EPRA
EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

RESPONSE

May 2021

EPRA RESPONSE

to the Joint Consultation Paper concerning Taxonomy-related sustainability disclosures

EPRA*, representing the listed real estate sector in Europe, welcomes the opportunity to provide feedback on the European Supervisory Authorities (ESAs) consultation paper, on the EU taxonomy-related sustainability disclosure criteria for financial products and on the ESAs draft Regulatory Technical Standard (draft RTS). EPRA's feedback is focused on the listed real estate sector due to the Association's sector specific knowledge and expertise.

Key highlights:

- We welcome ESAs' proposed approach **to have a 'single rulebook'** for both the Regulation on Sustainability-Related Disclosure in the Financial Services Sector (SFDR) and the EU Taxonomy Regulation (TR) related disclosure for financial products, particularly because it helps minimise duplication and already extensive complexity in the area of ESG disclosure.
- Similarly, we agree with ESAs' proposal to **use the same template** as long as it accommodates well both SFDR and TR types of disclosure.
- We agree with a single figure for the financial products' entire portfolio to keep a simplified output of the ESG reporting or financial products. On the other hand, **EPRA does not agree with ESAs' proposed approach for non-financial investee companies** (explained in point 26 of the consultation paper and stated in Article 16b(1)-(3) of draft RTS) that the value in the numerator should correspond to the value of the securities invested by the financial product in those companies weighted by either the share of turnover, or capital expenditure or operational expenditure contributed to environmentally sustainable economic activities. Instead, **we recommend a weighted average ratio composed of all three KPIs, i.e. the taxonomy-aligned turnover, CapEx and OpEx, to avoid misleading information, enable comparability, align with the Article 8 TR disclosure and protect ultimate investors.**
- We stress that it should be made clear at the beginning, whether financial products pursue predominantly environmentally sustainable activities or socially sustainable activities. **Socially sustainable investments should be excluded from the Taxonomy alignment figure** (to avoid providing misleading information) and apply SFDR provisions (as indicated by the ESAs).

***About EPRA**

EPRA, the European Public Real Estate Association, is the voice of the publicly traded European real estate sector. With more than 280 members, covering the whole spectrum of the listed real estate industry (companies, investors and their suppliers), EPRA represents over EUR 670 billion of real estate assets* and 94% of the market capitalisation of the FTSE EPRA Nareit Europe Index.

EPRA's mission is to promote, develop and represent the European public real estate sector. We achieve this through the provision of better information to investors and stakeholders, active involvement in the public and political debate, promotion of best practices and the cohesion and strengthening of the industry. Find out more about our activities on www.epra.com.

**European companies only*

Full responses to the specific questions of the consultation paper (referenced to the draft RTS):

Q1: Do you have any views regarding the ESAs' proposed approach to amend the existing SFDR RTS instead of drafting a new set of draft RTS?

We welcome the ESA's proposed approach particularly because it helps minimise duplication and already extensive complexity in the area of ESG disclosure. Therefore, the ESA's aim to have a 'single rulebook' for both SFDR and TR specific requirements is much welcomed by the listed real estate sector.

In addition, there is a great need for a continuous convergence and alignment with the emerging sustainability related disclosure policy and regulatory initiatives, especially with a draft Article 8 TR Delegated Act and the proposed Corporate Sustainability Reporting Directive as part of the NFRD review. All efforts should be made to ensure a great level of alignment between various ESG related disclosure initiatives.

Q2: Do you have any views on the KPI for the disclosure of the extent to which investments are aligned with the taxonomy, which is based on the share of the taxonomy-aligned turnover, capital expenditure or operational expenditure of all underlying non-financial investee companies? Do you agree with that the same approach should apply to all investments made by a given financial product?

According to the ESAs proposed approach for non-financial investee companies (explained in point 26 of the consultation paper and stated in Article 16b(1)-(3) of draft RTS), the value in the numerator should correspond to the value of the securities invested by the financial product in those companies weighted by the share of turnover, or, where relevant, capital expenditure or operational expenditure contributed to environmentally sustainable economic activities. The financial market participant must choose one of the three types of calculation basis for all non-financial undertaking investee companies the product invests in and explain the reasons for that choice, including how that choice is appropriate for the investors in the product.

Following closely the interactive ESAs' open hearing on the Consultation Paper on Taxonomy-related sustainability disclosures, it seems that the main objective of limiting the KPIs to only one of the three types of KPIs relates to the protection of consumers (i.e. retail investors). ESAs expressed its views that it would be burdensome to expect from retail investors to understand what is behind 'turnover', 'CapEx' or 'OpEx', if they were to be disclosed for each financial products.

EPRA does not share this view and strongly recommends that all three KPIs should be used in correctly calculating the market value of all taxonomy-aligned investments of the financial products. We believe so for the following reasons:

- **TRANSPARENCY:** We think that consideration of all three KPIs is needed to avoid disclosure of partial information not indicating a full context of the underlying investment. Otherwise, we risk potential misleading information given that the EU Taxonomy is created with a focus on the underlying economic activities and not on the investee companies. It means that investee companies will disclose all three figures, but not for all underlying economic activities they are pursuing. Depending on the economic activity, investee will use either Turnover, CapEX or OpEx while avoiding a duplication of accounting, but in their final disclosure all three figures will be represented cumulatively showing the extent to which their underlying economic activities are EU Taxonomy aligned. While this will be fully determined in the Art. 8 TR Delegated Act of which draft was published by the Commission on Friday 7 May 2021, the TEG's Usability Report may give us already a clear indication that for e.g. transitional and enabling activities (such as *Renovation of existing buildings*), it is mostly CapEx which will be relevant to apply, on the other hand, for those activities that are 'environmentally sustainable' (such as

Ownership of eligible buildings), it is the turnover which will be relevant to apply. Forcing financial market participants to apply only one or the other for their financial product disclosure is ultimately forcing them to choose between transitional and enabling activities and those that are already environmentally sustainable. We would argue that such an outcome would go against the main objective of the EU Taxonomy which is to help the finance sector to redirect its capital to more sustainable activities, especially to help them finance the transition from 'brow' to 'green' or 'greener' activities. Therefore, they should be encouraged to disclose a full context behind their financial products and demonstrate to what extent they finance transitional activities and to what extent they focus on what is already green. Otherwise, there is potential misleading or only partial information on the underlying economic activities which are financed through financial products. For the listed real estate sector, we could demonstrate the above by the following examples:

- **Development of new building: CAPEX***
- **Renovation of existing buildings: CAPEX****
- **Acquisition of new building: CAPEX**
- **Ownership of eligible buildings: Turnover**

* Turnover for developers
** Turnover for construction companies

The above listed figures are to complement each other and are all needed to show a correct picture of the extent the undertaking's activities are associated with economic activities that qualify as environmentally sustainable under TR. If the ESAs require the financial market participants to choose only one KPI for calculating such an extent, it has a true potential to be misleading information.

- **ALIGNMENT WITH ARTICLE 8 OF THE EU TAXONOMY REGULATION:** Art. 8 of TR requires that investee companies disclose all three KPIs where relevant. In fact, it says in its Art 8(2): '***In particular, non-financial undertakings shall disclose the following: (a) the proportion of their turnover derived from products or services associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9; and (b) the proportion of their capital expenditure and the proportion of their operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9.'***

- **COMPARABILITY**: Comparability of financial products in terms of their TR's alignment is crucial. Even more so for retail investors who require a greater level of protection. We agree with the ESAs that such disclosure needs to be simple in order not to overburden all parties involved. However, when retail investors are being given options between various financial products, they need to have comparable information. It would be wrong to assume that end investor would be able to compare financial product which used turnover as a KPI to calculate its share of TR aligned investments in non-financial investee companies, with the financial product which used CapEx as a KPI to calculate its share of TR aligned investments in non-financial investee companies. These two figures are to complement the environmental story behind financial products and should both be used in demonstrating the extent to which the financial products are TR aligned.

  In addition, we highlight that the terms which are described and used in the draft RTS are not aligned with financial reporting. For example, there is no common definition of 'capex'. In the absence of clear definition of what 'capex' is and what it is not, each non-financial investee company will need to adopt its own definition which will render the consolidation at the level of the investor meaningless (in case of choosing CAPEX as a single KPI). Moreover, these concepts do not always align with yearly financial reporting, e.g. ‘capex’ can spread into multiple years and therefore it needs to be clarified how this will be accounted for by the investors and how this would align with the provisions stated in the Article 8 TR delegated act of the Commission. Without clearly defined rules, comparability will be hardly possible.

- **CONSUMER PROTECTION**: As stated above, we argue that it is for the purpose of consumer’s protection to have access to concise yet transparent and comparable information on all financial products. Making retail investors to potentially face two different financial products, one which used turnover as a KPI to calculate its share of TR aligned investments in non-financial investee companies, and one which used CapEx as a KPI to calculate its share of TR aligned investments in non-financial investee companies, would make their situation even more complex and burdensome.

EPRA final recommendation is that for investment in underlying non-financial investee companies, all three KPIs should be used, calculated and disclosed in a more comparable way. In terms of the calculation, we recommend a weighted average ratio composed of the taxonomy-aligned turnover, CAPEX and OPEX for non-financial investee companies. In terms of disclosure, we recommend a single figure for the financial products’ entire portfolio to keep a simplified output of the ESG reporting or financial products.

Q3: Do you have any views on the benefits and drawbacks of including specifically operational expenditure (OpEx) of underlying non-financial investee companies as one of the possible ways to calculate the KPI referred to in question 2?

As above.

Q4: The proposed KPI includes equity and debt instruments issued by financial and non-financial undertakings and real estate assets, do you agree that this could also be extended to derivatives such as contracts for differences?

N/A

Q5: Is the use of “equities” and “debt instruments” sufficiently clear to capture relevant instruments issued by investee companies? If not, how could that be clarified? Are any specific valuation criteria necessary to ensure that the disclosures are comparable?

Current Green Bond principles assume that the proceeds of Green Bond are 100% allocated to Green Assets irrespective of the actual capital structure of the investee company. It should be clarified that in that case, the equity cannot “claim” credit for the Green Bond Investment as well, otherwise you would be double counting the amounts which are effectively invested in the Green Products.

Q6: Do you have any views about including all investments, including sovereign bonds and other assets that cannot be assessed for taxonomy-alignment, of the financial product in the denominator for the KPI?

N/A

Q7: Do you have any views on the statement of taxonomy compliance of the activities the financial product invests in and whether those statements should be subject to assessment by external or third parties?

This question should be addressed in Level 1.

Q8: Do you have any views on the proposed periodic disclosures which mirror the proposals for pre-contractual amendments?

N/A

Q9: Do you have any views on the amended pre-contractual and periodic templates?

N/A

Q10: The draft RTS propose unified pre-contractual and periodic templates applicable to all Article 8 and 9 SFDR products (including Article 5 and 6 TR products which are a sub-set of Article 8 and 9 SFDR products). Do you believe it would be preferable to have separate pre-contractual and periodic templates for Article 5-6 TR products, instead of using the same template for all Article 8-9 SFDR products?

In line with our answer to Q1, we recommend to do what is necessary to help minimise duplication and already extensive complexity in the area of ESG disclosure. We therefore believe that use of the same template would be preferred, however, such a template must be accommodating both types of disclosure.

Q11: The draft RTS propose in the amended templates to identify whether products making sustainable investments do so according to the EU taxonomy. While this is done to clearly indicate whether Article 5 and 6 TR products (that make sustainable investments with environmental objectives) use the taxonomy, arguably this would have the effect of requiring Article 8 and 9 SFDR products making sustainable investments with social objectives to indicate that too. Do you agree with this proposal?

At the moment, the EU Taxonomy Regulation is set to determine environmentally sustainable investments. There is no legal provision in the Regulation stating that EU taxonomy will extend to capture social objectives. Therefore, at the moment it should be made clear that there is distinction between environmentally sustainable investments and socially sustainable investments. E.g. it should be made clear at the beginning, whether financial products pursue predominantly environmentally sustainable activities or socially sustainable activities. Afterwards, socially sustainable investments should be excluded from the Taxonomy alignment figure (to avoid providing misleading information) and apply SFDR (as indicated by the ESAs).

Q12: Do you have any views regarding the preliminary impact assessments? Can you provide more granular examples of costs associated with the policy options?

No comment.