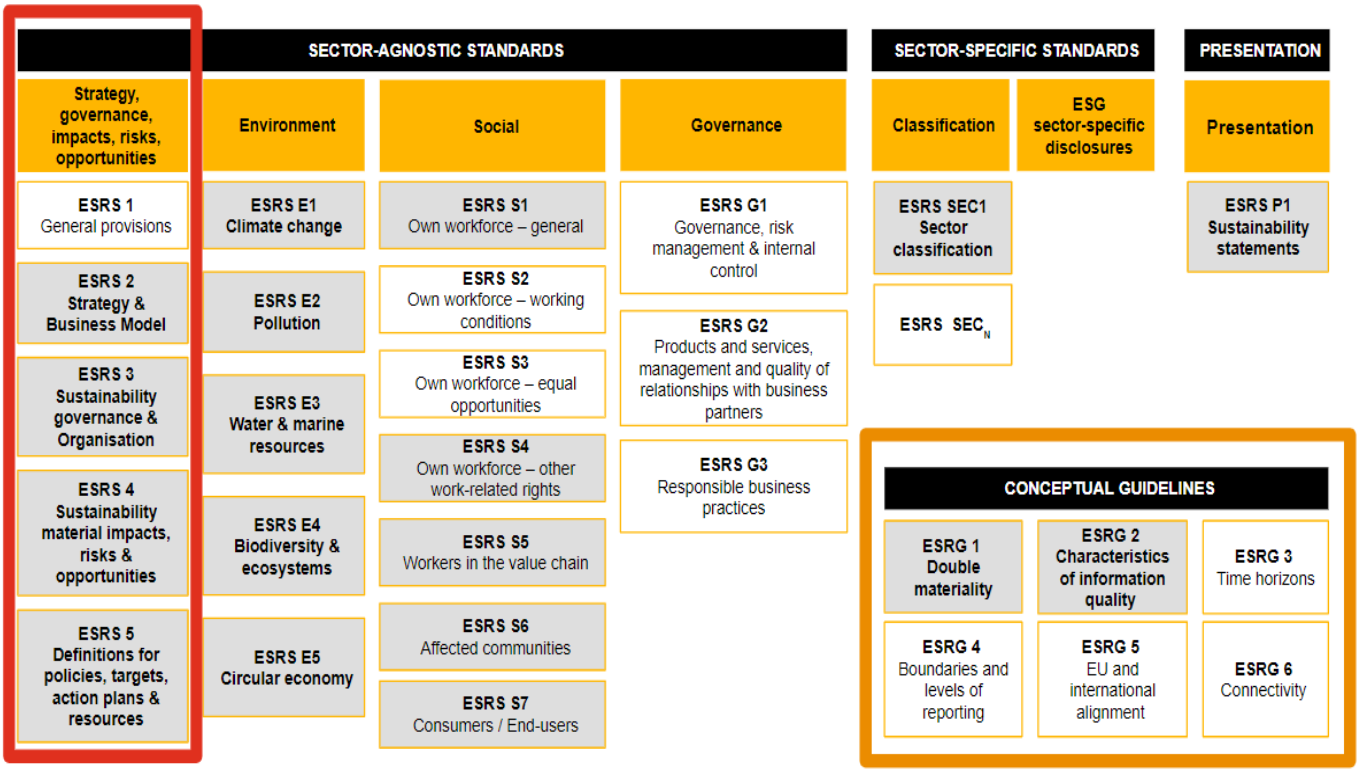
- Publication of remaining EFRAG prototypes by the end of March 2022
- EFRAG public consultations (all sustainability prototypes) from mid-May to end of July 2022

EFRAG – Cross-cutting standards and conceptual guidelines

EFRAG has planned to publish 5 cross cutting standards named ESRS 1 to 5 and 6 conceptual guidelines named ESRG 1 to 6.

Among these, it has already published in its batch 1:

- 4 cross-cutting standards covering Strategy and business model; Sustainability governance and organisation; Sustainability material impacts, risks and opportunities; Definitions for policies, targets, action plans and resources.
- 2 conceptual guidelines, on double materiality and characteristics of information quality.



Cross-cutting standards

The cross-cutting standards address disclosures on matters that are key to the relationship between the company's sustainability matters and its strategy, business model, governance and organisation. They describe how sustainability issues influence an undertaking's activity, and its governance and management from a general standpoint. The cross-cutting standards are intended to address disclosures on matters that are critical from an undertaking's overall perspective to fully understand:

- ESRS 1 General provisions (not yet published) aims to address general disclosure requirements of sustainability statements. It can be compared to/ is inspired by IAS 1 Presentation of Financial Statements, which sets out the overall requirements for, and standardises the presentation of financial statements. It will certainly

include the definition for policies, targets, action/transition plans and resources (ESRS 5) which specifies the key aspects to disclose:

(i) when the undertaking is required by other (cross-cutting or topical) ESRS to describe policies, targets, action plans and resources in relation to sustainability matters and;

(ii) when the undertaking decides to describe policies, targets, action plans and resources in relation to entity specific sustainability matters.

- The relationship for the undertaking between sustainability matters and its strategy and business model(s) – see ESRS 2. This is intended, among other disclosure requirements, to include all disclosure requirements related to strategy and business model(s), even when related to specific topics such as climate and other ESG topics, to promote a full understanding of the relationship between sustainability matters and the strategy and business model of the undertaking from an overall perspective.
- The relationship for the undertaking between sustainability matters and its governance and organisation – see ESRS 3. The same logic as is used in ESRS 2 applies here.
- The materiality assessment performed by the undertaking under a double materiality approach (impact materiality and financial / risks and opportunities materiality) – see ESRS 4.

Conceptual guidelines

The conceptual guidelines are not considered as "standards" but they are intended to be tools for the standard setter for the elaboration of standards to ensure proper translation of concepts into standards. They will provide guidance on complex concepts: double materiality, characteristics of information, definition of forward-looking and retrospective information…Two conceptual guidelines (out of the six planned), on double materiality (ESRG 1) and characteristics of information quality (ESRG 2) have already been published.

Double materiality

Information on sustainability matters which is material from one or both of the following perspectives ('double materiality') should be included in the sustainability statements. As a reminder, the double-materiality perspective covers:

- Impact materiality: how an undertaking impacts sustainability matters

→ *information is material from an impact perspective if :*
  - *the undertaking is connected to actual or potential significant impact on people or the environment; and*
  - *is related to the sustainability topic over the short, medium or long term.*

→ *this includes impacts directly caused or contributed to by the undertaking and impacts which are otherwise directly linked to the undertaking's upstream and downstream value chain.*

- Financial materiality : how sustainability matters affect the undertaking's development, performance and position

→ *differs from the definition of materiality used in financial reporting*

→ *information is material from a financial perspective if it triggers financial effects on undertakings, i.e. generates risks or opportunities that influence or are likely to influence the future cash flows and therefore the enterprise value of the undertaking in the short, medium or long term but are not captured by financial reporting at the reporting date*.

The objective is to determine which sustainability topics or subtopics are material, and therefore appropriate disclosures need to be defined by the ESRS.

A sustainability topic or information is considered material if it is material from the impact perspective or from the financial perspective or from both of these two perspectives.

Different guidelines are proposed, especially:

- In the materiality assessment process equal importance should be given to impact materiality and financial materiality.
- The Board of the undertaking should identify sustainability topics and structure them before performing the materiality assessment.
- The materiality assessment process should ensure that impact on all affected stakeholders is taken into account and not only the needs of users. For each identified sustainability topic, the Board should identify the relevant stakeholders and users and their information needs, as the basis for the process of deciding on the topic materiality and the development of related disclosure requirements.
- Materiality of a sustainability topic should be assessed over the whole value chain and over all time horizons.

Materiality will be the cornerstone of the future CSRD, which implies that its implementation must be reliable and relevant. The challenge will be to assess and explain both perspectives and this is not only a question of compliance, but it will also require a deep understanding and assessment of the undertaking, its activities and the "inside out & outside in" impacts.

Characteristics of information quality

This standards provides definitions, tools and processes related to the requested characteristics of the quality of sustainability information, in relation also to the nature of this information. Guidelines cover in particular:

- The fundamental qualities are relevance and faithful representation
- Comparability, verifiability and understandability are quality characteristics that enhance the usefulness of information that is both relevant and provides a faithful representation of what it purports to represent.
- The quality of information depends on the nature of the disclosed information which may justify particular attention to certain characteristics.
- It also explains the definition of forward-looking and retrospective information, qualitative & quantitative information, the Tone-of-the-top concept (i.e.. the members of the highest governance body are ultimately accountable for the quality of the information included in sustainability reporting), the cost constraint on useful sustainability information…

The conceptual guidelines are not official standards but are intended to be tools helping the standard setter to effectively translate concepts into standards. They can be used as a non-authoritative reference for the implementation of the standards.

EFRAG - Updated climate standard prototype

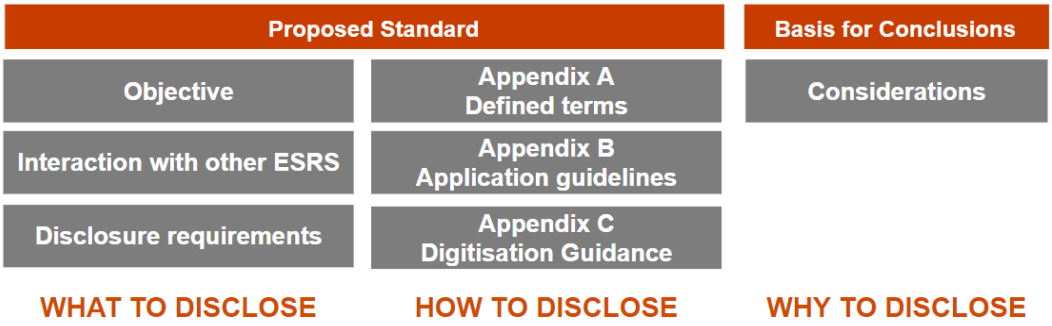
Background

EFRAG has been mandated by the EC to develop draft European Sustainability Reporting Standards (ESRS) within the framework of the CSRD proposal. On 20 January and 18 February 2022, EFRAG published working papers on the ESRS. These papers are not open to public consultation but will serve as work-in-progress documents leading to the exposure drafts to be submitted to a future public consultation.

The first batch of working papers published on 20 January 2022 includes an updated version of the climate standard prototype which was published by EFRAG in September 2021 (the last edition of our newsletter provided the first insights into the climate prototype --> here). It is clear that a certain priority was given to climate-related issues as the draft climate standard was the first sector-agnostic standard published by EFRAG. However, prototypes on other environmental considerations have already been published.

Overview

The updated working paper with the title "[Draft] European Sustainability Reporting Standard E1 Climate change" comprises 128 pages, is divided into three chapters and is accompanied by three appendices and the Basis for Conclusions. A similar structure will be followed for other draft standards:



- Disclosure Requirements provide detailed quantitative (data points) and qualitative disclosures related to climate change mitigation and climate change adaptation..
- Application Guidance describes how to apply the Disclosure Requirements, contains information relating to the calculation of metrics and provides templates for the disclosure. It has the same authority as the Disclosure Requirements and is an integral part of the proposed draft climate standard.
- Digitisation Guidance is an integral part of the proposed draft climate standard and describes the instructions for digital tagging. The instructions are currently being developed.
- Basis for Conclusions accompanies but is not part of the draft climate standard. It summarises the considerations and references of the EFRAG Board in developing the contents of the draft climate standard.

Key elements

- **Structure**: The draft provides a comprehensive structure for the presentation of climate-related information (what, how and why to disclose).
- **Materiality**: The draft is material to all undertakings regardless of their sector.
- **Layer of reporting**: The draft covers sector-agnostic Disclosure Requirements. Sector-specific Disclosure Requirements are developed separately in accordance with the classification included in ESRS SEC 1.
- **Quantitative and qualitative disclosures**: The draft comprises in total 24 sets of disclosures (including one Disclosure Requirement dedicated to EU Taxonomy), from which four are optional disclosures.
- **Comprehensive and detailed disclosures**: In general, the draft features in general a high level of detail and contains a number of potentially challenging Disclosures Requirements, e.g. on Scope 3 Greenhouse Gas (GHG) Emissions and its intensity, on carbon budgets as well as on the resilience analysis along the supply chain. Preparing quantitative climate scenario analysis could be a challenging area for preparers as well, considering that the assumptions used in the scenarios are based on estimates and judgements about remote but potentially very significant climate risks over the short, medium, and long term.

What's new compared to the previous prototype?

Mandatory and optional disclosures

The updated prototype makes a clearer distinction between mandatory and optional Disclosures Requirements. The four optional disclosures concern performance measurement, in particular:

- DR 17: GHG removals
- DR 18: Financing GHG mitigation projects outside of the undertaking's value chain
- DR 19: Avoided GHG emissions from products and services
- DR 23: Financial opportunities related to climate change mitigation or adaptation other than the EU Taxonomy

Negative declaration

The draft allows a negative declaration (in the sense of a comply or explain) for a few specific Disclosure Requirements. For example, if an undertaking has adopted a GHG emission target it should be aligned with the Paris Agreement targets (limiting global warming to well below 2°C) and if not, it shall explain why the target was not adopted.

If the undertaking has not adopted climate-related targets: "it shall disclose a) if and when such targets will be adopted; or b) reasons why there is no plan to adopt such targets; c) how progress is measured without specific climate-related targets; and d) the progress made in terms of climate change mitigation and adaptation" (DR 8 Paragraph 43).

SFDR and EU Taxonomy

The draft refers to the requirements of the EU Taxonomy with respect to climate change mitigation and climate change adaptation objectives and to SFDR requirements for financial market participants. The undertaking may elect to locate the climate-related Taxonomy Disclosure Requirements as a Disclosure Requirement additional to the ones mandated by the standard. If the undertaking elects not to do so, it should disclose the location of the Taxonomy Disclosure Requirements by an appropriate cross-reference.

Interaction with other standards

The Disclosure Requirements shall be read in conjunction with the other four environment related sector-agnostic standards (ESRS E2-E5) and the cross-cutting standards regarding Strategy and business model (ESRS 2), Governance and organisation (ESRS 3), Impacts, risks and opportunities (ESRS 4) as well as Policies, targets, action plans and resources (ESRS 5).

Connectivity with financial reporting

The draft incorporates requirements for connectivity with financial reporting. For example, when disclosing its total GHG emissions per net turnover (GHG intensity) the undertaking shall disclose a reconciliation of the net turnover reference to the most relevant amount presented in the financial statements.

Deferral option

In order to ease the first-time application of the standard, undertakings may elect to defer by one year the application of some aspects of the following Disclosure Requirements:

- DR 2: Resilience of the strategy and business model
- DR 15: Scope 3 GHG emissions
- DR 16: Total GHG emissions
- DR 21: Financial exposure to physical risks
- DR 22: Financial exposure to transition risks

Zooming in on the Disclosure Requirements

The proposed draft climate standard provides a list of 23 detailed Disclosure Requirements, four of which are optional, and one Taxonomy Disclosure Requirement. As the first version of the climate prototype, the updated draft is based on the three reporting pillars, which are going to be the same for all Sustainability Standards - Strategy, Implementation and Performance measurement.

The **first pillar** covers "Strategy and business model", "Governance and organisation" and "Impacts, risks and opportunities" and provides **6 Disclosure Requirements:**

1	Strategy and business model	Governance and organisation	Impacts, risks and opportunities
	Disclosure Requirement 1: Transition plan in line with the Paris Agreement	**Disclosure Requirement 3:** Climate-related targets and performance indicators in relation to compensation schemes	**Disclosure Requirement 5:** Processes to identify material climate-related impacts, risks and opportunities
	Disclosure Requirement 2: Resilience of the strategy and business model to principal climate- related transition and physical risks	**Disclosure Requirement 4:** Internal carbon pricing schemes	**Disclosure Requirement 6:** Material climate-related impacts, risks and opportunities

The **second pillar** covers "Policies and targets" and "Action plans and resources" and provides **4 Disclosure Requirements:**

2	Policies and targets	Action plans and resources
	Disclosure Requirement 7: Policies implemented to manage climate change mitigation and adaptation	**Disclosure Requirement 9:** Climate change mitigation and adaptation action plans
	Disclosure Requirement 8: Measurable targets for climate change mitigation and adaptation	**Disclosure Requirement 10:** Resources allocated to climate change mitigation and adaptation actions plans

The **third pillar** covers "Performance measurement" and provides **13 Disclosure Requirements** and **one Taxonomy Disclosure Requirement:**

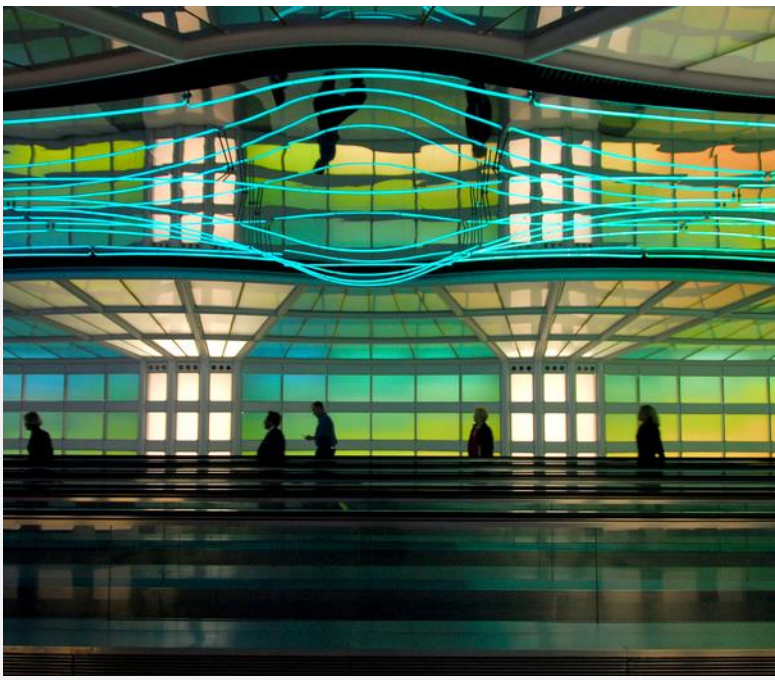
3	Performance measurement		
	Disclosure Requirement 11: Energy consumption & mix	Optional **Disclosure Requirement 17:** GHG removals	**Taxonomy Disclosure Requirements:** Taxonomy Regulation for climate change mitigation and climate change adaptation
	Disclosure Requirement 12: Energy intensity	Optional **Disclosure Requirement 18:** Financing GHG mitigation projects outside of the undertaking's value chain	**Disclosure Requirement 21:** Financial exposure to physical risks
	Disclosure Requirement 13: Scope 1 GHG emissions	Optional **Disclosure Requirement 19:** Avoided GHG emissions from products and services	**Disclosure Requirement 22:** Financial exposure to transition risks
	Disclosure Requirement 14: Scope 2 GHG emissions	**Disclosure Requirement 20:** GHG intensity	Optional **Disclosure Requirement 23:** Financial opportunities related to climate change mitigation or adaptation other than the Taxonomy Regulation
	Disclosure Requirement 15: Scope 3 GHG emissions		
	Disclosure Requirement 16: Total GHG emissions		

Impacts

The summaries included above are only highlights of the proposed draft climate standard. What is clear is how comprehensive and detailed the future climate standard will be. The proposed Disclosure Requirements are expected to provide valuable insights for stakeholders about the undertakings' climate-related disclosures. However, the ability of the undertaking to have the appropriate data available, and to identify the appropriate data sources and the relevant processes, will be very challenging for those preparing the reports.

Next steps

EFRAG is now gathering comments from expert groups and working closely with other clusters to finalise the current version of the prototype. A new version of the climate prototype will be published in March and public consultations are expected to start from mid-May 2022.



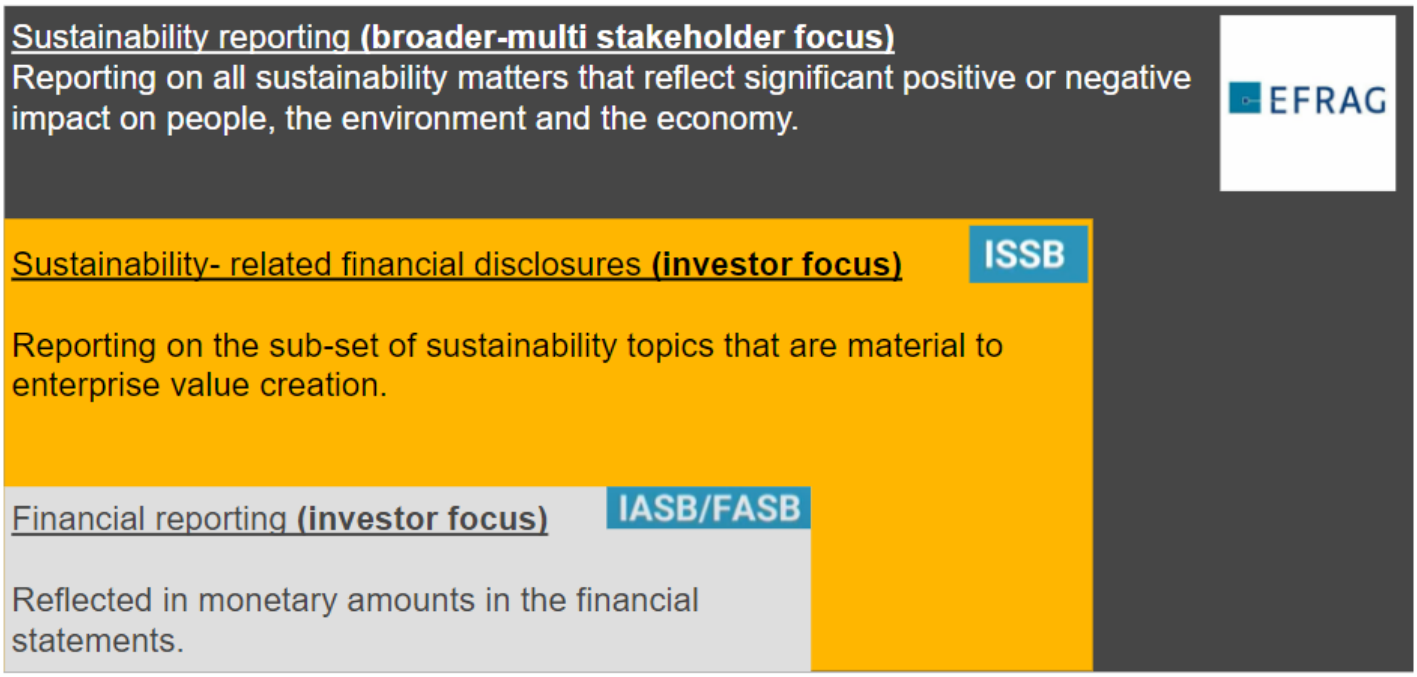
Comparison of EFRAG and ISSB climate prototype approaches

The process of standardising sustainability reporting is under way with a number of initiatives which are moving in this direction, most notably EFRAG and ISSB. There is a desire and a need for convergence. The EC has embarked on its bold plans to develop EU sustainability reporting standards via EFRAG. Internationally, The ISSB will do for sustainability reporting what the International Accounting Standards Board (IASB) does for financial reporting - develop standards for companies to report their performance to investors. Both will follow the same calendar, publishing the first set of standards by the end of 2022.

The key differences between EFRAG and ISSB climate prototypes are highlighted in this article.

Materiality : zooming in on ISSB and EFRAG approaches

Generally speaking, sustainability reporting is converging on a two-pillar structure. One pillar relates to strengthened financial reporting, focusing on companies' disclosures, addressing the financial implications of sustainability issues. This is where ISSB sits. In contrast, EFRAG has a broader "double materiality" mandate which means it will cover information of interest to stakeholders even if it is not of interest to investors.



Impacts in addition to Risks and Opportunities

- **EFRAG considers impacts in addition to risks & opportunities**. EFRAG considers the "inside-out" perspective in determining the impact of a company might have on the environment and on people, including impacts on their human rights. It only considers climate-related risks for the potential negative impact these would have on the company.
- ISSB considers only the "outside-in" perspective, following the TCFD approach which requires companies to consider climate-related risks and opportunities for a company.

Targets aligned with Paris Agreement Goal

- Under EFRAG, undertakings should fix their targets in accordance with EU regulation while undertakings under ISSB can fix their own targets, which they can choose to align with science-based targets or not .
- For example, EFRAG specified that GHG emissions targets shall be aligned with 2030 and 2050 EU targets and preferably set over five-year rolling periods.

Transparency on emissions and energy efficiency

- EFRAG requires disclosing Scope 3 emissions following GHG Protocol guidelines, while ISSB does not mention it.
- Under ISSB, locked-in emissions are more developed than the corresponding concept of legacy assets in IFRS CP §8 (b) and related stranded assets.
- EFRAG requires Energy consumption and mix, Energy and GHG emissions intensity per revenue.
- EFRAG requires more details on GHG emissions (EU ETS, market vs location, categories of scope 3, total, removals, offsets, avoided).

EU additional requirements

- EFRAG integrates EU requirements in its Climate Prototype, including Taxonomy-alignment ratios and SFDR metrics.
- ISSB's Climate Prototype does not refer to EU regulation, but rather adopt a modular approach, with countries complying with national regulations.

PwC Observation

The differences between EFRAG and ISSB's Climate Prototype are due to various CSRD requirements regarding double materiality, target alignment with the Paris Agreement and EU additional requirements such as Taxonomy or SFDR. Regarding Scope 3, it is not clear whether an undertaking shall include its Scope 3 emissions in the Net Zero Targets.

EU Taxonomy new developments

The EC adopted on 2 February 2022 a Complementary Delegated Act on climate change mitigation and adaptation covering certain gas and nuclear activities (--> here).

It also published two sets of FAQs in December 2021 (--> here) and February 2022 (--> here) designed to assist entities in preparing disclosures under Article 8 of the EU Taxonomy.

Finally, the final report on social taxonomy was issued on 28 February 2022 (--> here), an analysis will follow in our next issue.

Complementary delegated act

The Complementary Climate Delegated Act amends the Climate Delegated Act (--> here) and the Article 8 Delegated Act (--> here), both published in the EU Official Journal in December 2021.

Together with the Complementary Delegated Act, the EC also published:

- Annexes I and II detailing the technical screening criteria for nuclear energy and natural gas activities contributing to the climate mitigation objective (--> here) and to the climate adaptation objective (--> here).
- Annex III providing standard granular templates for disclosures under the Article 8 Delegated Act (--> here)
- An FAQ (--> here) explaining the rationale of the DA, the content and the processes the DA will go through.

Prior to adopting the Complementary Climate Delegated Act, the EC had requested on 31 December 2021 Member States Expert Group on Sustainable Finance and the Platform on Sustainable Finance to provide feedback on a draft text. The Platform of Sustainable Finance has expressed its views in a public report (--> here).

Nuclear Energy

The eligible activities included are:

- Advanced technologies to incentivise research and innovation into future technologies in terms of safety standards and minimising waste (with no sunset clause)
- New nuclear power plant projects for energy generation, which will be using best-available existing technologies, will be recognised until 2045 (date of approval of construction permit);
- Modifications and upgrades of existing nuclear installations for the purposes of lifetime extension, will be recognised until 2040 (date of approval by competent authority)

The technical screening criteria impose a requirement to use accident-tolerant fuel by 2025 for nuclear activities to be taxonomy-aligned. Accident-tolerant fuel for nuclear power plants is expected to provide additional protection against accidents resulting from structural damages to fuel or reactor components.

Natural Gas

The eligible activities included are:

- Electricity generation from fossil gaseous fuels
- High-efficiency co-generation of heat/cool and power from fossil gaseous fuels
- Production of heat/cool from fossil gaseous fuels in an efficient district heating and cooling system

In order to be taxonomy-aligned, each gas-related activity shall meet one of the following criteria:

- Lifecycle emissions are below 100g CO2e/kWh; or
- Until 2030 (date of approval of construction permit), and where renewables are not available at sufficient scale, direct emissions are:

  i) below 270g CO2e/kWh or,

  ii) for the activity of electricity generation, their annual direct GHG emissions must not exceed an average of 550kg CO2e/kW of the facility's capacity over 20 years. In this case, the activity must meet a set of cumulative conditions. For example, it replaces a facility using solid or liquid fossil fuels, it ensures a full switch to renewable or low-carbon gases by 2035, and a regular independent verification of compliance with the criteria is carried out.

Next steps

The European Parliament and the Council have four months to formulate any objections. This scrutiny period can be extended by two additional months if deemed necessary.

Once the scrutiny period is over, the Complementary Delegated Act is expected to enter into force and apply as of 1 January 2023.

FAQs

The FAQs documents released in December 2021 and February 2022 aim to provide implementation guidance on the content of the Article 8 Delegated Act. The December FAQs were accompanied by two documents prepared by the Platform on Sustainable Finance:

- An annex called "Platform considerations on voluntary information as part of Taxonomy-eligibility reporting" which provides supplementary information to help users of the EU Taxonomy with the disclosures required under Article 8 of the EU Taxonomy (--> here).
- An EU taxonomy NACE alternate classification which contains an indicative mapping of selected industry classification systems and how they relate to the description of economic activities in the EU Taxonomy (--> here).

The combined FAQs contain 55 questions some of which are summarised below.

General provisions

- Mixed groups, e.g. consisting of financial and non-financial undertakings, shall report consolidated taxonomy information based on the type of undertaking of the parent company. Additional voluntary information could be provided on subsidiaries when considered relevant for a better understanding of the group's eligibility and alignment thereafter. (Q4 of EC Dec. FAQs).
- Voluntary taxonomy eligibility disclosures shall not contradict or misrepresent the mandatory information and should not be given more prominence than the mandatory disclosures. Voluntary disclosures should be accompanied by supporting detail setting out the basis for this disclosure and methods used for its preparation along with a clear explanation of how it differs from mandatory disclosures (Q12 of EC Dec. FAQs - Q7 of EC Feb. FAQs).
- Furthermore, in order to facilitate comparability between eligibility and alignment reporting, it is recommended to use for eligibility reporting dedicated annexes that shall be used for reporting alignment (Q14 of EC Dec. FAQs, Q10 of EC Feb. FAQs).

Financial Undertakings

- The Article 8 Delegated Act is silent on the underlying data that financial undertakings shall use to prepare eligibility reporting. Financial undertakings are encouraged to rely on their counterparties' taxonomy eligible capex and revenue (Q11 of EC Dec. FAQ).
- Generally speaking, financial undertakings shall disclose mandatory eligibility and alignment reporting on the basis of the actual information provided by their counterparties. Whenever this information is not available, as is the case for 2022 taxonomy eligibility reporting, financial undertakings may choose to use estimates to assess the eligibility of the economic activities of their exposures. In such a case, disclosed information is deemed to be voluntary (Q12 of EC Dec. FAQs).
- Financial undertakings shall 'look through' their portfolio of assets/investments to assess the eligibility of the economic activities of those investee undertakings that are the ultimate beneficiary for the purpose of their eligibility reporting (Q13 of EC Dec. FAQs).
- Financial undertakings shall include the eligible proportion of the proceeds of environmentally sustainable bonds and debt securities whose purpose is to finance specific identified activities, as part of the numerator of the eligibility disclosure. Debt securities in this context include SME and non-EU issuers' use of proceeds but do not include use of proceeds loans. There is no requirement that proceeds from debt products be independently verified as taxonomy-eligible. Lastly, financial undertakings shall not include their green sovereign debts in their eligibility disclosures; these shall be excluded from the calculation of the numerator and the denominator of KPIs. (Q21 of EC Dec. FAQs, Q30 to Q32 of EC Feb. FAQs).

Non-financial undertakings

The main clarifications for non-financial undertakings have been summarised here.

PwC has published illustrative disclosures pursuant to Art. 8 of the EU Taxonomy Regulation for two fictitious non-financial undertakings. It illustrates the disclosure requirements that would apply to such an undertaking pursuant to Art. 8 of the EU Taxonomy and the corresponding delegated acts for the financial year 2021. Two sets of examples are presented: one for a group very concerned by the Taxonomy Regulation (--> here) and another for a group less concerned (--> here).

Next steps

- Expected by the end of Q1.2022
  - Final report on the four remaining environmental objectives
  - Final report on significantly harmful & no significant impact activities
- 2nd quarter 2022: draft DA on the four remaining environmental objectives (to be confirmed)
- 1 January 2024: application of DA on the four remaining environmental objectives (to be confirmed)

Proposal on Corporate Sustainability Due Diligence

On 23 February 2022, the EC published the long-awaited draft Directive on Corporate Sustainability Due Diligence (--> here), along with its annexes (--> here) and a factsheet (--> here).

This regulation is inspired in particular by existing laws in France and Germany.

What's the objective?

The objective is to establish rules for companies to respect human rights (e.g. child labour and worker exploitation) and the environment (e.g. pollution and biodiversity impacts) in global value chains for a fair and sustainable economy, under penalty of administrative or judicial sanctions. This means that companies will have to identify, prevent and stop the negative impacts of their activities on human rights and the environment.

This project of Directive is consistent with the initiative on standardisation of sustainability reporting:

- The "Corporate Sustainability Reporting Directive" - CSRD clarifies what a company must include in its sustainability information (What to report)
- The "Corporate Sustainability Due Diligence" establishes rules on the respect of human rights and the environment by companies (What to do)

What are the consequences for companies?

The consequences will vary from country to country.

There are countries with existing national legislations including Germany, France, Netherlands, Belgium…

In order to comply with the Corporate Sustainability Due Diligence, companies need to:

- integrate due diligence into policies;
- identify actual or potential adverse human rights and environmental impacts;
- prevent or mitigate potential impacts;
- bring to an end or minimise actual impacts;
- establish and maintain a complaints procedure;
- monitor the effectiveness of the due diligence policy and measures;
- and publicly communicate on due diligence.

Companies must take appropriate measures to prevent, end or mitigate impacts on the rights and prohibitions included in international human rights agreements, e.g. regarding workers' access to adequate food, clothing, and water and sanitation in the workplace. Companies are also required to take measures to prevent, end or mitigate negative environmental impacts that run contrary to a number of multilateral environmental conventions.

In addition, the new proposal requires certain large companies to adopt a plan to ensure that their business strategy is compatible with limiting global warming to 1.5 °C in line with the Paris Agreement.

Implications for directors as well...

Directors will have to implement the due diligence, oversee its implementation and integrate it into corporate strategy. They will have to take into account the consequences of their decisions on human rights, climate change and the environment, including in the long term.

The draft directive requires certain large companies to adopt a plan to ensure that their business strategy is compatible with limiting global warming to 1.5°C, in line with the Paris Agreement, which will have to be factored into directors' remuneration in order to give them a financial incentive to meet these parameters.

Which companies are concerned?

The new due diligence rules will apply to the following companies and sectors:

EU companies:

- Group 1: all EU limited liability companies of substantial size and economic power (with 500+ employees and EUR 150 million+ in net turnover worldwide).
- Group 2: Other limited liability companies operating in defined high impact sectors, which do not meet both Group 1 thresholds, but have more than 250 employees and a net turnover of EUR 40 million worldwide and more. For these companies, rules will start to apply two years later than for Group 1.

Non-EU companies active in the EU with turnover threshold aligned with Group 1 and 2, generated in the EU.

Small and medium enterprises (SMEs) are not directly in the scope of this proposal. But in practice, a number of them will be indirectly subject via their relationships with their principals, regardless of their position in the value chain.

Application date?

Depending on the date of adoption, it could apply starting January 2025 (to be confirmed).

What are the next steps?

The draft directive will be submitted to the European Parliament and the Council for approval. The directive must be finalised in 2023 and then transposed at the national level of each member country within two years of adoption. Once adopted, Member States will have two years to transpose the directive into national law and communicate the relevant texts to the Commission.

Authority and sanctions?

Each Member State will have to designate one or more authorities to supervise compliance with the obligations. The competent authority will be that of the Member State in which the company has a branch or subsidiary. If the company has branches or subsidiaries in several countries, it will be the one in which it generates the most revenue.

The national administrative authorities designated by the Member States will be responsible for monitoring compliance with these new rules and may impose fines in case of infringement. In addition, victims will have the possibility to sue for damages that could have been avoided by taking appropriate due diligence measures.

Assurance on Sustainability Reporting

Sustainability information, sometimes referred to as Environmental Social Governance, or 'ESG" information, is increasingly important and users expect it to be relevant, consistent, and comparable. Assurance supports this information to be transparent and trustworthy. Limited assurance will be mandatory as part of the CSRD and the Taxonomy Regulation in the near future. This article discusses three key considerations in preparing for assurance on sustainability information.

Answer the loud cry for trustworthy sustainability information

Investors want to invest sustainably; employees want to work for an organization that make a positive impact and customers want to purchase sustainable products. The sustainable story line needs non-financial information, and organizations can use this information to show their long-term value creation and social contribution to stakeholders (--> here). The need for this information has been endorsed for some time by for example BlackRock and the NFRD of the EC. In addition to large organizations, SMEs are also increasingly recognizing the importance of assurance on sustainability information.

Currently, companies ask for mainly limited assurance over their sustainability information. This is largely done on a voluntary basis. With the implementation of the CSRD, the EC will require that the assurance level in the future is equivalent to that of a financial audit.

51% of companies report sustainability information with some level of assurance on it

Research by IFAC (--> here), examining 1,220 reports in 22 jurisdictions in 2019, shows 51% of the large companies report sustainability information with some level of assurance. Two levels are distinguished, namely limited assurance (review) and reasonable assurance (audit). Although more and more organizations are asking for assurance, only a very small percentage of companies choose reasonable assurance. In addition, a distinction is made between assurance for specific sustainability indicators, several chapters of the sustainability information or the entire sustainability report.

Three steps to assurance on sustainability information

In this article we identify three key considerations to obtain assurance on sustainability information: relevant information supported by suitable criteria, internal process and controls ensuring the reliability of information within the company and an assurance provider with expertise.

1. Relevant, consistent, and comparable sustainability information based on suitable criteria

Information becomes relevant when it is 'decision useful' for stakeholders, regardless whether those decisions are financially, socially, or environmentally driven. A wide support is crucial, both from the perspective of the organization and internal stakeholders ('inside out') and from external stakeholders ('outside in').

Strategic anchoring of sustainability information is crucial in this respect. In addition, consistency and comparability of information is key to form the basis for meaningful analyses, which is challenging as sustainability reporting is relatively immature. For example, an absolute lower CO_2 emission might look good, but gives a different view when CO_2 intensity expressed in CO_2 per tons of produced products increases. Using recognized reporting frameworks as criteria for the information, such as that of the Global

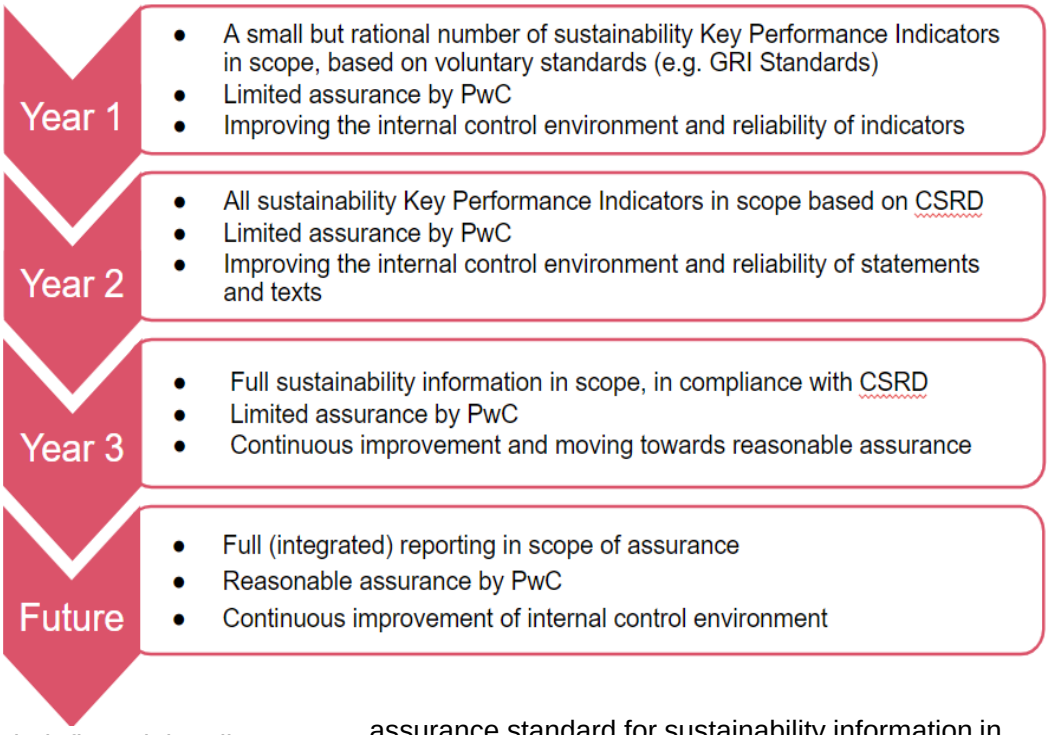
Reporting Initiative of the Greenhouse Gas Protocol, can help with this, as well as transparent disclosures around processes and assumptions used to produce the data.

2. Implement checks and balances for reliable information

Where financial accounting utilizes a 'double entry' system, sustainability information often is tracked on a 'single entry' system, which is more prone to error. Overall, it is more complex to ensure the accuracy and completeness of sustainability information. To obtain reliable sustainability information, the organization therefore needs to set up adequate processes and controls. Reporting manuals, automation and an internal control framework support this reliability, for both quantitative and qualitative disclosures. It also helps in uniformity between subsidiaries around the globe. Most companies have considerable experience with these tools from a financial perspective, which is knowledge that can be applied to sustainability information as well.

3. Use an assurance provider with expertise

Sustainability assurance is a journey, where companies amongst others need to think about the suitability of the assurance standard, the level of assurance and the assurance provider. In most cases it takes the form of a demarcated scope and limited assurance by an experienced audit firm. Over time, the company can evolve its reporting towards an extensive scope with reasonable assurance. Companies can familiarize themselves with publications such as 'A buyer's guide to assurance on non-financial information' of the World Business Council for Sustainable Development (--> here) for discussions with their financial auditor.



A professional assurance provider with the right accreditations, high ethical standards and expertise on both sustainability information and audit is often the key to success in a company's journey. In practice, the steps described bring many challenges. Mainly because reporting of sustainability information is still very much fragmented and relatively immature. In addition, standards available on how to assure this information are under scrutiny. The International Auditing and Assurance Standards Board published a concept guidance document to complement the broadly used ISAE 3000 and ISAE 3140 standards for assuring non-financial information and GHG statements. The Netherlands already has a specific assurance standard for sustainability information in place, the NBA Standard 3810N, a new version including an English translation will be available soon. So, standards to provide assurance are available, but are expected to evolve in the future. A larger population of our auditors are specializing in assuring sustainability information, supported by dedicated training.

Conclusion

Assurance is a logical next step by the EC to make sustainability information truly relevant for stakeholders. Standards to provide assurance are available but are expected to evolve in the future in a journey to relevant, consistent, comparable and verified sustainability information.

Regulator's updates

ESMA published its Sustainable Finance Roadmap 2022-2024

The roadmap (--> here) identifies priorities for ESMA's work such as tackling greenwashing, building capacity of national authorities and monitoring and assessing ESG markets and risks. The roadmap sets a number of deliverables to support the supervision of greenwashing risks, including guidance to the market and authorities on the level 2 measures under article 8 of the Taxonomy, as well as clarifying the rules for investors under the Sustainable Finance Disclosures Regulation (SFDR). ESMA will also support national authorities in their risk assessment and identification of greenwashing.

ESMA has also published a Call for Evidence (--> here) on ESG ratings, with the aim to gather information on the market structure for ESG rating providers in the EU. Stakeholders may respond to the questionnaire by 11 March. The call for evidence is intended to complement a public consultation (--> here) to be launched imminently by the EC, that will seek views on the use of ESG ratings and functioning of the market. A proposal for a regulation of ESG ratings is expected by Q1 2023. ESMA also published an article assessing the implementation of the Guidelines on the disclosure of ESG factors in credit rating agency press releases. ESMA finds that the overall level of disclosures increased, but there is a high level of divergence across agencies. Last year, the EC published a comprehensive study on sustainability ratings (--> here) exploring how to enhance their quality and reliability.

What's next?

CSRD

- June 2022? Consensus on CSRD proposal: finalisation of the CSRD is subject to approval by the Parliament and Council, which is expected during the French presidency of the Council

EFRAG

- Publication of remaining prototypes by the end of March 2022
- Public consultations (all sustainability prototypes) from mid-May to end of July 2022

ISSB

- First half of 2022: consult on the Exposure Drafts
- By the end of 2022: finalise the sustainability standards

Taxonomy

March 2022?

- Final report on the four remaining environmental objectives
- Final report on significantly harmful & no significant impact activities

Q2 2022?

- Draft DA on the four remaining environmental objectives
- Report on minimum social safeguards
- FAQs on alignment

2024:

- Application of DA on the four remaining environmental objectives

Abbreviations

CDP	Carbon Disclosure Project
CDSB	Climate Disclosure Standards Board
CSRD	Corporate Sustainability Reporting Directive
DA	Delegated Act
DNSH	Do no significant harm
EFRAG	The European Financial Reporting Advisory Group
ESEF	European Single Electronic Format
ESG	Environmental, social and corporate governance
ESMA	European Securities and Markets Authority
ESRS	European sustainability reporting standards
GRI	Global Reporting Initiative
IOSCO	International Organization of Securities Commissions
ISSB	International Sustainability Standards Board - IFRS Foundation
IFAC	International Federation of Accountants
KPI	Key Performance Indicator
NFRD	The Non-Financial Reporting Directive
PAI	Principal Adverse Impact
PTF-ESRS	Project Task Force on European Sustainability Reporting Standards
RTS	Regulatory Technical Standards
SASB	Sustainability Accounting Standards Board
SEC	Securities and Exchange Commission
SFDR	Sustainable Finance Disclosure Regulation
SMEs	Small and medium-sized enterprises
TCFD	Task Force on Climate-Related Financial Disclosures
TRWG	Technical Readiness Working Group - IFRS Foundation
VRF	Value Reporting Foundation
ECON	European Parliament Committee on Economic and Monetary Affairs
ENVI	European Parliament Committee on Environment, Public Health and Food Safety
DEVE	European Parliament Committee on Development
EMPL	European Parliament Committee on Employment and Social Affairs
ITRE	European Parliament Committee on Industry, Research and Energy

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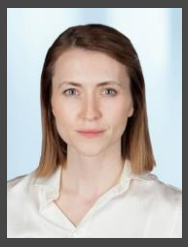

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