

EPRA response to the ESMA Consultation on Guidelines on funds' names using ESG or sustainability-related terms

Introduction

EPRA*, representing listed real estate in Europe, welcomes the opportunity to provide feedback on ESMA's Consultation on Guidelines on funds' names using ESG or sustainability-related terms. EPRA's feedback is focused on the listed real estate sector due to the Association's sector specific knowledge and experience.

The European Public Real Estate Association (EPRA) represents a broad spectrum of the European listed real estate industry, ranging from the major listed property investment companies (i.e. companies that own, develop and trade investment property), to investors and property professionals. Our members stand strongly behind the EU sustainable finance policy enabling the European listed real estate sector's ability to advance rapidly on the climate driven objectives. We are more than convinced that a core responsibility in the 21st century is to make substantial and meaningful efforts to re-direct the investment in economic activities which have a true positive impact on the planet. This is a responsibility we share with:

- 1) the policy makers who have the responsibility to draw overall policies that will allow us to reach a common goal,
- 2) the business and investment communities in implementing the necessary actions that will transform these policies into real results, and
- 3) the regulators who have the responsibility to ensure a sound supervision.

The Sustainable Finance Disclosure Regulation (SFDR) is one of the very first building blocks of the EU sustainable finance policy package. It was adopted in 2019, before the EU Taxonomy was put in place defining environmentally sustainable investments (at least partially). The Corporate Sustainability Reporting Disclosure (CSRD) is only about to bring first – advanced - sustainability reports for financial years starting on or after 1 January 2024. As a result, there has been a number of real challenges in the financial market participants' efforts to apply SFDR rules due to a significant lack of required data from issuers, due to persisting confusions of sustainable investment's definition and also due to limited and delayed convergence between relevant regulations which form part of the EU sustainable finance package (e.g. EU Taxonomy, CSRD).

We also highlight that the SFDR was designed by the European policy makers as an ESG transparency regime which applies to financial market participants and to their products. The SFDR was not intended to create a labelling mechanism, although having a different classification introduced by Articles 6, 8 and 9 have fuelled the market to apply such differences in disclosure categories also as a foundation to market their products alongside. ESMA itself has been vocal against the use of SFDR and its Articles 8 and 9 as labels. It seems that the current proposal for the 'Guidance on the funds' names using ESG or sustainability-related terms' would lead the

market to the opposite direction as it works specifically with the two classification categories of 1) ESG-related [Article 8] and 2) Sustainability-related [Article 9].

To summarise the above, we wish to highlight that the SFDR, designed as a transparency regime, would not be an appropriate foundation for the quantitative thresholds criteria, at least not without further adjustment as part of the upcoming legislative review.

Addressing greenwashing

The EU Sustainable Finance initiative is highly important in helping the financial markets and real estate industry to advance on its ambition towards building a more sustainable built environment. At the same time, certain specific aspects of the SFDR brought to the market confusion in terms of its appropriate application. Such a confusion may have a significant impact on how the market responded in the SFDR's application and may have very well stimulated the behaviour which we now observe and consider as potential greenwashing.

We understand the seriousness of the situation on the market and existing need to address greenwashing. Therefore, we would like ESMA to consider the two aspects of SFDR which in our view may have stimulated the misapplication of the specific rules and a confusion around SFDR either by the financial market participants themselves or the end investors.

1) Definition of sustainable investments

The SFDR definition of sustainable investments in Article 2(17) is neither sufficiently clear nor well aligned with the EU Taxonomy. Even if it was aligned, the EU Taxonomy is not yet complete and therefore does not provide a sufficient guidance on what environmentally sustainable investments are. Even after the EU Taxonomy extends to cover all six environmental objectives, its scope remains limited to those activities which are eligible as having a potential to contribute substantially to one of the six environmental objectives. In other words, the EU Taxonomy is not intended to address yet any of the activities which contribute to environmental objectives less substantially and also any of the activities which contribute to social objectives. Having said that, it is evident that the definition of sustainable investments in SFDR and the EU classification system of sustainable investments will not overlap even after the EU Taxonomy is fully in place.

2) Differentiation between the Article 8 and Article 9 disclosure requirements

While the SFDR was designed as an ESG transparency regime, it also introduced a differentiation between Article 8 and Article 9 to enable financial market participants apply related disclosure requirements while taking into consideration their level of ambition. As a result, the financial market participants (FMPs) were required to choose their 'level' of disclosure requirements based on the level of ambition of their products. This was done without stating minimum criteria/threshold for the products which the FMPs would classify under either Article 8 or 9 and then consequently market (which was also not the intention of the legislation).

It goes without saying that such a structure of the regulation is very confusing. We therefore advise to consider to amend relevant provisions in SFDR, as part of the SFDR Review, which are not only confusing but prompting the market to apply it in an unintended way.

SFDR was not designed as a labelling regime. We would therefore like to reinforce its original ambition, as we see a high value in mandatory disclosure requirements. If we were to remove classification between Article 8 and 9, then there would be an uniform regime requiring the same

disclosure requirements on each product. It is our view that in such a framework there would be much greater clarity, much less confusion and much less of greenwashing.

Review of SFDR to accommodate better impact or transition investments, especially in ‘energy retrofitting of existing buildings’

Alternatively, we propose to first review SFDR to be a more suitable foundation for a labelling framework. More specifically, we would like the policy makers and consequently also the regulators to consider better the key objective of the EU sustainable finance initiative which is to finance Europe’s transition to a more sustainable growth. This objective will not be fulfilled if there is no sufficient understanding and **inclusion of relevant impact and transition investment amongst the most sustainable investment products**. For example in listed real estate, the energy retrofitting of existing buildings (i.e. those where objective is the reduction of carbon’s footprint/improvement of energy performance of the asset) has a positive environmental impact not only on the investment portfolio of the concerned financial institution (or investment portfolio of listed property company) but also on the society. Energy retrofitting of existing buildings has a greater climate mitigation potential (i.e. decrease of carbon’s footprint) than building a new building.

In addition, we would welcome improvement of the following:

- 1) the SFDR’s definition of what sustainable investment means would get closer aligned with the Science Based Targets Initiative (SBTi).
- 2) real estate related metrics and labels referred to in SFDR (e.g. EPC)

Introduction of the quantitative thresholds criteria for the use of ESG-related and sustainability-related terminology (i.e. labels) should follow such a review of SFDR and not precede.

ESMA Proposal on the Guidelines on funds’ names using ESG or sustainability-related terms

In addition, we do not consider Guidelines to be the most appropriate tool to introduce quantitative thresholds criteria for the use of ESG-related and sustainability-related terminology (i.e. labels). The consequences of such introduction could eventually bring even greater confusion on the market, especially as they would be based on a SFDR definition of sustainable investments which is still very vague.

Besides, depending on the region, there is a different understanding of ESG-related terminology and sustainability-related terminology. In fact, the ultimate end investor may not perceive any difference between ESG and sustainability. We would therefore like to ask ESMA to conduct a targeted research on the expectations from the end investors to see what terminology to use when considering such quantitative thresholds.

We remain available to discuss this further at your convenience. Please contact Jana Bour, EPRA ESG Policy & Advocacy Manager, at j.bour@epra.com.

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 790 billion

of real estate assets¹ 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.

¹European companies only

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Responses to consultation questions

Q1 : Do you agree with the need to introduce quantitative thresholds to assess funds' names?

We do not oppose the introduction of quantitative thresholds to assess funds' names in the future. However, we suggest to first review the parts of SFDR regulation which brought confusion on the market and only then look at introduction of quantitative thresholds if the issues of greenwashing does not improve.

Q2 : Do you agree with the proposed threshold of 80% of the minimum proportion of investments for the use of any ESG-, or impact-related words in the name of a fund? If not, please explain why and provide an alternative proposal.

As above, we suggest to first review the SFDR and its parts which brought confusion on the market. Most particularly, we believe that the definition of sustainable investment in Article 2(17) is vague and any minimum proportion based on such definition would not resolve the existing issue related to greenwashing.

Q3 : Do you agree to include an additional threshold of at least 50% of minimum proportion of sustainable investments for the use of the word "sustainable" or any other sustainability-related term in the name of the fund? If not, please explain why and provide an alternative proposal.

As above.

Q4 : Do you think that there are alternative ways to construct the threshold mechanism? If yes, please explain your alternative proposal.

No answer.

Q5 : Do you think that there are other ways than the proposed thresholds to achieve the supervisory aim of ensuring that ESG or sustainability-related names of funds are aligned with their investment characteristics and objectives? If yes, please explain your alternative proposal. If yes, please explain your alternative proposal.

We believe that the ESMA Supervisory briefing: Sustainability risks and disclosures in the area of investment management, dated 31 May 2022, provides for adequate solutions until the review of SFDR is completed. After the review of SFDR, or alongside it, the more robust discussion about the subject matter should be conducted.

Q6 : Do you agree with the need for minimum safeguards for investment funds with an ESG- or sustainability-related term in their name? Should such safeguards be based on the exclusion criteria such as Commission Delegated Regulation (EU) 2020/1818 Article 12(1)-(2)? If not, explain why and provide an alternative proposal.

As above.

Q7 : Do you think that, for the purpose of these Guidelines, derivatives should be subject to specific provisions for calculating thresholds?

No answer.

a) Would you suggest the use of the notional value or the market value for the purpose of the calculation of the minimum proportion of investment?

No answer.

b) Are there any other measures you would recommend for derivatives for the calculation of the minimum proportion of investments?

No answer.

Q8 : Do you agree that funds designating an index as a reference benchmark should also consider the same requirements for funds' names as any other fund? If not, explain why and provide an alternative proposal.

No answer.

Q9 : Would you make a distinction between physical and synthetic replication, for example in relation to the collateral held, of an index?

No answer.

Q10 : Do you agree of having specific provisions for "impact" or impact-related names in these Guidelines?

We strongly agree that transition and impact investing should be greater considered and encouraged within the SFDR framework. Such alteration would require changes in the regulation itself and should be part of the debate on the SFDR review.

Q11 : Should there be specific provisions for “transition” or transition-related names in these Guidelines? If yes, what should they be?

As above. We strongly agree that transition and impact investing should be greater considered and encouraged within the SFDR framework. Such alteration would require changes in the regulation itself and should be part of the debate on the SFDR review.

Q12 : The proposals in this consultation paper relates to investment funds’ names in light of specific sectoral concerns. However, considering the SFDR disclosures apply also to other sectors, do you think that these proposals may have implications for other sectors and, if so, would you see merit in having similar guidance for other financial products?

No answer.

Q13 : Do you agree with having a transitional period of 6 months from the date of the application of the Guidelines for existing funds? If not, please explain why and provide an alternative proposal.

A 6-month period is far too short to transition/accommodate changes if the proposed Guidelines were to be adopted.

Q14 : Should the naming-related provisions be extended to closed-ended funds which have terminated their subscription period before the application date of the Guidelines? If not, please explain your answer.

No answer.

Q15 : What is the anticipated impact from the introduction of the proposed Guidelines?

We feel that the impact of the proposed guidelines will more likely result in funds’ abstaining from using any ESG-related or sustainability-related terminology in their names. We would support to review SFDR so that the issue of greenwashing is being addressed in a manner which would not simultaneously potentially disincentivise or slow down investment critically needed in sustainability.

Q16 : What additional costs and benefits would compliance with the proposed Guidelines bring to the stakeholder(s) you represent? Please provide quantitative figures, where available.

No answer.