WHITE PAPER

How the Automotive industry can prepare for CSRD/ESRS

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CSRD and ESRS are the gold standard of ESG regulations, and are likely to result in the harmonization of ESG reporting in Europe. With more than 100 ESG KPIs demanded by the regulator, the level of complexity and volume of ESG-related data requirements will significantly increase for the Automotive industry.

The regulatory ESG landscape has advanced rapidly since the Paris Agreement in 2015, with an inevitable impact on the Automotive industry. For example, as part of Fit for 55, European Parliament set the target of zero CO2 emissions for new passenger cars and light commercial vehicles by 2035. Furthermore, the current draft of the Corporate Sustainability Due Diligence Directive defines requirements for enforcing higher human rights and environmental standards along the full value chain beyond suppliers.

In order to improve disclosure towards various stakeholder groups, the European Union (EU) is leading the shift from voluntary towards mandatory ESG reporting requirements. On June 9th, 2023, an updated draft Delegated Act to supplement its earlier CSRD/ESRS draft was being issued asking companies to report against their material topics (whilst some KPIs were adjusted from mandatory to voluntary and extended phase-in period were allowed).

Both the Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS) are driving the harmonization of sustainability data in the EU. While CSRD extends the Non-Financial Reporting Directive (NFRD), compelling significantly more companies to disclose comprehensive ESG criteria, ESRS addresses and formulates CSRD requirements for in-scope entities. Given the high level of complexity and the volume of ESG-related data requirements, these regulatory commitments will pose significant challenges for the Automotive industry. Indeed, CSRD/ESRS regulations require more than 100 ESG key performance indicators (KPIs), obliging Automotive industry companies not only to adjust reporting processes, but also to update their ESG strategies, governance, and data capabilities.

Corporate Sustainability Reporting Directive (CSRD)

- Extends and strengthens existing Non-Financial Reporting Directive (NFRD) as uniform sustainability disclosure standard
- Expands scope to include more companies than the NFRD and requires corporates to report on a wider range of sustainability-related issues
- Improves data availability on sustainability risks of companies as well as the effects of their activities on the environment
- Based on the principle of "double materiality", obliging companies to report on how their business is affected by sustainability issues, and how their activities impact society and the environment
- Scope:
    - From 2024 onwards: Large public-interest entities[1] with more than 500 FTEs already subject to NFRD. First reporting in 2025
    - From 2025 onwards: Large EU undertakings,[2] which are currently not subject to NFRD. First reporting in 2026
    - From 2026 onwards: Listed small and medium-sized enterprises (SMEs) and small, non-complex credit and captive insurance undertakings. First reporting in 2027 with a postponement option to 2029
    - Non-EU companies from third countries will also become subject to the CSRD if certain criteria are met

European Sustainability Reporting Standards (ESRS)

- Developed by the European Financial Reporting Advisory Group (EFRAG)
- Builds on CSRD requirements, and can be viewed as the operational guidance for companies
- Standards aim to synchronize underlying methodologies and therefore harmonize ESG reporting while also aligning with existing standards, e.g., the Global Reporting Initiative (GRI)
- ESRS covers 12 different standards (ESRS 1-2, E1-5, S1-4, G1), including climate change, biodiversity as well as social and governance
- Draft Delegated Act published by the European Commission allows
    - more flexible and voluntary disclosure of certain data points
    - phase-in of data points after the first year's disclosure
- Applies to companies within the EU and to non-EU companies, both as defined as per the CSRD

1. Public-interest entities include listed companies, as well as banks and credit institutions, insurance companies, and other companies designated by national authorities to be of public interest
2. Large EU undertakings meeting at least two of the following criteria: > 250 FTE, > €20M total assets, > €40M net revenue (per Article 3 of Directive 2013/34/EU)

Growing urgency to prepare for CSRD/ESRS reporting

The deadline for CSRD/ESRS implementation is imminent

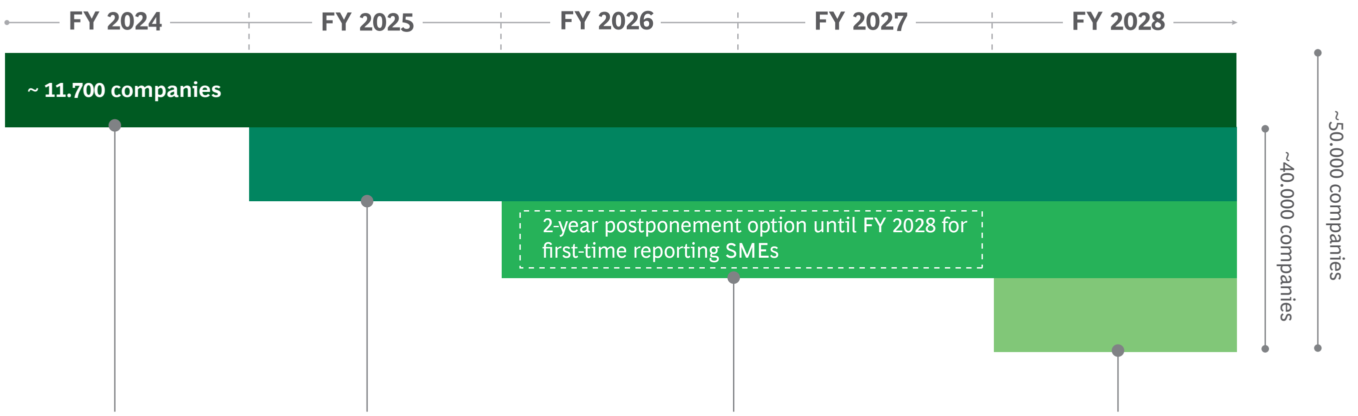
The deadline for the implementation of CSRD/ESRS is fast approaching, as the CSRD became effective from January 1, 2024.

CSRD and ESRS will be implemented in multiple stages – first focusing on large public-interest entities, and later moving to cover small and medium-sized entities. For large public-interest entities already subject to NFRD, the CSRD and ESRS requirements will apply from financial year 2024 onwards with a first reporting in early 2025. For these in-scope entities, timely and accurate CSRD/ESRS reporting will be of significant strategic importance. It is vital, therefore, that such companies make immediate preparations for the 2024 requirements by devising and institutionalizing the relevant processes.

For other large entities that are currently not subject to NFRD, reporting obligations will start a year later, with data to be captured for financial year 2025 onwards and initial reports to be prepared in 2026. Starting from financial year 2026, listed SMEs will also be required to report, but with an option to opt out until financial year 2028. In addition, EFRAG is planning to develop distinct and proportional standards for SMEs in the coming years.

Exhibit 1 - CSRD/ESRS will apply progressively to EU entities from Financial Year (FY) 2024 onwards

CSRD reporting requirements for in-scope entities (FY)



Large public-interest entities (PIEs)[1]:

- Listed companies and other PIEs[1] only
- Reporting under NFRD
- With > 500 FTE

Large EU undertakings:

- Listed & unlisted companies
- Meeting at least 2 criteria:
  > 250 FTE
  > €20M total assets
  > €40M net revenue

Small and medium-sized EU enterprises (SME), which are also PIEs[1]:

- Listed SMEs and other PIEs[1] only
- Meeting at least 2 criteria:
  > 50 FTE
  > €4M total assets
  > €8M net revenue

Third-country undertakings (Non-EU companies):

- Listed & unlisted companies[3]
- > €150M net revenue in EU

Meeting at least 1 criteria:
- EU Branch (> €40M net rev.)
- EU subsidiary

Out of scope	1)	Non-listed EU SMEs	2)	Listed micro-enterprises	3)	Companies meeting thresholds in one consecutive FY only

Source: BCG.

[1] Public-interest entities include listed companies, as well as banks and credit institutions, insurance companies, and other companies designated by national authorities to be of public interest.

[2] Meeting thresholds considered to be a large undertakings or a SME undertaking; CSRD = Corporate Sustainability Reporting Directive; FY = Financial Year.

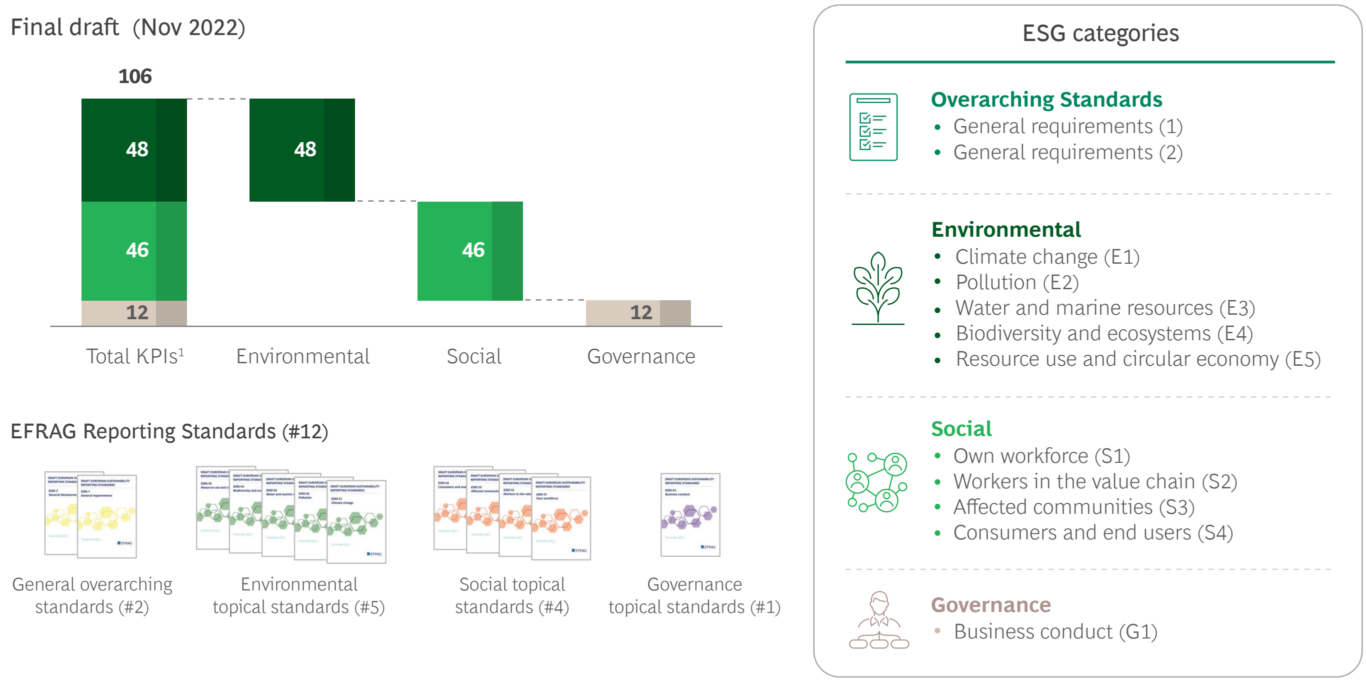
CSRD/ESRS require a large amount of ESG data

The CSRD/ESRS regulations entail granular qualitative and quantitative KPIs across ten categories, covering all the dimensions of ESG – for example, climate change, pollution and biodiversity for “E”, workers in the value chain for “S”, and business conduct for “G”. The types of KPIs that the Automotive industry companies needs to submit across all dimensions follow a certain pattern - including descriptions of policies, targets, action plans, transition plans and potential financial impact. The proportion of quantitative or qualitative KPIs per thematic category varies and depends on the type of information required.

The draft Delegated Act published by the European Commission includes certain measures to rationalize reporting obligations but keeping the ambitious objectives. To apply standards effectively all undertakings can phase-in certain requirements after the first year’s disclosure such as anticipated financial effects related to non-climate environmental issues or data-points related to own workforce. For companies with less than 750 employees further KPIs can be omitted in the first two years.

Additionally, certain disclosures will be voluntary or can be handled more flexible. For example, biodiversity transition plans or indicators about “non-employees” will not be mandatory. Further data points can be disclosed more flexible, like financial effects arising from sustainability risks or KPIs about corruption and bribery.

Exhibit 2 - CSRD/ESRS specifies qualitative and quantitative KPIs across ten specific and two overarching categories



Source: BCG.

[1] Number of KPIs depends on the applied aggregation logic; Note: Priority sectors standards to be released in 2024: I) Agriculture, Farming and Fishing, II) Coal Mining & Mining, III) Energy and Utilities, IV) Food and Beverages, V) Motor Vehicles, VI) Oil and Gas, VII) Road Transport, VIII) Textiles, Accessories, Jewelry and Footwear.

Assurance of CSRD/ESRS requirements must be effectively managed

With ESG requirements expanding rapidly, the Automotive industry should be aware of the consequences if they do not comply. These could potentially include fines, legal consequences, or damage to reputation and business relationships.

The CSRD is a much broader Directive than its predecessor, NFRD. It has introduced an audit requirement, for which the Automotive industry needs to prepare accordingly. This statutory audit requirement applies for three main reasons: 1) More companies are affected by CSRD; 2) the CSRD/ESRS regulations demand additional information; and 3) CSRD/ESRS requires limited assurance on sustainability information, although the end goal is to move to reasonable assurance in the longer term.

The challenge of implementation for the Automotive industry

One of the main challenges for the Automotive industry is that CSRD/ESRS requirements are not yet sector-specific. Automotive-specific standards were expected to be published before the end of 2024, but recently EFRAG has decided to postpone sector-specific standards and now plans to develop these under a “modified timetable”. It is anticipated that auto-specific standards will call for further KPIs, and potentially some additional guidance on existing standards. That said, the current interpretation of standards is not likely to change significantly even when sector-specific standards come into force. As a result, Automotive industry companies should continue preparing their data-capturing capabilities and develop their initial report according to certain hypotheses.

In comparison with other industries, companies have not been approaching the upcoming regulatory changes completely unprepared. We analyzed the reported KPIs of selected European OEMs and found that 50% of the KPIs required by ESRS were already reported in 2021.

Key hypotheses for the Automotive industry to consider when setting out their CSRD/ESRS reporting objectives

The Automotive industry needs to integrate CSRD/ESRS requirements into their existing operations. This involves not only strategy and steering, but also governance and risk management as well as quantification and enablers. We have identified four critical hypotheses that the Automotive industry will need to consider when incorporating CSRD/ESRS reporting into their target operating model:

1. Setting targets: The Automotive industry will need to set targets that include social and governance dimensions as well as environmental goals

The current targets of Automotive industry companies focus almost exclusively on the climate change component. CSRD/ESRS imposes an increasing regulatory expectation on the Automotive industry to set targets beyond climate-related matters – including, for example biodiversity and pollution as well as social and governance issues. As the first step, CSRD/ESRS requires the Automotive industry to publish those ESG targets that have already been set without having to formulate new targets. However, with the increasing ESG momentum among other competitors in the market, it can be expected that this will lead Automotive industry companies to formulate and publish new ESG targets. These will need to be incorporated into strategies and processes and must be aligned to existing initiatives, such as carbon accounting.

Exhibit 3 - BCG ESRS Automotive industry Benchmarking

Peer comparison indicates similar maturity levels across industry regarding ESG reporting

Initial outside-in evaluation

	Automotive company 1	Automotive company 2	Automotive company 3	Automotive company 4
Climate change	16 / 20	15 / 20	14 / 20	17 / 20
Pollution	3 / 7	3 / 7	5 / 7	3 / 7
Water & marine resources	3 / 6	2 / 6	2 / 6	3 / 6
Biodiversity & ecosystems	2 / 8	3 / 8	5 / 8	3 / 8
Resource use & circular economy	3 / 7	2 / 7	3 / 7	2 / 7
Own workforce	15 / 31	20 / 31	15 / 31	16 / 31
Workers in the value chain	2 / 5	1 / 5	1 / 5	2 / 5
Affected communities	1 / 5	– / 5	1 / 5	1 / 5
Consumers & end-users	– / 5	– / 5	– / 5	– / 5
Business conduct	5 / 12	6 / 12	6 / 12	4 / 12
Total[1]	50 / 106	52 / 106	54 / 106	51 / 106

(# of KPIs covered / # total KPIs in category) xx - Environment xx - Social xx - Governance

Insights

Overarching assessment: Peer comparison indicates similar maturity levels regarding ESG reporting across industry with 47% of KPIs covered by OEM 1

(E)nvironment category: ~ 55% of environmental KPIs reported among peers, with some gaps in pollution data & and biodiversity risk assessments

(S)ocial category: ~ 40% of social KPIs are reported among peers, but gaps in human rights, affected communities as well as consumers & end-user metrics

(G)overnance category: Few governance KPIs to report (~ 40% coverage among peers), peer comparison shows gaps in payment practices and business conduct

Source: Companies sustainability reports, BCG.

[1] Number of KPIs depends on the applied aggregation logic.

2. Drafting transition plan: The Automotive industry will need to report how they will achieve their sustainability targets

As part of ESRS, Automotive industry companies should disclose a time-bound transition plan, including a high-level explanation of how it will adjust their strategy and business model towards a climate-neutral economy. Companies are required to provide an understanding of the transition plan for the undertaking and its compatibility with the goal of limiting global warming to 1.5°C in line with the Paris Agreement (or an updated international agreement on climate change).

The transition plan also requires assessment of cumulative potential locked-in greenhouse gas (GHG) emissions from key assets and products until 2030 and 2050, and for the lifetime of products. Furthermore, the Automotive industry companies should provide an explanation of their transition plans for transforming, decommissioning or phasing out their GHG- and energy-intensive assets and products.

Finally, the transition plan needs to detail the alignment with the overall business strategy and financial planning, as well as updates on the progress of implementation.

3. Establishing governance structures: To institutionalize ESG reporting, ESG governance structures need to be critically reviewed

For the implementation of CSRD/ESRS reporting, departments across the entire organization (including group sustainability, human resources, compliance, and finance) will be involved. In comparison to a fragmented and siloed approach by individual business units, views on all ESG topics from across the entire organization should be gathered. Given the increasing volume of ESG-related regulations, a suitable governance structure should be put in place to manage the organization's reporting and allow for comprehensive steering.

The governance structure would aim to identify responsibilities in the report generation process and support the interaction between various individuals and divisions, allowing for a smooth reporting process. This should be supplemented by the operational IT infrastructure and constant collaboration with internal and external auditors.

4. Expanding data capabilities: To meet CSRD/ESRS requirements, companies must dramatically boost their IT capabilities

To fulfill CSRD/ESRS requirements, current IT capabilities need to be significantly upgraded in order to create a holistic ESG perspective. The initial starting point would be to understand what ESG data is available, where it is being created, and to what extent it is already managed in an IT system. Typically, a comprehensive ESG database needs to access and collect data from many different IT systems. The CSRD/ESRS data collection operation and IT systems landscape should ideally follow the same structure and processes as financial reporting. An established organizational structure, as well as risk management and internal controls, should support the reporting process. Automotive industry companies need also to focus on addressing the skills gap in their workforce to prepare them for new ways of CSRD/ESRS reporting and for using new systems.

Exhibit 4 - BCG ESRS approach for Automotive industry companies

Four-step approach to assess CSRD/ESRS readiness and built future ESG target picture

1 Gap analysis

- Assess current state and cross check with upcoming CSRD/ESRS requirements to identify reporting gaps
- Identifying measures to resolve potential gaps

2 Double materiality assessment

- Developing shortlist of ESG topics
- Preparation of materiality survey
- Carry out survey and interviews with key stakeholders
- Refine material and produce final materiality report

3 Implementation based on roadmap

- Including more than 70% of the KPIs in initial reporting period
- Automated KPI reporting as long term objective
- Establish a matrix project organization
- Set up ESG committee as ultimate decision-making body

4 Implementation based on roadmap

- Define a global minimum standard that applies to all jurisdictions
- Considering local specialties only within impacted entities

Source: BCG analysis.

Practical implementation: our recommended approach

To assess CSRD/ESRS readiness and build a future ESG reporting target picture, we suggest a four-step approach, which involves carrying out a gap analysis, conducting a materiality assessment, implementing the roadmap, and introducing smart compliance.

Gap analysis to assess CSRD/ESRS readiness and develop a target picture

To assess CSRD/ESRS readiness and derive a clear view of the maturity of the Automotive industry's ESG reporting, the latest sustainability report – if available – should be examined against upcoming CSRD/ESRS requirements. The aim of this analysis is to identify reporting gaps and to determine whether the current availability of data and the system landscape meet future CSRD/ESRS reporting requirements. For a first outside-in assessment, KPIs can be systematically analyzed from an operations perspective and then cross-checked against published sustainability reports. After the initial gap assessment, companies should develop concrete measures to resolve potential issues. This would include devising internal and external system solutions to support ESG reporting. To gauge readiness, the company should design a future governance model based on the ESG target picture, and also define an implementation roadmap.

Double materiality assessment

Companies within the Automotive industry are obliged to conduct a double materiality assessment for all KPIs. It should be leveraged as a tool to capture stakeholders' perspectives on ESG. Furthermore, such an assessment can inform ESG strategies and indicate where future investment may be required. Introduced by CSRD, the double materiality assessment involves reporting from two angles: how ESG-related issues affect the company; and how the company's own actions affect people and the environment. Except for the "general requirements" only data points identified in the materiality assessment have to be disclosed.

BCG has developed a proven approach for conducting a double materiality assessment for Automotive industry companies in an effective way to kick-start sustainability reporting. First, a shortlist of relevant ESG themes, based on EFRAG standards, market practices and distinctive characteristics of the client, should be drawn up. Second, the materiality surveys can be prepared, including a weighting logic for the materiality scoring tool and pre-engagement with stakeholders. Third, the materiality survey and additional key stakeholder interviews should be carried out for a preliminary framing of the materiality matrix. The last step of the assessment is to refine material by clustering ESG themes and then produce the final materiality report. The assessment findings should inform the implementation roadmap for the coming years.

Implementation based on a previously defined roadmap and matrix project organization

We recommend defining an implementation roadmap to prioritize the 106 KPIs. CSRD/ESRS requires high-level reporting readiness even in the first reporting year for around 80% of KPIs. The Automotive industry should therefore start preparing them now for reporting in 2024. The remaining 20% of KPIs, which are particularly focused on the value chain (e.g., policies related to biodiversity and ecosystems; processes for engaging with value-chain workers), can be implemented over the three-year implementation period permitted by CSRD/ESRS. For all types of KPI, reporting will probably be done manually at first, but should be automated over time, as IT and data capabilities are accelerated and developed.

Automotive industry companies should continually reassess the target operating model against the ESG reporting target picture. Since companies within the Automotive industry are characterized by complex organizational structures, we recommend that they establish a matrix project organization that includes a strong central team and content owners. This matrix project organization would, for example, handle target setting and data computation in a consistent way across the group. An ESG committee should also be set up in companies as the ultimate decision-making body and highest escalation authority for ESG issues. The committee should be supported by a coordination group that provides updates on project progress, as well as by a CSRD/ESRS steering committee that has the mandate to make rapid decisions based on project needs and to execute any relevant iterations.

Introduction of smart compliance

In addition to the steps above, we strongly encourage Automotive industry companies to adopt a “smart compliance” approach. Given that CSRD/ESRS is not the only upcoming mandatory ESG reporting requirement, companies face challenges in adhering to a set of varying local requirements (e.g., US SEC Climate Disclosure, CS3D, Deforestation). Consequently, “smart compliance” means defining a global minimum standard that applies across the various jurisdictions, whilst accounting for local particularities only within the impacted entities.

Conclusion: Anticipating requirements

Given the complexity of the CSRD/ESRS regulations, and the ambiguity of individual value-chain KPIs and disclosure requirements, the Automotive industry should start thinking about ESG reporting readiness now.

It is important for the Automotive industry to anticipate additional requirements and commitments well in advance so that they are well prepared for any eventuality. To respond to the upcoming regulatory changes, companies will need to incorporate new ESG reporting requirements into their approach. In this way, they can gradually develop their KPI reporting, building it up continuously. A new or expanded ESG governance structure within the organization would ensure successful project management and prepare the ground for the initial report.

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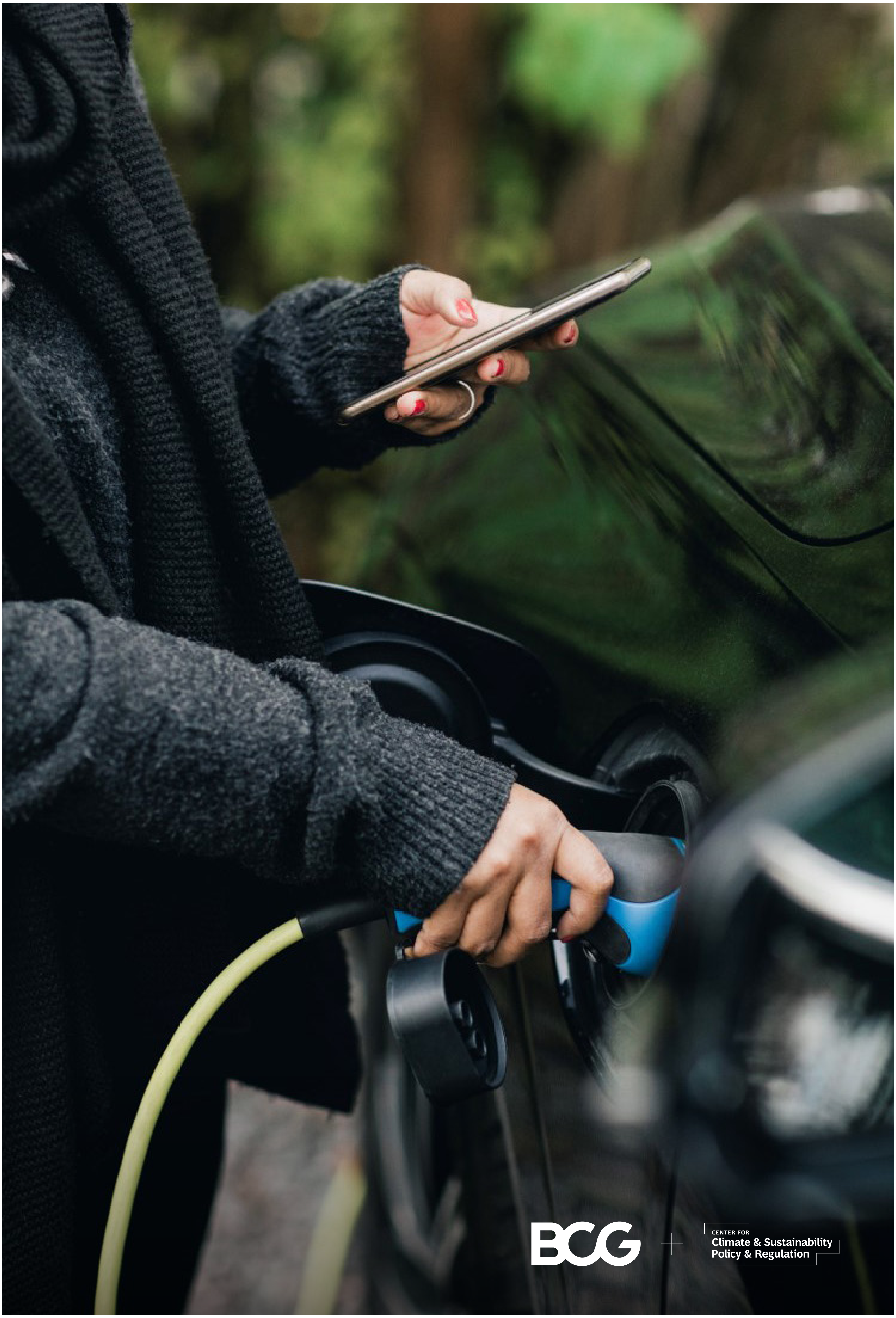
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