Unpacking Sustainable Finance Disclosure Regulation

An investment industry perspective on the benefits, challenges and road ahead

The Sustainable Finance Disclosure Regulation (SFDR) is designed to create transparency and trust in financial markets by setting clear rules and requirements related to sustainable investment disclosures for asset managers, fund managers and financial market participants. As such, its influence on asset managers with funds in, or marketed into, the EU is significant.

This report, based on a survey of 100 private equity, wealth and asset managers globally, explains why SFDR matters to asset managers globally. The report looks at the evolving regulatory landscape. It identifies key signs of maturity amongst asset managers. And it offers five “no-regret actions” that asset managers could take to stay ahead of the market.

Why SFDR matters

It’s expected that the transition to a low-carbon economy and the achievement of the United Nations' (UN) Sustainable Development Goals (SDGs) will require an acceleration in the pace of private investment into sustainable activities. The Sustainable Finance Disclosure Regulation (SFDR) is part of a package of legislative measures arising from the European Commission’s Action Plan for Sustainable Finance which seeks to help redirect capital flows towards sustainable activity.

The SFDR requires financial market participants and financial advisors in the EU, those with EU shareholders, and those marketing themselves in the EU (including AIFMs and UCITS managers) to provide prescript and standardized disclosures in relation to sustainability risks, the consideration of adverse sustainability impacts in their investment processes, and the provision of sustainability-related information with respect to financial products. Ensuring compliance requires a significant organizational response.

“Many PE managers are still trying to determine what ESG metrics make the most sense for their investments. The challenge is to find well-defined metrics that can be monitored and reported. Those with a portfolio of diversified investments will need to take a more holistic approach.”

Glenn Mincey
Global Head of Private Equity,
KPMG International

The state of the market

Market data suggests that activity around sustainable funds is growing. As of December 2023[1]:

- US$5.62 trillion in AUM was linked to either Article 8 or 9 funds
- 47.4 percent of funds reported were being classified as either Article 8 or 9 funds
- Article 8 funds represented 55.5 percent of market AUM and Article 9 represented 3.5 percent.

[1] Report title: *SFDR Article 8 and Article 9 Funds: Q4 2023 in review*
Source: Morningstar Inc. website, United Kingdom, (December 2023)

An evolving regulatory landscape

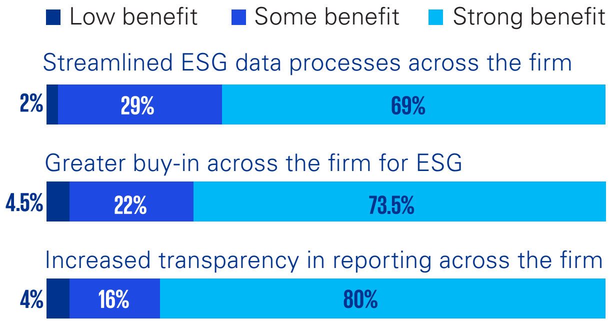
SFDR is under review by the European Commission. The consultation is a preliminary information gathering exercise that seeks to capture views on the usefulness and compatibility of the current rules, and possible changes to the disclosure requirements.

Despite industry practice, the Articles were never intended to be used as product categories. This will need to be addressed through the consultations. Its likely the EC will also want to use the opportunity to clarify existing challenges — for example, while the definitions of what classifies as an eligible Article 8 investment are fairly clear, they are less clear for Article 9 products.

There are concerns, however, that the consultations may result in rather significant changes to the regulation. Asset managers with products marketed in Europe should want to pay close attention. The outcomes could require the reclassification of funds and the reconstruction of internal processes.

The benefits of SFDR

Our survey of 100 asset managers and financial market participants shows that 47 percent report that SFDR has had a positive impact on their firm, with the strongest benefits arising from the increased transparency they are achieving in their reporting across the firm.



Source: KPMG 2023 SFDR Market Assessment survey, KPMG International, August 2023

According to our survey, asset managers have also experienced a markable increase in demand for Article 8 and Article 9 funds. Managers in the Europe, Middle East and Africa (EMA) region were the most likely to report increased demand (91 percent) and those in North America the least likely (59 percent), no doubt reflecting the investment criteria and allocation requirements of regional investors.

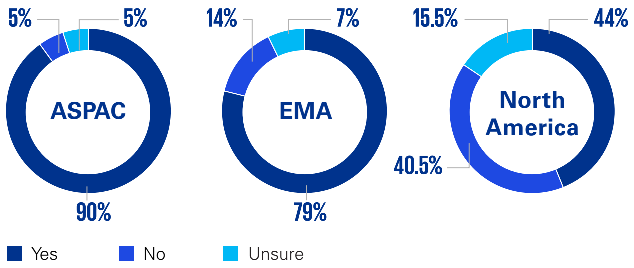
	Increase in demand for Article 8 or 9 funds		Increased demand for funds which incorporate net zero/decarbonization objectives	
	Yes	No	Yes	No
Global	77%	23%	74%	26%
ASPAC	76%	24%	95%	5%
EMA	91%	9%	70%	30%
North America	59%	41%	67%	33%

Source: KPMG 2023 SFDR Market Assessment survey, KPMG International, August 2023
Survey response number for “Demand for Article 8 and 9 funds”: 97; response number for “Demand for net-zero products”: 96

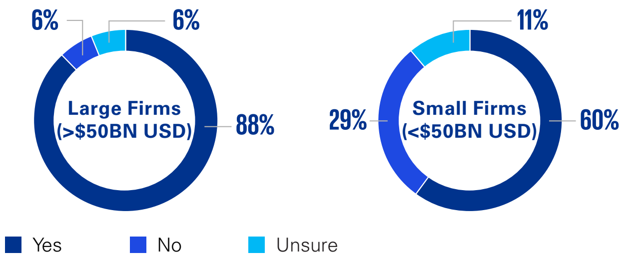
Operationalizing SFDR

There are actions that asset and fund managers could be taking to improve the maturity of their sustainability disclosures and readiness to adapt to regulatory change. In our view, an ESG engagement policy is a must-have for asset managers around the world, just 70 percent of fund managers responding to our survey were confident they had an engagement policy in place and 31 percent indicated they had no specified deadlines in their engagement policy.

Firms with an engagement policy (Regions)



Firms with an engagement policy (Size)

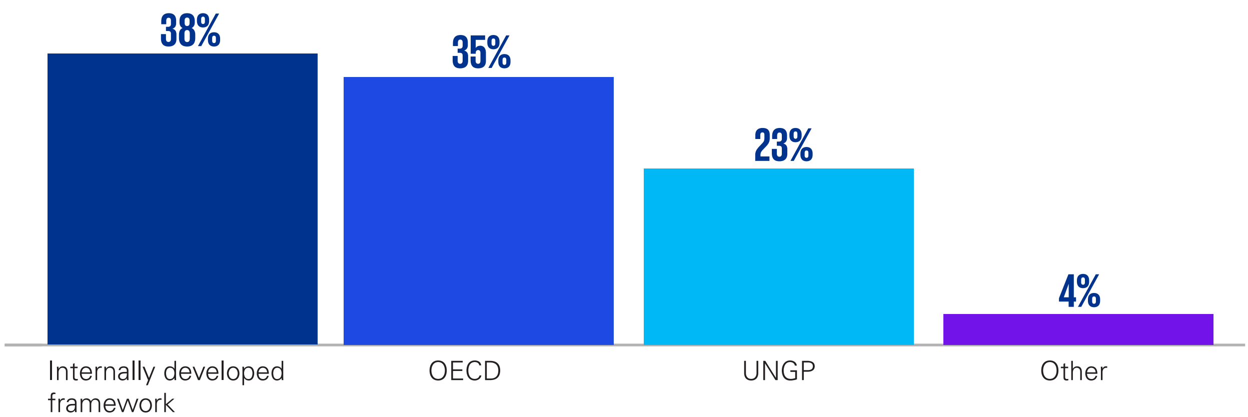


Survey response number: 97

Source: KPMG 2023 SFDR Market Assessment survey, KPMG International, August 2023

Nearly 80 percent say they use (or plan to use) an internationally recognized framework to prove their investments are making a contribution to sustainable investment objectives. However, managers are split on which international frameworks to use for governance, with 38 percent saying they have developed their own internal frameworks.

Engagement Frameworks (Global)



Survey response number for Engagement frameworks: 97
Source: KPMG 2023 SFDR Market Assessment survey, KPMG International, August 2023

5 "no-regret actions" to help build solid foundations

While regulation and investor expectations continue to evolve, there are a number of 'no regret actions' that asset managers could be taking in order to improve maturity and enhance agility.

Create a strong policy foundation. At a firm level, this should include policies and clear definitions that ensure SFDR compliance is being measured and managed.

Build flexible data systems and infrastructure. As reporting requirements increase, many asset managers are investing in additional data, improving systems and the supporting infrastructure.

Ensure you have appropriate governance. Make sure you have allocated clear roles and responsibilities for SFDR implementation and adaptation.

Make it part of your culture. Invest in education to promote the understanding of the long-term value case for ESG. Build consensus across the firm on the importance of robust sustainability reporting.

Stay on top of the trends and look for strategic synergies. Keep abreast of changes as they occur but focus on being proactive and strategic in action.

Methodology

About the KPMG 2023 SFDR Market Survey

This survey, conducted with 100 private equity, wealth and asset managers between 31 July and 22 August 2023, provides an insight into the current state of the private equity, wealth and asset management market with respect to the SFDR implementation and gauges the sustainable investment ambitions of firms globally.

Respondents were captured across a variety of company sizes, with more than three-fourths of respondents representing firms greater than US$1 billion in Assets Under Management (AUM). The survey included decision makers from eight markets (Australia, Canada, China, France, Germany, Japan, the UK and US) within wealth and asset management and private equity. The SFDR research involved 53 c-suite level respondents, with wealth and asset management being the largest financial sub-sector represented.

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