Joint position paper on exposure draft ESRS E5: Resource use and circular economy

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Introduction

We welcome the substantial efforts made by the EFRAG PTF-ESRS in developing the exposure draft ESRS E5 on resource use and the circular economy (the **Exposure Draft**). We recognise that the absence of existing comprehensive and authoritative disclosure standards on the topic of the circular economy had rendered this work particularly challenging. For this same reason, it is essential that the final ESRS E5:

- fully reflects the concept of a circular economy accurately, in a clear manner that will help undertakings embed an understanding of the principles of the circular economy in their strategies;
- aims for the highest possible ambition, in order to show the way forward to any other upcoming standard or regulation in other jurisdictions or pursuant to other initiatives; and
- aims to align with upcoming standards to the extent possible, while recognising the differences in approach taken to fundamental issues such as impact materiality

To aid the PTF-ESRS in their review of our detailed comments provided in the consultation response, we have set out our most critical comments in this position paper along with our detailed comments in the form of a mark-up of the Exposure Draft (the **Mark Up**). This has been a collaborative effort between the signatory organisations in consultation with external experts.

Summary

Our main concern about the Exposure Draft is that the key concept that should underpin the standard - that of the circular economy - has not been fully and correctly defined, and that the most important elements of the circular economy are not reflected properly in the disclosure requirements. In the current form, we are concerned that undertakings disclosing information pursuant to ESRS E5 will not be providing information that accurately reflects their impacts, risks, performance and policies with regards to the circular economy.

In this position paper, we first discuss the opportunities to improve the guidance on the impact materiality assessment and detail our recommendations (Part 1). We then address first the problems with the definition of circular economy, and propose a definition that incorporates the key elements of the circular economy (Part 2). Finally, we break this definition into its component parts, and provide comments on the ways in which the component parts are not properly reflected in the Exposure Draft, with specific recommendations about how to address this (Part 3).

Part 1: Impact materiality assessment

Reference	Relevant text
General, Strategy, Governance and Materiality Assessment	*14. (b) the process to identify material resource use and circular economy-related impacts, risks and opportunities and the outcome of this process, referring to ESRS 2 Disclosure Requirements IRO 1 and IRO 2.*

At present, most impact materiality assessments are conducted through desk review and stakeholder engagement. Where stakeholders consulted are representative and diverse, this is a useful tool, but remains limited by subjectivity. As a general point, we consider that the environment-related ESRS should provide that in every case, the impact materiality assessment be science-based, and that in each of the environmental standards, topic-specific Application Guidance be provided about how to conduct a science-based materiality assessment in relation to that topic.

In the case of ESRS E5, the provision of Application Guidance on how undertakings should conduct a science-based impact materiality assessment is particularly important. We are aware that for some undertakings, the concept of the circular economy may be relatively new. Such Application Guidance would therefore: (i) improve uniformity in the conclusions drawn by the impact materiality assessment, (ii) guide undertakings to better understand how they contribute to resource depletion, providing a much more robust framing for their disclosures under ESRS E5 and their approach to the circular economy in general and (iii) through their reporting on the process for determining materiality, contribute to a general understanding of where and how companies currently contribute to resource depletion, providing a useful baseline to guide circular economy policymaking.

Recommendation: In addition to the general recommendation that for environmental topics, the impact materiality assessment be science-based, we recommend that Application Guidance be incorporated into ESRS E5 with science-based approaches to determining their impacts in terms of resource use. We strongly recommend that this includes detailed guidance for undertakings on how to assess their use of resources across the lifecycle of their activities i.e. with reference to their own operations, as well as upstream and downstream, and incorporating their usage of both renewable and non-renewable resources. We further suggest that this Application Guidance makes reference to methodologies for measuring environmental impacts that incorporate a lifecycle perspective. The suggestions provided in the Mark Up are a starting point for EFRAG to build on with the support of experts on materiality analysis and environmental impact assessment methods.

Part 2: Defining the circular economy

Reference	Relevant text
Objective, 4	*"Circular economy is a restorative system in which waste and pollution are eliminated and resource use is minimised through systemic design, maintaining and improving the value of products and components and achieving a circular flow of resources, while regenerating natural ecosystems."*
Appendix A: Defined terms	*"Circular economy: Economic system that uses a systemic approach to maintain a circular flow of resources, by regenerating, retaining or adding to their value, while contributing to sustainable development. (ISO)."*

We note that the definition in the Objective section of the draft standard has improved considerably since the PTF's ESRS E5 working paper (the **ESRS E5 Interim Draft**) was published, and now better reflects academic, policy and industry consensus on the defining features of a circular economy[1].

However, certain elements of the definition remain vague, or are likely to not be fully understood by issuing companies without detailed explanation. As such, we have proposed a refined and clearer definition for inclusion in Objective, 4 below.

Recommendation: We recommend that the definition is clarified as follows, with the same text used in Objective, 4 and in Appendix A: *"Circular economy is an economic system that, by design, eliminates waste and pollution, minimises resource use, minimises the extraction of non-renewable resources, regenerates natural ecosystems and reverses the depletion of the stock of renewable resources, while keeping products and materials in use at their highest value for as long as possible."*

[1] Geissdoerfer M., Savaget P., Bocken N.M.P., Hultink E.J, 'The Circular Economy - A new sustainability paradigm?', Journal of Cleaner Production, 1 February 2017, pp. 757-768.

More critically, the definition of 'circular economy' in Appendix A is not only different from that in Objective, 4 (which in itself is likely to create confusion) but considerably weaker, for the following reasons:

1. This definition does not refer to the elimination of waste and pollution explicitly.
2. There is no reference to the need to minimise resource use.
3. The reference to a *"circular flow of resources"* is vague, and is likely to be interpreted to mean replacing virgin materials with recycled and renewable materials (all the more so as there is no reference to minimising resource use).
4. As explored in more detail in Part 3, (iv) on Regenerating ecosystems, the reference to *"regenerating"* is unclear and seems misplaced: it is not resources that should be regenerated, but ecosystems.
5. The reference to *"contributing to sustainable development"* is extremely vague.

We also note that the origin of the definition in Appendix A is an ISO working draft which has not been agreed upon. Publishing the definition and incorporating into the ESRS E5 Exposure Draft is therefore a breach of ISO guidelines.

Recommendation: Use the same definition for Objective, 4 and Appendix A, replacing both with the amended definition proposed above.

Part 3: Reflecting the definition and principles of the circular economy in the structure and content of ESRS E5

The definition of 'circular economy' in the Objective section of the ESRS E5 Exposure Draft sets out a clear vision of a circular economy. However, several of the elements included in this definition have not been accurately reflected in the Disclosure Requirements themselves. These include:

(i) elimination of waste

(ii) systemic design for circularity

(iii) minimising resource use

(iv) regenerating ecosystems

Below we explain why the ESRS E5 Exposure Draft does not accurately incorporate each of these elements, in each case providing recommendations as to how to rectify this.

(i) Elimination of waste

A key principle of the circular economy - as reflected in the definition used in Objective, 4 - is the elimination of waste and pollution. From a circular economy perspective, the creation of waste results in the value of resources being lost to the economy.

Reference	Relevant text
E5-6- Waste	*"39. The undertaking shall provide information on its wastes* *[...]"*

Whilst the fact that waste arises as an outflow from an activity is relevant to understanding the undertaking's performance with regards to the circular economy, the outcomes for that waste (i.e. what waste disposal methods are applied) are not relevant. Moreover, including a standalone disclosure requirement on waste in ESRS E5 is likely to create confusion among undertakings, by implying that 'improving' the waste disposal outcome equates to progress in improving circularity.

Recommendation: We strongly recommend E5-6 be removed as a standalone requirement, and instead, requirements relating to waste be incorporated in E5-5 (i.e. outflows) to reflect the weight and proportion of outflows that are not designed to be recovered by any means, and those that are not recovered by any means in practice.

In alignment with the amendments we propose to E5-5 below under Part 3 (ii) Systemic design, more specifically, we recommend that undertakings be required to disclose a) the total weight and percentage of products and materials, including packaging, that do not incorporate any form of systemic circular design, and are therefore not designed to be recoverable in any way,[2] b) the total weight and percentage of total outflows represented by products and materials, including packaging, that are not recirculated in practice, disaggregated by hazardous and non-hazardous waste[3] and c) the total weight and percentage of outflows represented by processing waste that is not recirculated in practice, disaggregated by hazardous and non-hazardous waste[4].

We fully recognise that methods of waste disposal have differing environmental impacts, and that reporting on waste disposal methods is highly relevant for ascertaining undertakings' environmental impacts, so we further recommend that disclosure requirements on waste disposal are included in ESRS E2 Pollution, since both waste management and a failure to manage waste give rise to pollution considerations.

(ii) Systemic circular design

Whilst we appreciate that efforts have been made to better incorporate systemic circular design in the ESRS E5 Exposure Draft than as in the ESRS E5 Interim Draft, we consider this feature of the circular economy should be addressed with greater clarity and more comprehensively and consistently.

[2] 37(a)(xii) in the Mark Up.
[3] 37(d)(1) in the Mark Up.
[4] 37(d)(2) in the Mark Up.

Reference	Relevant text
E5-2	*"21. The undertaking shall disclose the resource use and circular economy-related targets it has adopted.* *[...]*
E5-5	*"34. The undertaking shall provide information on its resource outflows.* *[...]* *37. The disclosure required by paragraph 34 shall include the amount in both absolute and percentage terms of material and products that are designed along circular principles: durability, reusability, repairability, disassembly, remanufacturing/refurbishment, recycling or other optimisation of the use of the resource".*
E5-5, AG 25(b)	*AG 25 The disclosure required under paragraph 34 shall include: [...] (b) the total weight and percentage of products containing substances of concern (as defined in ESRS E3 Water and marine resources); [...] "*
E5-7	*"43. The undertaking shall provide information on its strategy to optimise resource use in creating circular business models* *[...]* *46. The disclosure required by paragraph 43 shall include the share of net turnover from products and services that leverage the transition to a circular economy through circular business models such as pay-per-use, sharing or repairing services."*

First, we note that the term *"systemic circular design"* is not defined in Appendix A, and that the inclusion of such a definition would provide greater clarity, particular with reference to the parts of ESRS E5 relating to systemic circular design (or which we recommend *should* refer to systemic circular design) listed above. Without such a definition, undertakings will be free to apply their own definition of *"systemic circular design"*, which is likely to result in inconsistent, incomparable and unclear disclosures.

Recommendation: We propose that the term "systemic circular design" is defined in Appendix A as follows: *"Systemic circular design is a practice of designing systems based on the principles of the circular economy and systems thinking through which products, product-service-systems, business models, and inter-organisational or regional systems are created with the aim of meeting societal needs, protecting and regenerating ecosystems, and minimising the use of resources, while enabling products and materials to be kept in use at their highest value."*

Secondly, we note that the ESRS E5 Exposure Draft does not properly differentiate between different circular strategies, both by not requiring undertakings to provide disaggregated data on the types of circular strategies they are utilising and seeming to put circular strategies that are not of equivalent value on an equal footing.

Below, we provide the hierarchy of circular strategies set out in the European Commission's 2020 document, *"Categorisation system for the circular economy"*. This sets out circular strategies in an order of increasing circularity.

R1	Refuse	Make product redundant by abandoning its function or by offering the same function by a radically different (e.g. digital) product or service
R2	Rethink	Make product use more intensive (e.g. through product-as-a-service, reuse and sharing models or by putting multi-functional products on the market)
R3	Reduce	Increase efficiency in product manufacture or use by consuming fewer natural resources and materials
R4	Re-use	Re-use of a product which is still in good condition and fulfils its original function (and is not waste) for the same purpose for which it was conceived
R5	Repair	Repair and maintenance of defective product so it can be used with its original function
R6	Refurbish	Restore an old product and bring it up to date (to specified quality level)
R7	Remanufacture	Use parts of a discarded product in a new product with the same function (and as-new-condition)
R8	Repurpose	Use a redundant product or its parts in a new product with different function
R9	Recycle	Recover materials from waste to be reprocessed into new products, materials or substances whether for the original or other purposes. It includes the reprocessing of organic material but does not include energy recovery and the reprocessing into materials that are to be used as fuels or for backfilling operations

Source: European Commission, "Categorisation system for the circular economy" (2020), p.7.

As demonstrated by the diagram, upstream circular strategies should always be prioritised as they keep the integrity and utility of materials and products at their highest for the longest time. The ESRS E5 Exposure Draft does not make any such distinction between circular strategies.

Recommendation: We propose that the circular strategy hierarchy reflected in the above diagram be incorporated into ESRS E5 by way of a definition of *"Circular strategy hierarchy"* as follows: *"List of generic, sector-agnostic actions in order of priority according to their circularity as set out by the European Commission in their 2020 document "Categorisation system for the circular economy", p. 7."* This defined term should be used at relevant places in ESRS E5,[5] to clearly differentiate between the differing levels of circular values of different strategies and to guide the prioritisation of undertakings' strategies and actions during the development of their policies and action plans.

In addition to these general comments, we make further specific comments on the topic of systemic circular design below:

E5-2 - Measurable targets for resource use and circular economy

Currently, E5-2 does not identify targets to increase circular design as a category of target that undertakings should disclose. Moreover, whilst *"targets for circular material use rate"* is included as a category of target - which we assume is meant to capture targets relating to recirculation in practice - the absence of a definition for this term does not make this sufficiently clear.

Recommendation: We recommend that *"targets to increase circular design"* be added as a category of target to those categories listed in E5-2.

We further recommend that the term *"circular material use rate"* be defined in Appendix A as follows: *"Recirculation of materials, components and products in practice after first use employing the following strategies (in order of preference): (i) maintenance/prolonged use, (ii) reuse/redistribution, (iii) refurbishment/remanufacturing, (iv) recycling, composting, or anaerobic digestion"* in order to reflect the Circular strategy hierarchy.

E5-5 - Resource outflows

Whilst we welcome the inclusion of a requirement to disclose information on outflows that have been designed according to circular principles, we note that the examples of types of circular design listed in E5-5 37 are not equivalent to one another in the circular strategy hierarchy, yet E5-5 37 does not specify that undertakings should disclose the information on a disaggregated basis according to which circular strategy has been applied. For example, one issuer may be designing all packaging for reuse, and another for recyclability - these strategies are at opposite ends of the circular strategy hierarchy and so cannot be considered as equal value in terms of circularity.

[5] Specifically in E5-1 on policies, E5-3 on action plans and the Application Guidance to E5-3.

Recommendation: E5-5, 37 should be restructured to require companies to disclose the amount (absolute and percentage terms) of outflows that are designed along circular principles, disaggregated according to the type of circular strategy applied and reflecting the circular strategy hierarchy in the order they are listed. (Please see the Mark Up for specific recommendations).

We note that a requirement to disclose the weight and percentage of products containing substances of concern has now been added to the ESRS E5 Exposure Draft. We strongly support its inclusion in light of the importance of safe-by-design products in facilitating a circular economy. The presence of substances of concern in materials represents a significant obstacle to achieving greater circularity, impeding the safe reuse, material recovery and recycling of products and shortening product lifetimes. Where renewable materials are contaminated by substances of concern, they cannot safely be returned to the biosphere.

However, at present, the requirement to disclose the total weight and percentage of products containing substances of concern is located in the Application Guidance to Disclosure Requirement E5-5 AG 25(b). Given that this text introduces a critical concept not referred to in the Disclosure Requirements themselves, the Application Guidance is not the correct place for its inclusion.

Recommendation: We recommend that this text be removed from the Application Requirements and inserted into E5-5.

E5-7 - Resource use optimisation

Currently, E5-7 on resource use optimisation provides that companies should report on net turnover from *"circular business models"* (E5-7, 46). However, *"circular business model"* is not defined in Appendix A, nor does the relevant Application Guidance clarify further what kind of business models are referred to here. We are concerned that the failure to specify what is meant by circular business models, coupled with a lack of guidance and inclusion of any safeguards, will lead to companies reporting turnover from seemingly circular strategies that actually rely on linear models and products that may be designed for circularity, but are not effectively circulated in practice.[6]

[6] For example, a pay-per-use scooter service that disposes of scooters that have ceased to function every six months.

Recommendation: We propose the inclusion of a definition of *"Circular business model"* in Appendix A as follows: *"Business models that, by design, keep products and materials circulating in the economy at their highest value for as long as possible, enabling an increase in their lifetime and utilisation"*. We further propose that a non-exhaustive list of examples of circular business models be provided in the Application Guidance to E5-7[7] along with safeguarding provisions to ensure that the business model is genuinely aligned with circular principles[8].

(iii) Minimising resource use

At present, the references to 'renewable' resources and raw material in the ESRS E5 Exposure Draft imply that renewable resources are exempt from the overall requirement to minimise resource use and prevent the extraction of natural resources referred to in Objective, 7 and a key feature of a circular economy.[9]

We are very concerned about this implication, and strongly advise that efforts are made to rectify it, as per our recommendations below and in the Mark Up. Resource extraction must be reduced in absolute terms and not just shifted to renewable materials.The use of renewable materials is *not* circular by default. Use of renewable materials in a linear economy is not a circular strategy in and of itself. Renewable materials can be circular, but only provided that the other tenets of the circular economy are also observed.

Reference	**Relevant text**
E5-1, 17	*"The undertaking shall disclose separately its policies (i) to decouple economic activity from extraction of non-renewable resources and (ii) regeneration of renewable resources and ecosystems"*
E5-1, 18	*"The principle to be followed under the Disclosure Requirement is to provide an understanding of the undertaking's ability to transition away from extraction of virgin non-renewable resources…"*
E5-2, 25	"*The description of the targets required by paragraph 21 shall include information on: [...] c) targets to eliminate the use of virgin non-renewable raw material"*
E5-4	*"... the weight in both value (tons) and percentage of renewable input materials used to manufacture the undertaking's products and services (including packaging)"*.

[7] AG 34(a) in the Mark Up.
[8] AG 34 (b) in the Mark Up
[9] Also referred to in Objective, 7: *"Decoupling economic activity from extraction of natural resources can take place through the implementation of circular strategies to prevent natural resources extraction and intensify circular material use."*

By referring to company policies *"to decouple economic activity from extraction of non-renewable resources"* (E5-1, 17) and *"extraction of virgin non renewable resources"* (E5-1, 18), the text of E5-1 implies that renewable resources are exempt from the circular economy principle of decoupling economic activity and resource extraction.

Recommendation: We recommend that E5-1, 17 be modified to refer to *"decoupl[ing] economic activity from extraction of natural resources"*, to include renewable and non-renewable within its scope and that E5-1, 18 be modified to refer to *"virgin resources"*, for the same reason.

This same problematic message is reinforced in E5-2 25(c), which provides *"targets to eliminate the use of virgin non-renewable material"*.

Recommendation: We recommend that E5-2, 25 (c) be reformulated to include targets for elimination of the use of virgin materials, with specific sub-targets for non-renewable raw materials and renewable raw material.

Similarly, E5-4 33 on resource inflows requires companies to disaggregate inflows only by a) *"renewable input materials"* and b) *"reused or recycled input materials"*. This disaggregation is too broad. With reference to renewable materials, it does not require undertakings to specify whether or not renewable materials are regeneratively produced or not, which is key to understand if an undertaking is sourcing circular renewable materials or not. Moreover, the request to disclose only inputs from reused or recycled materials seems incomplete and could lead to confusing and underreporting. A category of non-virgin materials is a better choice that would ensure all non-virgin input materials are disclosed.

Recommendation: We recommend that E5-4, 33 be modified to require greater disaggregation on input materials, according to the following categories: (i) non-virgin (i.e. reused and recycled products and materials), (ii) sourced from by-products/waste stream (iii) virgin but renewable and regenerative produced materials, (iv) virgin but renewable and sustainably produced (products and materials that are produced sustainably, but not regeneratively) (v) None of the above (virgin and not sustainably or regeneratively produced), in each case requiring evidence. N.B. the reference to *"sustainably produced"* is subject to our comments below, under Part 3, iv on Regenerating ecosystems.

iv) Regenerating ecosystems

Not all renewable resources are made equal: the production of renewable resources that lead to ecosystem degradation, land-use change, or other negative environmental impacts should not be regarded as sustainable and therefore do not fit in a circular economy. We appreciate that efforts have been made to incorporate the concept of regenerative production of renewable materials in the ESRS E5 Exposure Draft. However, we consider that inconsistent use of the term and the absence of a definition must be rectified.

Reference	Relevant text
Objective, 1(a)	*"The objective of this draft standard is to specify disclosure requirements which will enable users of the sustainability statements to understand: [...] (a) how the undertaking affects resource use, including the depletion of non-renewable resources and the regeneration of renewable resources…"*
Appendix A: Defined terms	*"Circular economy: Economic system that uses a systemic approach to maintain a circular flow of resources, by regenerating, retaining or adding to their value, while contributing to sustainable development. (ISO)."*
E5-1, 17	*"The undertaking shall disclose separately its policies … (ii) for regeneration of renewable resources and ecosystems"*
E5-1, 18	*"The principle to be followed under this Disclosure Requirement is to provide an understanding of the undertaking's ability… to implement practices that secure and contribute to the regeneration of the stock of renewable resources and the ecosystems they are part of"*
E5-2, 25(d)	*"The resource use and circular economy targets above-mentioned shall be classified in the following categories: [...] (d) targets for regeneration of renewable resources and ecosystems."*
E5-4, 32	*"The principle to be followed under this Disclosure Requirement is to provide an understanding of the resource use in the course of the undertaking's own operations, considering separately renewable and non-renewable resources and including transparency on virgin versus non virgin materials and on sustainable versus regenerative source [sic]".*

At a high level, regeneration is a term used to refer to i) regenerative practices in agriculture and ii) the regeneration of damaged ecosystems, which describes the return of degraded or damaged sites to a state of acceptable ecosystem health through human intervention.

In some places in the ESRS E5 Exposure draft, the terms *"regeneration"* and *"regenerative"* have been used with reference to resources (e.g. *"regeneration of the stock of renewable resources"* and *"regeneration of renewable resources"*) suggesting what is meant is a secure, regrowing source of renewable resources, which is incorrect and contradicts the meaning given to the term elsewhere in the ESRS E5 Exposure Draft (for example, the reference to *"regenerating natural ecosystems"* in Objective, 4).

Adding to the confusion, the terms *"regeneration"* and *"regenerative production"* are not defined in Appendix A. Robust definitions of these terms must be included to ensure that disclosures relating to this topic are relevant and useful. Given that the production of renewable resources can lead to several, serious negative environmental outcomes (as listed above), it is particularly important that the definition of *"regenerative production"* includes the necessary safeguards to not only ensure that these are not occurring, but to ensure a net-positive outcome for nature.

Recommendation: We recommend that the following definition of *"Regeneration"* is added to Appendix A: *"Promotion of self-renewal capacity of natural systems with the aim of reactivating ecological processes damaged or over-exploited by human action"* to use with reference to the regeneration of ecosystems. We further recommend that the following definition of *"Regenerative production"* is added to Appendix A: *"Regenerative production is an approach to managing agroecosystems that provides food and material — be it through agriculture, aquaculture or forestry — in ways that create positive outcomes for nature. These outcomes include, but are not limited to, healthy soils, improved air and water quality, and higher levels of carbon sequestration. They can be achieved through a variety of context-dependent practices and can together help regenerate degraded ecosystems and build resilience on farms and in surrounding landscapes. Any approach must be supported by evidence*" to be used with reference to regenerative production of renewable resources.

Moreover, E5-4 and the relevant Application Guidance (AG 5) make reference to *"sustainable versus regenerative source[s]"* of renewable materials. The term *"sustainable"* is not defined in Appendix A, nor is any clarification given about what is to be considered a *"sustainable"* source of renewable materials in comparison to a *"regenerative"* source. In principle, we do not consider that there is a place for reference to anything other than regeneratively produced renewables in the circular economy standard, as unless they are produced in a manner that meets the definition of regenerative production, they will be produced in a way that undermines the regeneration of natural ecosystems - itself an element of the definition of the circular economy. If a reference to "sustainable" sources is to be included in ESRS E5, at the very least it should be accompanied by a robust definition referring to relevant certification schemes, and reflecting that sustainable production is to be considered a transition to regenerative production.

Recommendation: The references to *"sustainable"* sources of renewable materials should be deleted. Renewable materials that are not regeneratively grown undermine the objective of the regeneration of ecosystems, and as such, should not be considered "circular" for the purposes of reporting under ESRS E5. In any event, if the reference to sustainable production is maintained, this should be considered only as a transitional measure, and the term should be defined to reflect this and with reference to certification schemes that can attest to the sustainability of production methods. Please see the Mark Up for our proposed definition.