ZIA response to

ESAs' joint consultation on ESG diclosures

01 September 2020

Introduction and general considerations:

As an umbrella organization of entrepreneurs and federations, the German Property Federation (ZIA) represents the interests of the property sector along its entire value chain, as well as all its types of uses. Among the members represented by the ZIA are a large number of financial market participants, including more than 40 AIFM that manage open and closed-end real estate AIF. As AIFM are directly affected by the obligations of the Disclosure Regulation (SFDR), consultation is of immense importance for the ZIA.

ZIA supports the objectives of the Sustainable Finance Action Plan with the aim of redirecting financial flows into sustainable investments. Investment in the buildings sector plays a key role in this respect, as it is responsible for 40% of energy consumption and 36% of greenhouse gas emissions in the EU. The SFDR is an important element of the Sustainable Finance Action Plan to make the consideration of ESG factors and ESG risks in investment decisions and financial products transparent to investors and the public. ZIA therefore welcomes the SFDR approach.

The consulted proposals of the regulatory technical standards are extremely detailed and complex. We are concerned that in many respects the specifications will raise significant issues for practical implementation. Against this background, it is not conceivable from today's perspective that implementation can be achieved by the planned date of entry into force of 10 March 2021. The ZIA therefore strongly advocates postponing its application, preferably until 1 January 2022.

With regard to the RTS proposals, we would like to identify the following key problems:

- The provisions of the RTS are aimed almost exclusively at company investments. Investments in real estate are hardly considered at all. This is particularly evident in the specifications, definitions and calculation formulas of the template for the presentation of the principle adverse impacts (PAI), but is also reflected in the other regulations, e.g. on products according to Art. 8 (ESG strategy) and Art. 9 (Impact) of SFDR. Due to missing or inappropriate specifications, it will either not be possible to determine the required data or only through individually chosen and therefore inconsistent methods. As a result, the intended comparability cannot be achieved.

- Irrespective of inadequate or inappropriate definitions, the granularity of the requirements means that a large amount of information, figures and data must be collected. Some of the data requested will either not be available or will be disproportionately expensive to obtain.

- The specifications lack proportionality. Type of investment, size and orientation should be better taken into account for the scope and nature of the information to be provided as it is designed in the Level 1 text.

Q1 : Do you agree with the approach proposed in Chapter II and Annex I – where the indicators in Table 1 always lead to principal adverse impacts irrespective of the value of the metrics, requiring consistent disclosure, and the indicators in Table 2 and 3 are subject to an "opt-in" regime for disclosure?

In principal we agree with the approach of a reporting template providing information about principle adverse impacts (PAI), but with a total of 32 mandatory indicators as well as two additional voluntary indicators it is too complex and raises numerous questions regarding its practical implementation.

We consider it fundamentally problematic that the specified indicators in Annex I are only partially defined or - where definitions exist - they contain further undefined terms that raise further questions.

From the perspective of the real estate sector it is particularly challenging that definitions and calculation formulas consider investments in companies, while the specific characteristics of real estate investments are not taken into account at all. Specific definitions for the real estate sector are essential to enable the identification and calculation of data. Apart from missing definitions, there are also serious concerns that reliable data is not available or difficult to establish for several indicators.

Against this background, we fear that one of the main objectives of establishing comparability among financial market participants can hardly be achieved.

Q2 : Does the approach laid out in Chapter II and Annex I, take sufficiently into account the size, nature, and scale of financial market participants

In our view size, nature, scope and orientation of financial market participants and their products are not sufficiently considered in Chapter II and Annex I. Regardless of the size of a company, the sector to which it belongs or the type of investments made, all financial market participants must provide infor-mation on all indicators (of Table 1).

Proportionality is laid down in the Level 1 text (Art. 4 (1)) and should be taken into account accordingly. For example the 'Scope-3-emissions' queried under 'Green House Gas Emissions' are likely to entail much higher costs for investments of smaller financial market participants, where often a large number of service providers is involved, than for large companies, where this is not the case.

In addition, there is a lack of sector-specific differentiation, so that many indicators suggested by the ESAs do not work for specific sectors as for example for real estate (see above).

Q3 : If you do not agree with the approach in Chapter II and Annex I, is there another way to ensure sufficiently comparable disclosure against key indicators?

In principle, the indicators could be retained, but the number of mandatory indicators should be significantly reduced in favour of optional indicators. Which indicators should be mandatory and which optional should depend on the clarity of the definitions and the degree of data availability (see Q4).

Q4 : Do you have any views on the reporting template provided in Table 1 of Annex I?

We would like to comment on the indicators as follows:

1. **<u>Green House Gas Emissions (indicators 1- 4.)</u>**

Definitions / calculation formulas regarding indicators 1-3.:

The definitions and calculation formulas for greenhouse gas emissions in Annex 1 No. 1 (c) to (g) and (i) are oriented towards investments in companies only and disregard other assets such as real estate. The definition of 'enterprise value' is inappropriate with regard to real estate, the definitions of 'value of investments' in (d) and (h) are insufficient.

Consequently, the formulae in (f), (g) and (i), for which the above definitions are needed, cannot be applied. Due to the lack of viable definitions for the real estate the calculation of data for the indicators under 1-3. would currently involve considerable uncertainties.

Scope 1, 2 and 3 emissions (Def. (a)): In principal, we consider a subdivision into Scope 1, 2, and 3 carbon emissions on the basis of known definitions to be comprehensible. With regard to real estate, data on Scope 1 and 2 emissions should be generally available.

However, there are doubts regarding scope 3 emissions. As these would often have to be procured either from external service providers or in the course of production (building materials) or even from tenants, it is highly questionable whether they are available at all. The collection of data from tenants would also be problematic in terms of data protection law.

Against this background, we suggest that only Scope 1 and 2 emissions should be used as mandatory indicators. Information on Scope 3 emissions should be voluntary. In any case, it should be made clear that no data needs to be collected from tenants.

Carbon Footprint (2.):

Although the formula under (g) cannot be used for the real estate sector (see above), the calculation of the carbon footprint for buildings is basically feasible and common practice. A distinction is made between 'market based' and 'location based'. For real estate, it should be determined which basis is decisive.

Solid fossil fuel sector exposure (4.): Apart from the fact that it is not exactly clear what kind of fossil fuels is captured by 'solid fossil fuel', there is no indication of how this indicator should be applied regarding real estate. In contrast to companies, real estate per se cannot be assigned to a certain energy sector. We therefore assume that no disclosures are required for investments in real estate for the purposes of this indicator. However, if this should be the case, a breakdown according to whether tenants belong to the solid fossil fuel sector should be avoided in any case, as this would lead to contradictory and incomprehensible results. In this context, we refer to the TEG's proposals on taxonomy criteria for buildings, where the tenants' affiliation is not relevant either.

2. Energy Performance (indicators 5.-8)

Total energy consumption and indicators 5.+ 6. (in GWh): The data to be reported should be available for the property sector in general. In order to achieve results that are as accurate and comparable as possible, the emission factors for real estate should be precisely defined (e.g. whether market or location based).

Energy consumption intensity (7.): According to the definition, energy consumption must be reported in relation to the revenue of the investee companies. The definition does not work for real estate as revenue is not a suitable reference. A separate definition for buildings based on energy consumption referencing to square meter gross floor area should be added.

Energy consumption intensity per sector (8.): A more detailed breakdown by NACE sectors as proposed is hardly feasible for the real estate sector, as the

NACE sectors for real estate are divided into buying and selling, renting and intermediation. If at all, a breakdown could be provided by type of use (e.g. residential, commercial, office). However, we are concerned that the data collection of such a breakdown would involve a disproportionate effort. Against this background, indicator 8 should only be optional.

3. Biodiversity, Water, Waste (indicators 9-16)

For these sectors, there are proposals within the framework of the TEG recommendations on taxonomy (DNSH), which in our view are basically feasible. However, the PAI template does not correspond with the taxonomy specifications. Rather, it is based on how the respective investees companies deal with it. Therefore, no information can be given on indicators 9. to 16. regarding real estate investments.

It should be made clear that, accordingly, no information should be provided on these indicators.

4. Social and employee, respect for human rights, anti-corruption and anti-bribery matters (indicators 17-32.)

All information to be provided within indicators 17-32. is based on how the respective investees companies deal with it. Therefore, no information can be given on indicators 17-32. regarding real estate investments..

It should be made clear that, accordingly, no information should be provided on these indicators.

Q5 : Do you agree with the indicators? Would you recommend any other indicators? Do you see merit in including forward-looking indicators such as emission reduction pathways, or scope 4 emissions (saving other companies´ GHG emissions)?

In principle, we think it makes sense to think about forward-looking indicators. However, given the com-plexity and the issue of data availability already with regard to the proposed indicators, the addition of further indicators should not be considered at this stage.

Q6 : In addition to the proposed indicators on carbon emissions in Annex I, do you see merit in also requesting a) a relative measure of carbon emissions relative to the EU 2030 climate and energy framework target and b) a relative measure of carbon emissions relative to the prevailing carbon price?

Given the complexity and the issue of data availability already with regard to the proposed indicators, the addition of further indicators should not be considered at this stage.

Q7 : The ESAs saw merit in requiring measurement of both (1) the share of the investments in companies without a particular issue required by the indicator and (2) the share of all companies in the investments without that issue. Do you have any feedback on this proposal?

As mentioned before, the measurement of both do not work regarding real estate investments in most cases.

Q8 : Would you see merit in including more advanced indicators or metrics to allow financial market participants to capture activities by investee companies to reduce GHG emissions? If yes, how would such advanced metrics capture adverse impacts?

Even though the question is related to investee companies and not to real es-tate: as mentioned be-fore the proposed indicators are highly complex and raise questions about data availability at several points. Therefore, more advanced indicators and metrics should not be added at this stage.

Q9 : Do you agree with the goal of trying to deliver indicators for social and employee matters, respect for human rights, anti-corruption and anti-brib-ery matters at the same time as the environmental indicators?

Q10 : Do you agree with the proposal that financial market participants should provide a historical comparison of principal adverse impact disclosures up to ten years? If not, what timespan would you suggest?

In our view, there is no corresponding regulation or empowerment for the presentation of a historical comparison in the Level 1 text. Due to the lack of a basis for the introduction of a historical comparison, it should therefore be de-leted.

Apart from this, we consider the presentation of indicators over a 10-year period to be too extensive, especially in view of the extremely rapid development of environmental and social regulation and stand-ards, changes in emission benchmarks, etc. If, for example, an investment is to be presented with sus-tainability indicators from 2010 onwards, this could possibly give misleading ideas about how sustainable the investments were in the past. If the historical comparison is to be maintained at all, the period should be reduced to a maximum of 5 years.

Q11 : Are there any ways to discourage potential “window dressing” techniques in the principal adverse impact reporting? Should the ESAs consider harmonising the methodology and timing of reporting across the reference period, e.g. on what dates the composition of investments must be taken into account? If not, what alternative would you suggest to curtail window dressing techniques?

Q12 : Do you agree with the approach to have mandatory (1) pre-contractual and (2) periodic templates for financial products?

In general, standardized templates can facilitate the fulfilment of reporting requirements and are likely to improve comparability for end investors. At the same time, they bear the risk of being too rigid and lack flexibility. For financial products pursuant to Art. 8 and Art. 9 SFDR, various asset classes can be considered, e.g. companies or real estate. The template proposed for Principal Adverse Impact Reporting is already too little focused on the classification of real estate investments, as many of the indicators are not applicable to them. We can only support a binding template if it takes these product-specific differ-ences into account.

Q13 : If the ESAs develop such pre-contractual and periodic templates, what elements should the ESAs include and how should they be formatted?

As mentioned above, mandatory templates can lead to the problem that they are not flexible enough to take into account the different characteristics of financial products and asset classes. In any case, it should be emphasized that indicators do not need to be answered if no data is available for them or if they do not suit to the respective asset class / product.

Q14 : If you do not agree with harmonised reporting templates for financial products, please suggest what other approach you would propose that would ensure comparability between products.

Q15 : Do you agree with the balance of information between pre-contractual and website information requirements? Apart from the items listed under

Questions 25 and 26, is there anything you would add or subtract from these proposals?

Q16 : Do you think the differences between Article 8 and Article 9 products are sufficiently well captured by the proposed provisions? If not, please suggest how the disclosures could be further distinguished.

Q17 : Do the graphical and narrative descriptions of investment proportions capture indirect investments sufficiently?

Q18 : The draft RTS require in Article 15(2) that for Article 8 products graphical representations illustrate the proportion of investments screened against the environmental or social characteristics of the financial product. However, as characteristics can widely vary from product to product do you think using the same graphical representation for very different types of products could be misleading to end-investors? If yes, how should such graphic representation be adapted?

We see a risk that graphic representations in this context may lead to misleading statements, particularly given the wide range of products and asset classes. For example, Art. 8 SFDR products (ESG strategy) are likely to be comparable if they invest in companies (e.g. UCITS) and if they are selected according to the "best-in-class" principle. In contrast, a best-in-class approach is not common for real estate portfolios resp. such a compilation would be based on completely different standards. It will therefore hardly be possible to make comparisons between different asset classes / products, or it will only seemingly be possible. Graphic representations must therefore take into account product and asset-specific features and contain clear explanations. Otherwise, they can give the end investor a false impression.

Q19 : Do you agree with always disclosing exposure to solid fossil-fuel sectors? Are there other sectors that should be captured in such a way, such as nuclear energy?

It remains unclear how this factor is to be applied regarding real estate. In contrast to companies, real estate per se cannot be assigned to a certain energy sector. We therefore assume that no disclosures are required for investments in real estate. However, if this should be the case, a breakdown according to whether tenants belong to the solid fossil fuel sector should be avoided in any case, as this would lead to contradictory and incomprehensible results. In this context, we refer to the TEG's proposals on taxonomy criteria for buildings, where the tenants' affiliation is not relevant either.

Q20 : Do the product disclosure rules take sufficient account of the differences between products, such as multi-option products or portfolio management products?

Q21 : While Article 8 SFDR suggests investee companies should have "good governance practices", Article 2(17) SFDR includes specific details for good governance practices for sustainable investment investee companies including "sound management structures, employee relations, remuneration of staff and tax compliance". Should the requirements in the RTS for good governance practices for Article 8 products also capture these elements, bearing in mind Article 8 products may not be undertaking sustainable investments?

In our view, the requirements of the Level 1 Regulation do not provide a further specification of good governance for Art. 8 products (ESG Strategy), as Art. 8 SFDR does not refer to Art. 2(17) SFDR. At the same time, recital 18 and subsequent recitals of level 1 Regulation emphasize the different level of requirements for products under 8 SFDR and those with impact under Art. 9 SFDR and states that a distinction must be made in the requirements. The higher standard for Art. 9 products should therefore not be adopted for Art. 8 products.

Q22 : What are your views on the preliminary proposals on "do not significantly harm" principle disclosures in line with the new empowerment under the taxonomy regulation, which can be found in Recital (33), Articles 16(2), 25, 34(3), 35(3), 38 and 45 in the draft RTS?

We believe it is essential to ensure consistency between the Taxonomy Regulation and the Disclosure Regulation. It is therefore essential to harmonise the "Do no significant harm" rule.

Q23 : Do you see merit in the ESAs defining widely used ESG investment strategies (such as best-in-class, best-in-universe, exclusions, etc.) and giving financial market participants an opportunity to disclose the use of such strategies, where relevant? If yes, how would you define such widely used strategies?

So far, the definitions are not sufficient to distinguish products under Art. 8 SFDR adequately from products under Art. 9 SFDR in all cases. Therefore further clarifications of the definitions would be helpful. At the same time, in view of the integration of ESG factors into product governance under MiFID II, possible definitions should by no means be too narrow, so that investors can be offered a wide range of sustainable products. Further clarifications should also necessarily take into account the characteristics of different types of assets (real estate). Provisions that are too narrow, focusing on individual asset classes, could run counter to the objectives of the Sustainable Finance Action Plan by classifying too few products as eligible under Articles 8 or 9 SFDR.

Q24 : Do you agree with the approach on the disclosure of financial products' top investments in periodic disclosures as currently set out in Articles 39 and 46 of the draft RTS?

Q25 : For each of the following four elements, please indicate whether you believe it is better to include the item in the pre-contractual or the website disclosures for financial products? Please explain your reasoning.

- **a) an indication of any commitment of a minimum reduction rate of the investments (sometimes referred to as the "investable universe") considered prior to the application of the investment strategy - in the draft RTS below it is in the pre-contractual disclosure Articles 17(b) and 26(b);**
- **b) a short description of the policy to assess good governance practices of the investee companies - in the draft RTS below it is in pre-contractual disclosure Articles 17(c) and 26(c);**
- **c) a description of the limitations to (1) methodologies and (2) data sources and how such limitations do not affect the attainment of any environmental or social characteristics or sustainable investment objective of the financial product - in the draft RTS below it is in the website disclosure under Article 34(1)(k) and Article 35(1)(k); and**
- **d) a reference to whether data sources are external or internal and in what proportions - not currently reflected in the draft RTS but could complement the pre-contractual disclosures under Article 17.**

Q26 : Is it better to include a separate section on information on how the use of derivatives meets each of the environmental or social characteristics or sustainable investment objectives promoted by the financial product, as in the below draft RTS under Article 19 and article 28, or would it be better

to integrate this section with the graphical and narrative explanation of the investment proportions under Article 15(2) and 24(2)?

Q27 : Do you have any views regarding the preliminary impact assessments? Can you provide more granular examples of costs associated with the policy options?
