

Environmental, Social and Governance (ESG) Division
Financial Conduct Authority
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Response by email to dp23-1@fca.org.uk

10 May 2023

Response to FCA DP23/1 Finance for positive sustainable change: governance, incentives and competence in regulated firms¹

We, the Association of Real Estate Funds² (AREF), welcome the opportunity to respond to the Financial Conduct Authority (FCA) regarding DP23/1 (the Discussion Paper)

We have collaborated with other associations, BPF, IPF and INREV³, to produce a real estate focussed response to this Discussion Paper.

We understand the FCA's interest in how firms' governance structures can contribute to the transition to a net zero economy and support a more sustainable long-term future.

Our response has a real estate focus. In the past decade, the sustainability challenges of the real estate industry have increasingly been in the spotlight. [According to the World Economic Forum](#), buildings account for nearly 40% of global greenhouse gas emissions, 50% of the world's energy consumption and 40% of raw material use. The UK's Department for Business, Energy & Industrial Strategy (BEIS) states⁴ that one of the most difficult decarbonisation challenges the nation faces is the built environment and that commercial (including industrial) buildings pose a particular challenge as they account for a third of UK emissions from the built environment.

The buildings use very different amounts of energy, usually dependent on the size of the building. In England and Wales, only 7% of the buildings are larger than 1,000sqm; however, they consume over 53% of all the energy used by commercial buildings and are responsible for the associated carbon emitted from these buildings. [Forecasts indicate](#) that approximately 80% of all UK buildings in 2050 have already been built, so a major task is retrofitting existing buildings and determining how to measure and report these decarbonisation efforts.

Fund and asset managers (on behalf of their investors) hold real estate – whether in the UK or elsewhere – via a range of structures: listed and unlisted. We look forward to engaging with you to explain the range of structures with proposals on how regulation should apply appropriately to asset managers who would be subject to the regulation. By way of context, the structures may have real estate-specific characteristics and differ from structures for other alternative assets classes.

We note the FCA's intention for this Discussion Paper to act as an early-stage conversation about how UK fund managers are preparing for the sustainability challenges and welcome the FCA's constructive engagement with industry about the areas addressed in the Discussion Paper. We highlight the need for proportionate and balanced

¹ https://www.fca.org.uk/publication/discussion/dp23-1_updated.pdf

² The Association of Real Estate Funds represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.

³ British Property Federation (BPF), investment Property Forum (IPF) and European Association for Investors in Non-Listed Real Estate Vehicles (INREV)

⁴ [BEIS – Introducing a Performance Based Policy Framework in large Commercial and Industrial Buildings in England and Wales](#)

accountability around the delivery of fund managers' sustainable investment objectives and commitments – and appropriate according to the size and resources of the fund manager (which may range from large to SMEs).

We suggest that the FCA considers carefully whether further regulation on governance, incentives, and competence within member firms is truly the best course of action at this time taking into account:

- Real estate sustainable investment is developing at a pace. It is important that fund managers are operating in an environment where there is flexibility and room for evolution and innovation. Given different firm models and strategies, adopting more prescriptive rules – and particularly a one-size-fits-all approach - could stifle innovation and damage the UK's ability to achieve its net-zero commitments.
- Secondly, at this point in time, regulation already in place across a number of areas in the Discussion Paper is sufficient, and as such, any further regulation is not only unnecessary but could create confusion amongst regulated firms. For example, the FCA's rules on climate disclosures by asset managers in line with the Taskforce on Climate-related Financial Disclosures (TCFD), are not just a reporting exercise, but a tool for companies to consider how they are governing risks and opportunities. The FCA Handbook already requires that communication regarding financial products is clear, fair and not misleading. We understand this will be reiterated in the FCA's proposed 'anti-greenwashing rule' proposed in its 2022 consultation on Sustainability Disclosure Requirements and Investment Labels.
- Many of our members have already implemented the EU's AIFMD delegated acts clarifying how asset managers should integrate sustainability risks and, where relevant, other sustainability factors in the areas of organisational requirements, operating conditions, risk management and product governance. The EU co-legislators have adopted a high-level principles-based approach, amending existing provisions within sectoral delegated acts, most of which, if not all, already exist within the FCA Handbook. This approach clarifies that firms should take into account material sustainability risks and opportunities when complying with existing rules as opposed to proposing new ones.

Below we outline some of the practical challenges – and industry solutions – that in our view suggest that there is not at this stage a need for more prescriptive requirements in this space.

Objectives, purpose, business and strategy

Many fund managers already assess and integrate material sustainability risks, opportunities and impacts into their operations and financing activities. Larger firms will often have specialised ESG teams who will develop sustainable investment frameworks and will work with portfolio managers to consider ESG risks.

The Discussion Paper notes that an increasing number of firms are committed to sustainable objectives and that more than 500 firms across more than 50 jurisdictions have voluntarily signed up to the Glasgow Finance Alliance for Net Zero (GFANZ).

Data: a key challenge

A key challenge relates to data. In relation FCA CP 22/20, we are pleased to have engaged with the FCA in submitting proposals, dated 13th January 2023⁵, in response to a dialogue with – and request from – the FCA for the real estate industry sectors' views/suggestions/input, principally aimed at a set of best practice principles in support of consistent reporting and disclosure transparency:

- to inform the development of real estate-specific metrics that enable consistent, transparent, and comparable reporting and disclosure for real estate portfolios and covering all real estate asset classes (committed via equity and/or debt); and

⁵ <https://www.aref.org.uk/uploads/assets/40b88c44-cd3f-4c90-9b19d672c6c56b55/Submission-to-FCATCFDISSB-Proposals-ESG-Metrics-for-Real-Estate13-January-2023.pdf>

- that are aligned with TCFD guidelines (and intended to supplement the PRI - Technical Guide: TCFD for real asset investors) and the evolving SDR, where we understand no industry template for real estate is proposed.

These principles and real estate specific metrics aim to facilitate consistency of disclosures across the EU and UK as well as internationally where the TCFD's recommendations will apply. While the principles are aimed at supporting consistent reporting and disclosure by international asset managers, local supplements may be appropriate or needed for domestic real estate-specific metrics. In the context of realising this aim, we look forward to progressing the dialogue with the FCA.

Governance of investor stewardship to influence positive change

In general, stewardship can be split into three areas that form an overall approach: (1) corporate engagement; (2) proxy voting; and (3) collaboration (i.e. moving the industry forward).

Many firms have specific internal teams which focus on engagement and ESG to help embed sustainability considerations in the dialogue with investors.

There is often a presumption that engagement means influence and this is reflected in an implicit bias in fund investors' due diligence questions, which often ask for objectives, timelines, outcomes and escalation processes. There is also a presumption that if there is not a lot of quantity of engagement for influence, then firms are not undertaking engagement. When considering regulatory measures to encourage effective stewardship, it is important to note that engagement for the purposes of insight is legitimate engagement and it is the quality, rather than quantity, of engagement that is important.

We would like to discuss with you the appropriate approaches to stewardship in a real estate and real estate funds context, given that several of our members have opted to comply with the UK Stewardship Code 2020⁶.

In November 2020, a report '[Investing for Purpose](#)' was published. This was the output from a Stewardship Working Group set up by the Asset Management Taskforce to make proposals for how stewardship and responsible investment could be strengthened in the UK. Recommendation 4 within this report states:

'More emphasis is needed on stewardship in private markets. Asset owners and investment managers should identify common criteria for best practice stewardship in private asset classes. The IA should consider the quality of UK Stewardship Code disclosures in relation to private markets and identify how to progress best practice stewardship in this asset class.'

AREF plans to work with the IA to develop a best practice framework for-real estate as an asset class.

Stewardship is an area that is still evolving and currently we do not believe that there is a need for additional regulatory measures to encourage effective stewardship, given existing expectations on firms.

Future regulatory expectations and guidance

This is a rapidly evolving environment, and we believe it is not appropriate at this stage to elaborate additional regulatory requirements in areas such as senior management responsibilities; or linking remuneration and sustainability-linked objectives. Firms need the opportunity to evolve in way that best suits their investment objectives and the requirements of their underlying investors.

Additionally, were any rules or guidance introduced, they should be proportionate to the size of firm. Any future regulations or guidance on these topics should focus on setting out minimum standards rather than attempting to adopt an approach which may not be achievable by all. Setting out minimum standards would make regulations achievable for the smallest firms while not restricting larger firms with the ability to do more.

⁶ <https://www.frc.org.uk/investors/uk-stewardship-code>

Further engagement

We appreciate the FCA's focus on this topic and would be happy to discuss any aspect of this submission in further detail, in particular in terms of it applying to fund and assets managers operating within the real estate sector. Please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (ibungay@aref.org.uk), Policy Secretariat at AREF, in relation to any further engagement. In addition, members of our ESG & Impact Investing Committee and Public Policy Committee are always willing to assist the FCA by sharing their wealth of knowledge and expertise in ESG and sustainability.

Yours sincerely



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