AREF
The Association of Real Estate Funds

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Response by email to: cp21-18@fca.org.uk

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Response to FCA CP21/18 Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets

Executive Summary

We, the Association of Real Estate Funds[1] (AREF) welcome the opportunity to respond to the FCA's consultation on enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets.

In our response, we have highlighted that in developing regulation policy makers should take into account specific characteristics which could apply in the case of funds – whether listed or unlisted - holding underlying real estate, for example:

- real estate which may be held directly and/or via special/intermediate/holding vehicles; and
- relevant data may only be available to occupiers and other third parties. The fund managers may not be entitled to such data.

We consider there should be a consistency and appropriate uniformity of approach between the listed and unlisted sectors, including a robustness with ratings and the methodologies that underlie the ratings. You will note our response to FCA CP21/17.

Our response to the consultation

We are responding to specific questions 17 to 20 inclusive focused on ESG data and rating providers, given that the issues raised can have a significant market effect for both the listed and unlisted funds holding underlying real estate. If you would like to discuss our response with us, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat at AREF. Also, as our members invest in real estate and other real assets for various types of open-ended and closed-ended funds, in the UK and in other jurisdictions, we are always willing to assist the FCA by sharing this wealth of knowledge and expertise.

Yours sincerely

Paul Richards
Managing Director, The Association of Real Estate Funds

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[1] The Association of Real Estate Funds represents the UK real estate funds industry and has around 60 member funds with a collective net asset value of more than £72 billion under management on behalf of their investors, including £18 billion on behalf of retail investors in the UK. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Quarterly Property Funds Index and the AREF/IPD Property Fund Vision Handbook.

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Response to CP21/18

Chapter 4 – Discussion topics on ESG integration in UK capital markets

	ESG data and rating providers
Q17	***Do you agree with how we have characterised the challenges and potential harms arising from the role played by ESG data and rating providers? If not, please explain what other challenges or harms might arise?.***
	AREF agree with how the FCA have characterised the challenges and potential harms. We anticipate that ESG data providers (including in relation to the real estate sector) will continue to have an increasingly prominent role in financial markets, and agree that this raises issues on transparency and conflicts of interest. Real estate fund managers – operating listed and/or unlisted funds – are also building references to third-party ESG ratings into the design and delivery of their sustainable investment products. We agree that the managers' due diligence obligations should extend to considering the fitness for purpose of the ESG rating services in addressing the manager's information needs, and their duty to act in the best interests of the fund investors. In the case of real estate and ESG ratings, however, interpretation is inherently challenging. We highlight the following issues: • *ESG performance is by its nature multi-dimensional.* Accordingly, each ESG rating provider makes different choices about which ESG factors to consider in its methodology, and which metrics to use to measure performance on each of these attributes. Each provider also combines these metrics in a different way, applying different weighting and aggregation methodologies. This is significantly different to credit ratings where creditworthiness is fairly easily defined as the 'likelihood of receiving full and timely payment of interest and principal'. • *ESG ratings are subject to data gaps.* There are data and knowledge deficiencies in a real estate context, particularly when trying to translate exposure to climate risk into some form of value impact: see Clayton, J.; Devaney, S.; Sayce, S. and van de Wetering, J. (2021) Climate Risk and Commercial Property Values: a review and analysis of the literature UNEP FI • *Other quality issues and reliability of ESG data* – There can be: - An overreliance on publicly available data such as news articles which may be misleading, not been subject to appropriate controls, or out of date. - A lack of willingness to engage with the issuer, to better understand and assess publicly available data. If engagement were to take place, it may be undertaken over a protracted period, meaning that the rating of the issuer may be inaccurate for a long-time while the engagement is taking place. • *Data governance and oversight* - ESG data and ratings providers may not have appropriate data governance and oversight processes in place in their assessment of the quality of data. ESG data and ratings providers do not seem to have systematic approaches to challenging the data they collect via questionnaires etc. Gaps in issuer data mean that clarity on each individual data provider's approach and to address these issues is important to real estate fund managers in their assessment of which ESG data and ratings providers' product is the most accurate and useful and reflects their own sustainable investment objectives. This could result in there being potential for harm to market functioning, including investors in both listed and unlisted funds in certain circumstances.

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Q18	***Would further guidance for firms on their use of ESG ratings – and potentially other third-party ESG data – be useful, potentially clarifying expectations on outsourcing arrangements, due diligence, disclosure and the use of ratings in benchmarks and indices? Are there other aspects such guidance should include?***
Q19	***We would welcome views on whether there is a case either to encourage ESG data and rating providers to adopt a voluntary Best Practice Code, or for the FCA to engage with the Treasury to encourage bringing ESG data and rating providers' activities inside the FCA's regulatory perimeter.***
Q20	***If there is a case for closer regulatory oversight of ESG data and rating providers, we welcome views on: 45 CP21/18 Annex 1 Financial Conduct Authority Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets.***
a.	***Whether transparency, governance and management of conflicts of interest are the right aspects of ESG data and rating providers' operations and activities to prioritise in regulatory oversight, and if not, what other aspects should be considered?***
b.	***Whether and how regulatory priorities should differ between ESG rating providers and other ESG data providers?***
c.	***The similarities and differences between the policy issues that arise for ESG rating providers and those that arise for CRAs, and how far these similarities and differences might inform the appropriate policy response?***
	We would prefer the implementation of a Best Practice Code for ESG data and rating providers, and thereby encourage voluntary, industry-led adherence to minimum conduct standards in areas such as transparency, governance and management of conflicts of interest. This is particularly relevant in the case of listed and unlisted real estate funds, given the widespread practice of managers to - respond to due diligence questionnaires; and - comply with codes of practice the due diligence questionnaires and codes of practice contain a focus on transparency, governance and management of conflicts of interest: a focus which is regularly monitored (and as appropriate updated) by industry organisations. The due diligence questionnaires and codes of practice can be developed to address issues relating to ESG data and rating providers. Our preference is to build on current successful self-regulation solutions, and thereby dispense with FCA involvement with closer regulatory oversight.