Unpacking Sustainable Finance Disclosure Regulation

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

KPMG International

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Foreword

COP28 underscored that climate finance still falls far short of the trillions eventually needed to support developing countries with clean energy transitions, implementing their national climate plans and adaptation efforts.[1] Governments and regulators have recognized that action must be taken to facilitate the flow of private capital into sustainable activities.

The Sustainable Finance Disclosure Regulation (SFDR) is part of the European Commission's Action Plan for Sustainable Finance. It aims to create greater transparency in sustainable investing through a standardized disclosure framework. By setting a strict minimum-disclosure standard, it enables data comparability with the objective of creating transparency and greater trust in financial markets with the intention of accelerating capital flows towards sustainable objectives.

As this report notes, the SFDR has had a significant impact on the financial market ecosystem and, in turn, on investment flows since coming into force in March 2021. Yet the regulation continues to evolve with the European Commission recently conducting consultations on the usefulness and compatibility of the current rules.[2] At the same time, investor appetite for sustainable assets is growing, creating new opportunities in financial markets.

Embracing change

For asset managers with funds in or marketed to the EU, SFDR requires decisive action and organizational change supported by a clearly defined investment strategy and approach to sustainability. The regulation also necessitates an evolution in processes, policy, governance, culture, systems and infrastructure.

To find out how asset managers are managing the implementation of SFDR and the related impact on their investment strategies and operations, KPMG International surveyed 100 asset managers globally. The survey asked about the benefits and challenges of implementing SFDR, explored the foundations of their SFDR readiness and compliance, and addressed key levers such as their divestment strategies, engagement policies and remediation plans.

SFDR matters

In this report, professionals from KPMG's asset management and sustainable finance practices share the highlights and insights from this research. We explain the impact that SFDR is having on asset managers and financial markets globally. We look at the evolving regulatory landscape and its potential implications. We discuss key signs of maturity amongst asset managers. And we offer five "no-regret actions" that asset managers could take to stay ahead of the market.

To learn more about the data in this report — or to discuss your organization's unique response — contact your local KPMG member firm.

Investors, across asset management and private equity, are under pressure to respond to the changing regulatory and economic environment. Adopting a strategic approach to regulatory change can reduce operational overheads and create commercial opportunities as the economy transitions to a more **sustainable future.**

Glenn Mincey
Global Head of Private Equity,
KPMG International

Andrew Weir
Global Head of Asset Management and Real Estate,
KPMG International

[1] Article Title: "COP28 Agreement Signals "Beginning of the End" of the Fossil Fuel Era"
Source: United Nations Climate Change website, December 13, 2023

[2] The European Commission's review of SFDR
Source: KPMG International, "The European Commission's review of SFDR" (September 2023)

About the lead authors

Glenn Mincey
Global Head of Private Equity,
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Partner Head of Private Equity,
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Glenn has over 20 years of experience advising on private equity transactions globally, specializing in the use of partnerships and limited liability companies in domestic and cross-border mergers and acquisitions, financing transactions and restructurings.

Glenn joined the U.S. member firm of KPMG in 2008 as a direct-entry partner. Prior to joining KPMG, Glenn served in the Office of Chief Counsel of the IRS's National Office and was subsequently a member of another big 4 firm's Washington National Tax office.

Andrew Weir
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Andrew is KPMG's Global Chair of Asset Management and Real Estate. He has over 30 years of experience servicing listed companies, public bodies, investment funds and MNCs in Hong Kong, the Chinese Mainland, Asia and internationally. He has a keen interest in corporate governance, board leadership and business in the community, and leads the quarterly KPMG Independent Non-Executive Directors Forum.

Andrew is a Senior Partner of KPMG in Hong Kong (SAR), and has served in a number of senior national, global and regional roles with KPMG. Andrew also sits on the Global Client Advisory Board and is the Chair of the Audit Management Board. Andrew chairs KPMG's UK-China corridor, leading efforts to establish greater linkages between Chinese, UK and International business and investment partners. Andrew previously was the Head of Capital Markets, KPMG China, and ASPAC Head of Infrastructure, Government and Healthcare and ASPAC Head of Asset Management.

About the lead authors

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Andrew is a Director in KPMG Ireland's Sustainable Futures practice, where he leads on Investment Management and Private Equity. He has nearly two decades of deep experiential knowledge of the business of institutional investment management, global fund structuring and specialized innovation. Over his career, Andrew has served in senior roles within hedge funds, long-only managers, venture capital and institutional investment consulting firms.

Most recently, Andrew was a Director at Willis Towers Watson (London) where he served as a seconded subject matter expert in the application of ESG and sustainable finance to investment management. Whilst seconded to The Asset Management Exchange (*The AMX*), he lead the innovation effort of split pool voting resulting in the Environmental Finance's 2021 Sustainable Investment Award for ESG Initiative of the Year. Additionally, was the architect of a TCFD reporting tool for the UK pension market. Having served on the Irish Funds Industry Association's ESG Working group since 2019, Andrew has co-authored papers on such EU Taxonomy and SFDR.

Sarah O'Neill
Associate Director,
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Sarah is an Associate Director in KPMG's Global Decarbonization Hub, focusing on Private Equity and Asset Management climate and decarbonization, and Sustainable Finance.

The Global Decarbonization Hub brings together the global KPMG network to rapidly deliver a unified and consistent approach to tackling climate change, enabling us, our clients and partners to achieve our sustainable development goals.

Sarah has over 8 years' experience working in the Sustainability and ESG space. Prior to KPMG, she worked in International Development and Social Impact consulting, where she worked with purpose-led organizations to determine their impact strategy and transformation requirements, and worked with international donors developing and delivering large aid programs including projects targeting the development of renewable energy markets, and climate adaptation and resilience.

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The state of play for SFDR

SFDR is an EU regulation designed to accelerate flows of finance to sustainable investments, level the playing field, increase transparency in relation to sustainability risks, and reduce the potential for greenwashing of investment products. Three years in, the implementation of SFDR has already had a significant impact on the investment industry.

In this chapter, we explain what SFDR is and explore some of the regulatory trends and changes that are influencing SFDR's future.

Why the SFDR matters

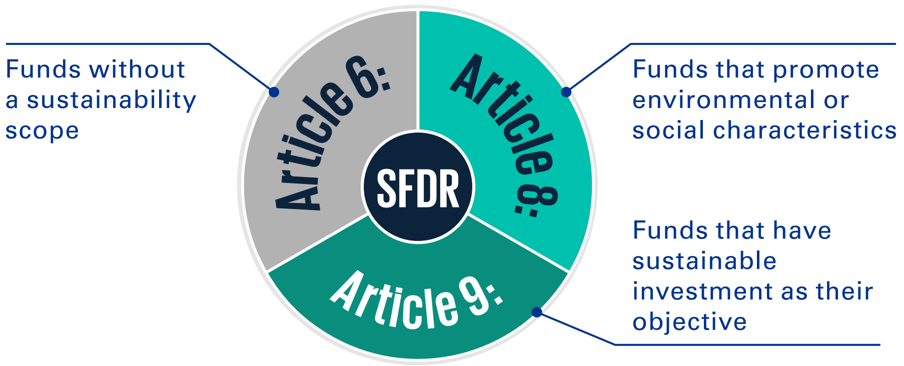
SFDR is designed to create transparency and trust in financial markets by setting clear rules and requirements related to sustainable investment disclosures for asset managers and financial market participants. As part of the European Commission's Action Plan for Sustainable Finance, it aims to help redirect capital flows towards sustainable activities. As such, its influence on asset managers with funds in, or marketed into, the EU is significant.

European regs with global legs

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.

Under SFDR, financial products are separated into three different categories. At one end of the spectrum, there are financial products that do not have any sustainability considerations (Article 6 funds). At the other end, there are funds that have sustainability as their key objective (Article 9 funds). In the middle of Article 6 and Article 9 there is a category of products ("Article 8 funds") that promote, among other things, environmental or social characters, or a combination of these, and comply with good corporate governance practices.[3]

Articles defined:



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.

[3] Fund classification and promotion.
Source: KPMG Finland, "Fund classification and promotion" (June 2022)

The SFDR applies to all asset managers with funds domiciled in or marketed to the EU, whether or not they have an express ESG or sustainability focus. It triggers additional disclosure requirements for financial market participants on their websites, in their prospectuses and in their periodic reports. Ensuring compliance requires a significant organizational response.

Avoiding greenwashing

Industry participants have argued the need for a consistent and transparent approach to sustainability reporting for some time. In part, it reflects a growing awareness that climate and sustainability risks are largely underpriced in the financial system and that greater transparency in the disclosure of climate and sustainability considerations is needed to level the playing field.

In the recent KPMG's Big shifts, small steps survey, it was found that for 90 percent or more of the world's 250 largest companies, sustainability reporting has become standard practice.[4] At the same time, many institutional investors have set ambitious net-zero targets and, as a result, are seeking to drive investment capital into funds that meet green and other sustainability objectives. SFDR helps increase transparency around sustainable products and helps mitigate the risk of "greenwashing".

The state of the market

Market data indicates that activity around sustainable funds has been growing year on year. Indeed, Morningstar, a market analyst group, reports that, as of the end of December 2023, approximately US$5.62 trillion (EUR5.2 trillion) in assets under management (AUM) were linked to either Article 8 (funds that promote environmental or social characteristics) or Article 9 (funds that have sustainable investment as their objective).[5]

A recent report by the Global Sustainable Investment Alliance (GSIA) estimates total global sustainable investment at US$30.3 trillion. In non-US markets, the report indicates sustainable investments under management (AUM) increased by 20 percent since 2020. Their calculations suggest that sustainable investments make up some 38 percent of total global AUM. Interestingly, the proportion of investments tagged as sustainable are higher in some markets outside of the EU — Canada reports 47 percent of investments are sustainable; Australia and New Zealand report 43 percent.[6]

[4] Big shifts, small steps
Source: KPMG International, "Survey of sustainability" (September 2022)

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

[6] Report Title: Global Sustainable Investment Review 2022
Source: Global Sustainable Investment Alliance website, (December 2023)

In non-US markets, sustainable investments under management (AUM) increased by

20 percent.[6]

Sustainable investments make up

38 percent

of global AUM.[6]

"SFDR is already helping to increase investment flows into sustainable activities in the EU and around the world. It is also creating increased transparency and awareness about sustainable investments, their impact and their returns. Asset managers will want to fully assess the impact of SFDR on their strategy and operations."

Andrew Weir
Global Head of Asset Management and Real Estate, KPMG International

The state of play for SFDR
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According to Morningstar, 47.4 percent of funds reported were classified as either Article 8 or 9 funds as of December 2023. And that number is growing. Morningstar also reports that some 231 funds upgraded their classification in the fourth quarter of 2023 alone. The vast majority (218) reclassified from Article 6 (funds without a sustainability scope) to Article 8, and 11 funds moved into the Article 9 category. During the same period, just 25 funds reclassified downwards.[7]

KPMG International's survey of asset managers reinforces this data.[8] 36 percent of respondents said they had reclassified funds in the last 6 to 12 months. Of those that reclassified, 83 percent upgraded funds, 14 percent downgraded funds and 3 percent both upgraded and downgraded funds. The majority were upgrades from Article 6 to 8, with a small number of upgrades from Article 8 to 9.

This likely reflects increased market confidence following a wave of downgrades in Q1 2023 in the wake of the redefinition of the Article 8 and 9 fund parameters at the end of 2022, which triggered a swell of funds moving from Article 9 to 8.[7] Further movement should be expected in line with the European Commission's SFDR consultation, which will likely further change the specific Article parameters and definitions.

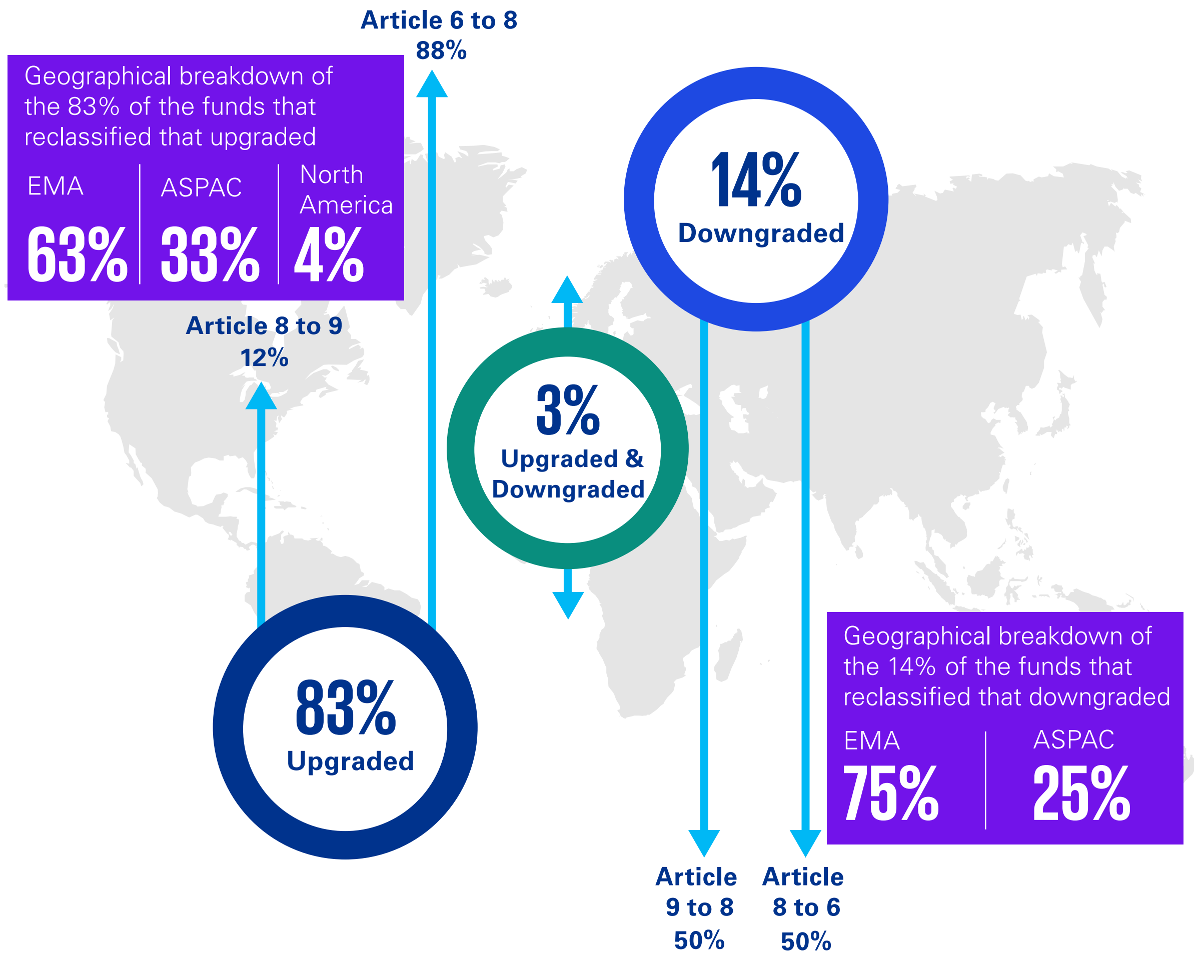
As of December 2023, Article 9 funds represented 3.5 percent of market AUM, while Article 8 represented 55.5 percent market AUM and non-sustainable funds represented 41 percent of market AUM.[9]

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

[8] KPMG 2023 SFDR Market Survey
Source: KPMG International, "Unpacking SFDR" (August 2023)

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

SFDR reclassifications and geographical distribution



Survey response number: 97

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

The state of play for SFDR
How asset managers are responding
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An evolving regulatory landscape

SFDR is under review by the European Commission. The European Securities and Markets Authority (ESMA) has launched a Common Supervisory Action into asset manager compliance. And there remains significant uncertainty about the direction of travel for the regulation of sustainable finance for regulators globally. Understanding the regulatory environment has never been more important.

[10] The European Commission's review of SFDR
Source: KPMG International, "The European Commission's review of SFDR" (September 2023)

Enhancing the framework

The European Commission's (EC) current consultations were embedded into the regulation to provide an opportunity for improvement once practical experience had been gained. Nonetheless, the broad scope of the consultation may be concerning for those who have invested heavily to overhaul processes, product strategy and operating models to comply with existing regulation.

Despite industry practice, the Articles were never intended to be used as product categories. This will need to be addressed through the consultations. It's likely the European Commission 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 clear, they are less clear for Article 9 products.

What is the European Commission reviewing?

The European Commission's 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. It also explores areas that could result in significant changes that would fundamentally revisit the structure of the regulation, including the possibility of bolstering the existing Article 8 and 9 disclosure requirements, or most strikingly of all, to remove them altogether in favor of new categories.[10]

As Patricia Dunne, Director of Securities and Markets Supervision at the Central Bank of Ireland, recently noted, considerable regulation has been put in place and now the focus "has broadly switched to implementing and consolidating what has been developed." And, specific to SFDR, she suggested that, "further enhancements are required in order to make the framework achieve its aims."[11]

It could be PAInful

There are concerns, however, that the consultations may result in significant changes. At the entity level, the consultations may result in a change in the mandatory ESG indicators that must be reported (known as Principal Adverse Impact indicators or PAIs) and a streamlining of processes.[12] At the product level, PAIs are also being reviewed, as well as questions around proportionality of applicability of the regulation based on size and whether standard disclosures should apply to all products regardless of their sustainability claims. Some also expect to see the European Commission establish a new categorization system for financial products.

Asset managers with products marketed in the EU should pay close attention to the consultations. The outcomes could require the reclassification of funds and the reconstruction of internal processes. Both could require managers to put significant time and effort — along with capacity building and upskilling — to align with the updated regulations. Should the consultations result in significant changes, managers may become more risk averse due to both the complexity and the perceived uncertainty of future regulatory change.

Concurrent to the European Commission's consultations, the European Securities and Markets Authority (ESMA) launched a Common Supervisory Action (CSA) in July 2023 with the intention of working with National Competent Authorities (NCAs) on sustainability-related disclosures and the integration of sustainability risks. Ultimately, the goal of that activity is to assess whether supervised asset managers are complying with relevant provisions in the SFDR and the Taxonomy Regulation.

The closer, the better

In terms of benefits, the consultations could add clarity to the Article classifications and requirements which, in turn, should help increase investor confidence. As such, the consultations could facilitate an acceleration in the pace of private investment into sustainable activities, which could lead to an overall increase in AUM and demand for sustainable funds.

There are also signals that these activities may help to better align SFDR with the UK's Financial Conduct Authority (FCA) proposals for Sustainable Disclosure Requirements (aligning categories to the labels being discussed by the FCA, for example). This would be a positive development for asset managers working across multiple jurisdictions, helping to ease regulatory and disclosure complexity. And, given the speed at which policy and regulation are being replicated across markets, it would not be surprising to see other jurisdictions take note of the consultations and start aligning their own regulation accordingly.

Similarly, there are synergies between ESG disclosure regulations, which share common goals around focusing capital towards sustainable investments, enhancing market transparency and avoiding greenwashing. Organizations should look to streamline processes, systems and data effectively across SFDR, EU Taxonomy and CSRD reporting requirements, where applicable.

The state of play for SFDR
How asset managers are responding
Moving forward

[11] Sustainable finance in practice for fund managers - Remarks by Patricia Dunne, Director of Securities and Markets Supervision
Source: Central Bank of Ireland website, Ireland, (September 2023)

[12] The European Commission's review of SFDR
Source: KPMG International, "The European Commission's review of SFDR" (September 2023)

The evolution of the SFDR[13]

The core requirements

10 March 2021
The level one text entered into force

1 January 2023
The level two text (the "Delegated Regulation") entered into force

Supervisory expectations and guidance

March 2022
ESAs published an updated supervisory **statement** on the application of the SFDR

May 2022
ESMA provided **guidance** for EU supervisors on sustainability risks and disclosures in asset management

June 2022
The ESAs published **clarifications** on key aspects of the draft SFDR level two text

Questions & Answers

July 2021
The Commission provided **answers** to the European Supervisory Authorities' (ESAs) initial questions

May 2022
The Commission provided **answers** to further questions from the ESAs

September 2022
The ESAs **sent** further queries to the European Commission These have not been answered to date.

November 2022
The ESAs published a **Q&A** on the Delegated Regulation

Other developments

May 2022
The European Commission sent letters to the ESAs asking them for proposals on:

1. **Revising** the PAIs and amending product-level transparency requirements
2. **Disclosures** regarding taxonomy-aligned gas and nuclear energy activities

July 2022
The ESAs published a **report** with their findings on voluntary Principal Adverse Impact disclosures

January 2023
The EU co-legislators are considering **amendments** to the Delegated Regulation (already adopted by the European Commission) regarding disclosures relating to taxonomy-aligned nuclear energy and gas activities

[13] Asset management ESG regulatory developments
Source: KPMG International, Asset management ESG regulatory developments (January 2023)

How asset managers are responding

Despite recent headwinds, overall the market for sustainable funds has been growing year on year. The big question, therefore, is how asset managers and financial market participants are adapting to the regulation.

KPMG International surveyed 100 managers across North America, EMA and ASPAC to find the answer. The following section shares the highlights of their responses and identifies the key characteristics of those leading the charge.

Sizing up the benefits

Our survey suggests that SFDR is already delivering significant benefits to those asset managers who have embraced the regulations and sustainable investment — transparency has increased, processes have been streamlined and demand for sustainable investments has risen. Yet the data also indicates that some managers — particularly those domiciled outside of the EU — are struggling to see the positive side of the regulations.

Making a positive impact

While SFDR is a relatively new regulation, it is already creating significant benefits for many asset managers. Our survey of 100 asset managers and financial market participants shows that most — 47 percent — report that SFDR has had a positive impact on their firm. Just 10 percent claim it has had a negative impact and 41 percent were neutral about the benefit of SFDR. Positivity is highest in the EU, where 57 percent claim a positive impact, and lowest in North America, where just 38 percent report a positive impact and 22 percent report a negative impact.

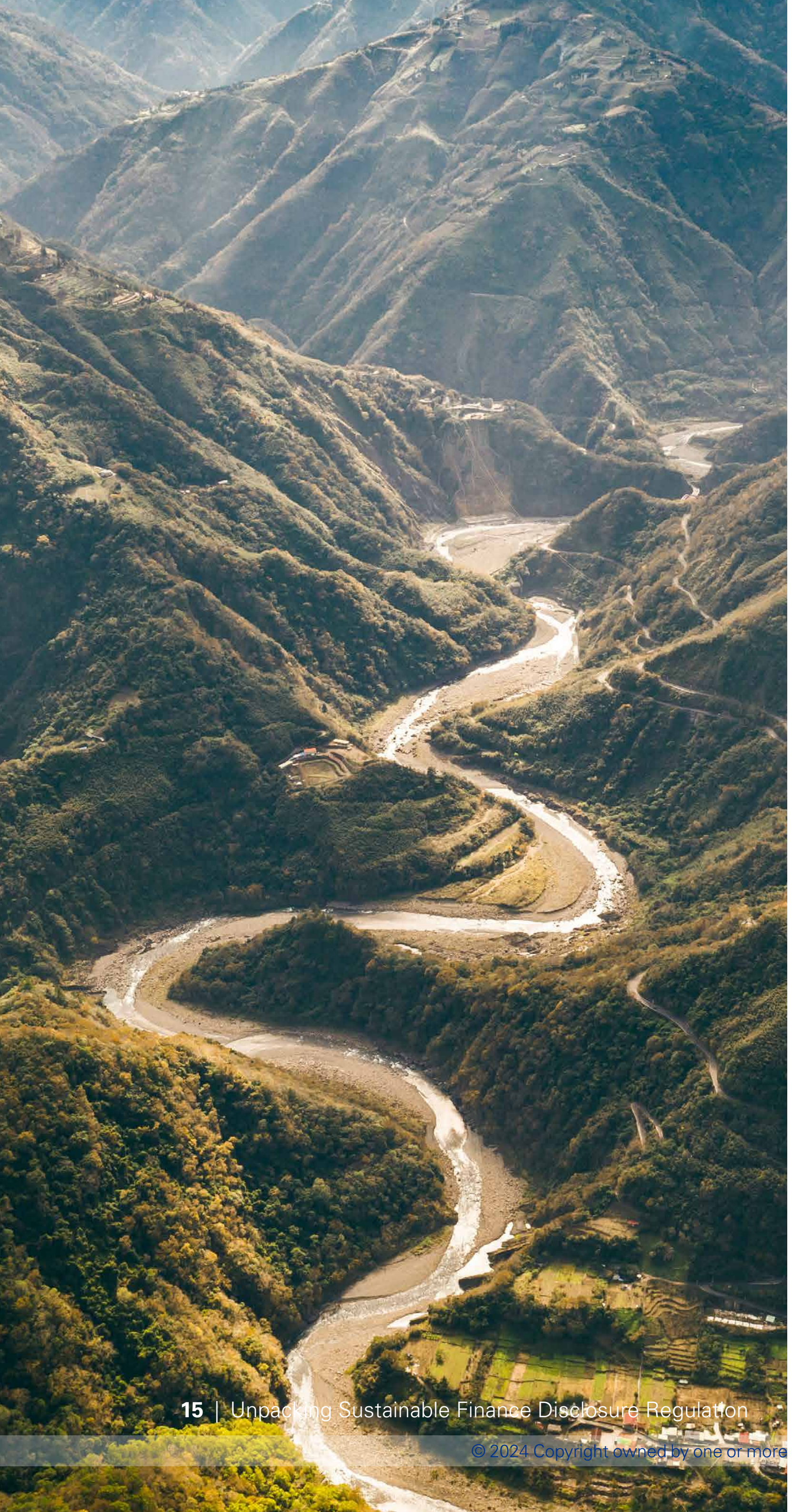
In part, this likely reflects a general frustration among North American managers averse to dealing with prescriptive foreign regulation. Some asset managers report being hesitant to talk to their investors about ESG in case they harbor anti-ESG sentiment, and potential negative attention from the public and press. This is likely creating a discrepancy between the US and other markets with regards to the positive effects of SFDR.

Impact of SFDR

	Negative	Neutral	Positive
Global	10%	41%	47%
ASPAC	0%	57%	43%
EMA	7%	36%	57%
North America	22%	38%	38%

Survey response number: 97, 1 'not applicable' response was received in North America, therefore total does not equal 100%

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

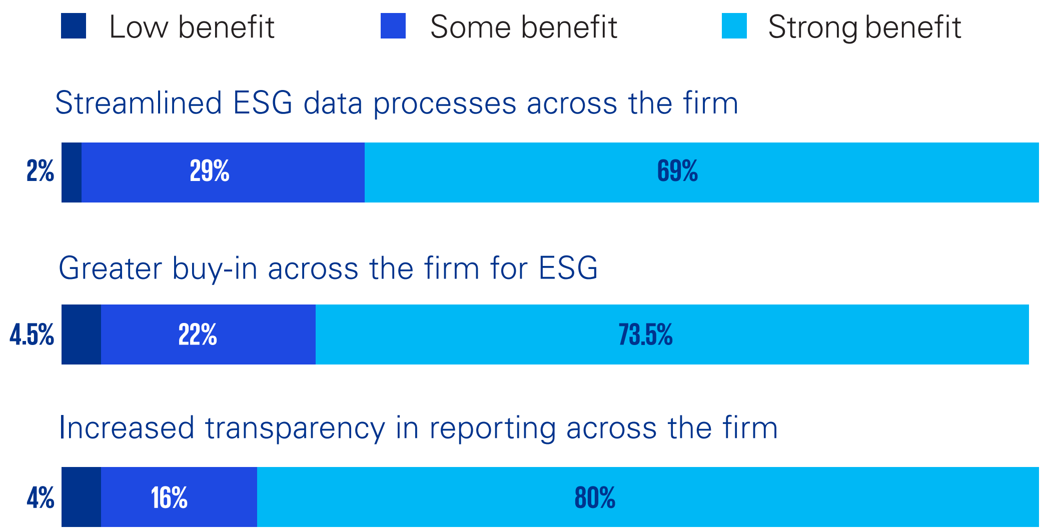


Our survey data also highlights that smaller managers (those with less than US$50 billion AUM) are slightly less likely to report positive benefits from SFDR, perhaps reflecting the heavier burden that the regulation brings in terms of administration, skills and capacity, and reporting requirements that may be easier for larger managers to absorb.

Seeing the benefits

Our survey shows that asset managers see the strongest benefits from the increased transparency they are achieving in their reporting across the firm. That is providing asset managers who play in a diverse set of asset classes with an opportunity to apply a transparent framework across all their products, thereby helping their sales teams to quickly identify the right products for specific investors.

Benefits seen as a result of implementing SFDR



Survey response number: 45

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

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The data also suggests asset managers are seeing benefits from the ability to streamline their ESG data processes across the firm, and their ability to generate greater buy-in for ESG. It is worth noting that these benefits are all interlinked — streamlined ESG data processes across the firm enables increased transparency in reporting which, in turn, encourages greater buy-in from across the organization — including management, deal and operations teams.

Meeting rising demand

According to our survey, asset managers have also experienced a notable increase in demand for Article 8 and Article 9 funds. Perhaps not surprisingly, 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), reflecting the investment criteria and allocation requirements of regional investors.

Interestingly, of those North American managers who said they had seen increased demand for Article 8 and 9 funds, 16 percent reported that SFDR had a negative impact on their firm. This likely reflects an imbalance between increased demand and profitability, suggesting some North American managers are experiencing a high administrative burden to meet the demand.

	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%

Survey response number for "Demand for Article 8 and 9 funds": 97; response number for "Demand for net-zero products": 96

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

> **"As asset managers start to compete around the sustainability and impact of their funds and products, disclosure and reporting is becoming increasingly critical. SFDR enables asset managers with sustainable funds to demonstrate transparency and build trust with their investors, regulators and stakeholders."**

Geri McMahon
Global Head of ESG for Asset Management,
KPMG International

The state of play for SFDR

How asset managers are responding

Moving forward

Enhancing maturity with agility

The environment for the disclosure of sustainable investments may still be in flux. The specifics of SFDR may evolve and a number of markets are still formulating their own regulatory regimes to formalize the disclosure of sustainability outcomes and investments. Yet there are actions that asset managers could be taking to improve the maturity of their sustainability disclosures and readiness to adapt to regulatory change.

Engagement is mandatory

In our view, an ESG engagement policy is a must-have for asset managers around the world. Indeed, an engagement policy is already a statutory obligation under shareholder rights directives in a majority of jurisdictions. At its most simple, it mandates public disclosure on how an asset manager monitors and engages with investee companies, or how an investor engages with an asset manager. More advanced disclosures specify how unresolved issues are managed, including escalation, remediation and whether divestment is a consideration.

Our survey indicates that just 70 percent of fund managers were confident they had an engagement policy in place. Surprisingly, 20 percent of EMA fund managers reported they did not have an engagement policy or were unsure — versus just 10 percent of ASPAC respondents. And 56 percent of North American respondents reported either lacking or being unsure of having an engagement policy.

70%

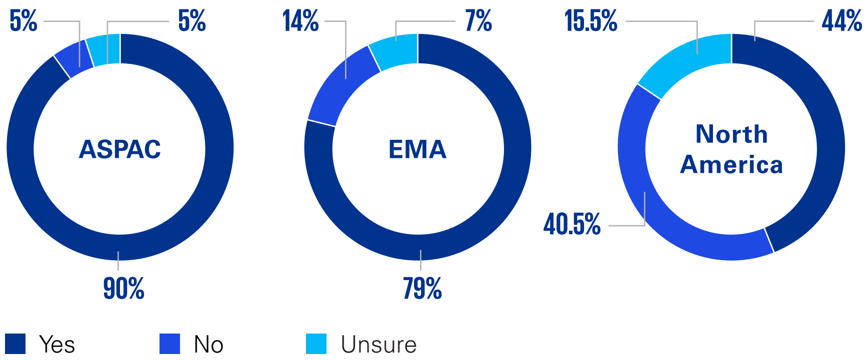
of fund managers reported that they have an engagement policy in place.

Survey response number: 97

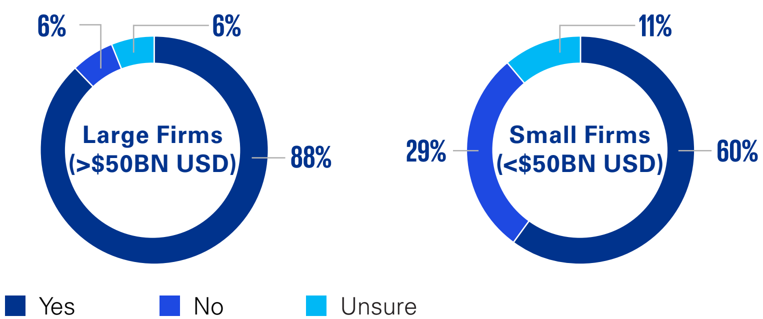
Source: KPMG 2023 SFDR Market Assessment survey, KPMG International, August 2023

Our data also suggests that larger managers — those with more than US$50 billion in AUM — were significantly more likely to have a formal engagement policy than smaller firms (those with less than US$50 billion in AUM). Of those who responded 'no' to having an engagement policy in place, 90 percent were smaller firms. This may suggest that smaller firms are struggling with some aspects of their engagement policy formulation and formalization.

Firms with an engagement policy (Regions)



Firms with an engagement policy (Size)



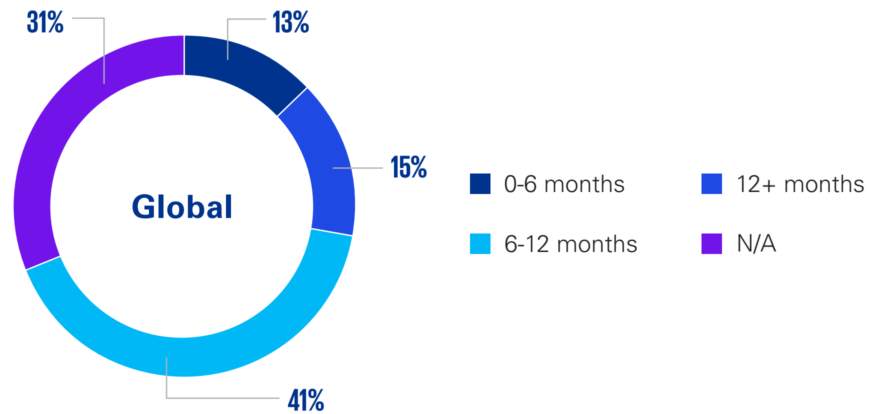
Survey response number: 97

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

Comparative maturity

Dig a little deeper and our data suggests that there is a significant maturity curve related to engagement policies. A more mature engagement policy, for example, would set clear time horizons for remediation action to be taken. Yet 31 percent of our respondents indicated they had not specified deadlines in their engagement policy. Of the 69 percent that did report deadlines, the majority said they give between 6 to 12 months for remediation which is in line with our expectations.

Engagement policy time frames



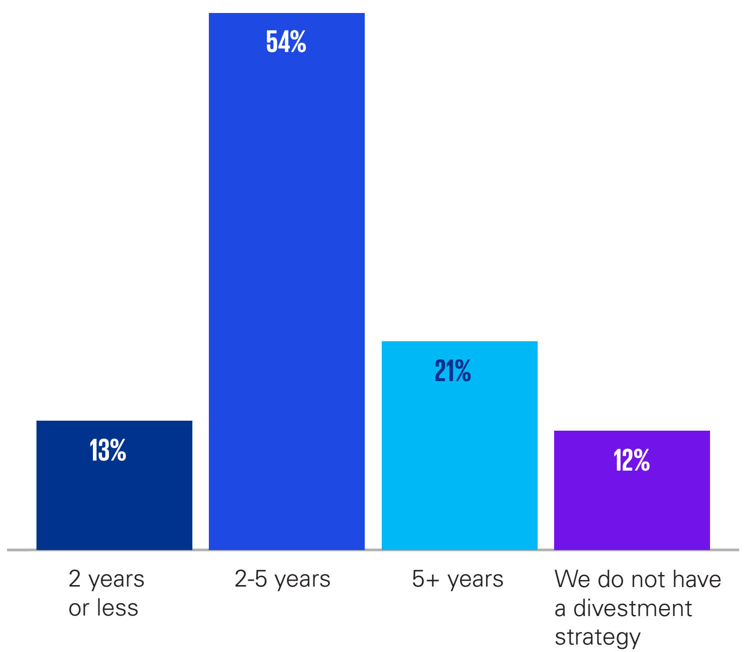
Survey response number: 68

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

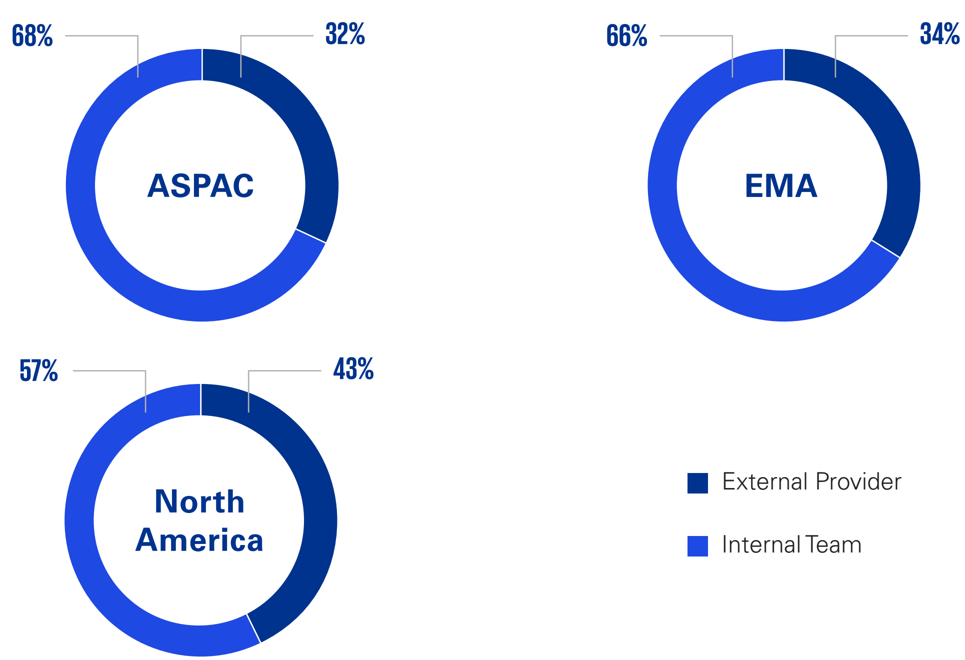
In a recent survey of asset management CEOs by KPMG International, 68 percent said they would be willing to divest a profitable but reputation-damaging part of the business.[14] One might therefore expect a more mature organization to have articulated their divestment strategy for assets or investees that are not aligned with their strategy and are unable to remediate in the timelines provided. Here, maturity seems a bit more advanced, with an average of just 12 percent disclosing they lack a divestment strategy. The majority said their strategy requires divestment within 2 to 5 years.

While it is difficult to say whether having an external engagement provider is a sign of maturity or not (some may choose to develop this capability in-house), it is interesting to note that only around a third of all respondents said they do use an external provider; North American respondents were more likely than most to use one.

Engagement policy & divestment strategy (Global)



How firms resource engagement



Survey response number for "Engagement policy and a divestment strategy": 68; Survey response number for "How firms resource engagement": 68

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

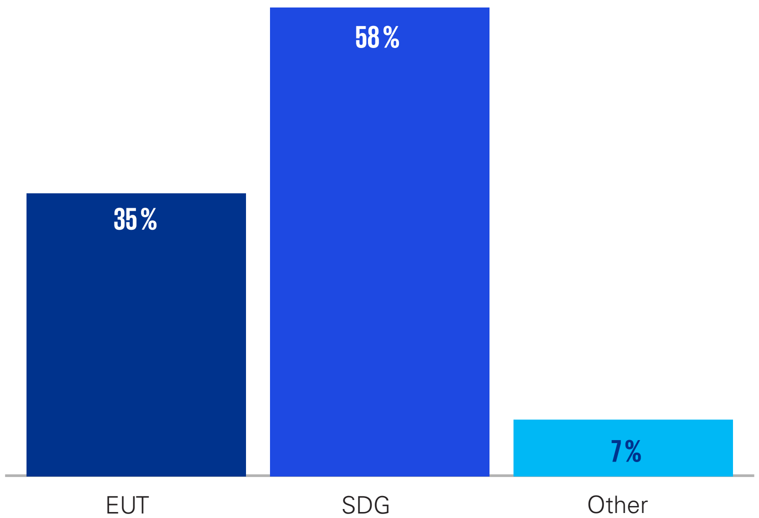
[14] KPMG 2023 Asset Management CEO Outlook
Source: KPMG International, "KPMG 2023 CEO Outlook Survey" (October 2023)

Aligning on frameworks

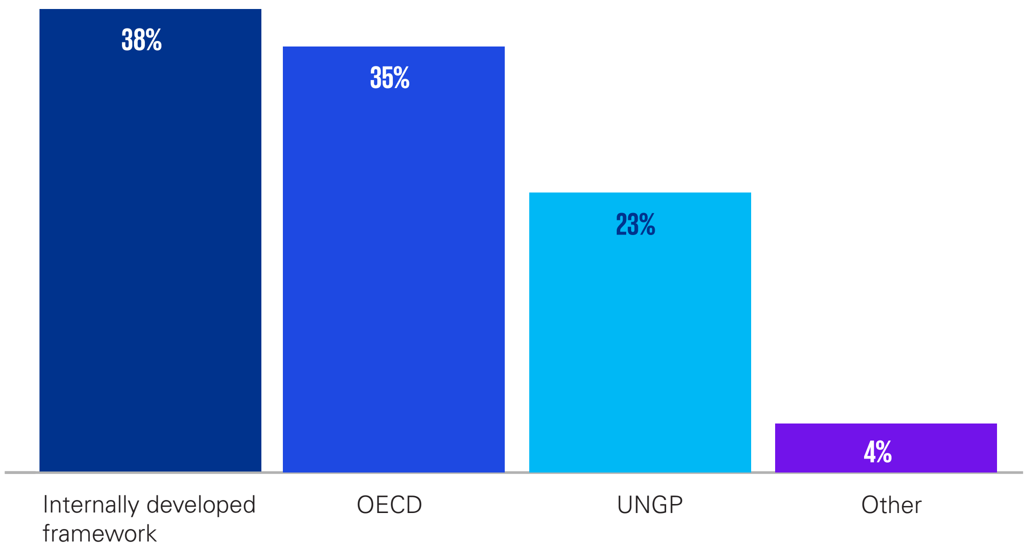
Another indicator of maturity is whether funds apply formal frameworks and consistent approaches to demonstrate how their investments are making a contribution to sustainable investment objectives. On this, nearly 80 percent said they use (or plan to use) an internationally recognized framework. 35 percent of those said they are aligning against the EU Taxonomy (EUT) and 58 percent said they are using the UN's Sustainable Development Goals (which are less prescriptive and more subjective in their interpretation and application than the EUT).

Frameworks are also critical to defining and ensuring adherence to good organizational governance practices. Our data shows that 38 percent of respondents said they have developed their own internal frameworks, likely leveraging an international framework and incorporating specific differentiators and nuances to reflect their own views or positions. Slightly fewer (35 percent) said they use the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance, while 23 percent use the UN's Guiding Principles on Business and Human Rights.

Adoption of external frameworks (Global)



Engagement frameworks (Global)



Survey response number for "Adoption of external frameworks": 77; response number for "Engagement frameworks": 97

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

"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

Moving forward

Regulation and investor expectations are continuing to develop. There are a number of "no-regret actions" that asset managers could be taking in order to help improve their maturity and create greater agility to pivot as the market develops.

Here are our top five "no-regret actions" and an overview of how KPMG can help you implement them.

Key action items

In this period of adjustment and potential uncertainty, there are a number of ”no- regret actions“ that asset managers and financial market participants can take to help enhance disclosure maturity, ensure greater flexibility to regulatory change, and drive a continued focus on the underlying sustainability value case.

Five ”no-regret actions“ to help build solid foundations:

Create a strong policy foundation. At a firm level, this should include policies that confirm SFDR compliance is being measured and managed to ascertain it remains comprehensive and effective. Definitions should be clear to help ensure that employees understand what is included and what is not. Core policies may include an Investment Policy, a Stewardship and Engagement Policy and an Escalation and Divestment policy.

Build flexible data systems and infrastructure. As reporting requirements increase, many asset managers are investing in additional data, improving systems and the supporting infrastructure. It is important to build flexibility into the systems and infrastructure to avoid technical debt and allow for further changes in regulatory requirements.

Ensure you have appropriate governance. Good governance — at the firm, fund and investment level — can be critical. Make sure you have allocated clear roles and responsibilities for SFDR implementation and address any capability or capacity gaps. Effective governance and reporting can help stakeholders, including fund boards, have a clear understanding of their roles and responsibilities.

Make it part of your culture. Invest in education to promote the understanding of the long-term value case for ESG, with a focus on the implications and impact of sustainability and climate risk on portfolios and funds, including the potential value creation opportunities it presents. Build consensus across the firm on the importance of robust sustainability reporting.

Stay on top of the trends and look for strategic synergies. Firms and asset managers should maintain a strong understanding of the current and future regulatory requirements, their strategic implications, the obligations and the points of divergence and synergy across jurisdictions. Asset managers should focus on being proactive and strategic in their action, rather than reactive to individual pieces of regulation. The shift towards sustainable investing opens creates new commercial opportunities for asset managers, from developing new funds to investing in emerging sectors of the economy.

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How KPMG can help

KPMG's global network of asset management and sustainable finance professionals is well positioned to help organizations turn regulatory change into growth opportunities. Our multidisciplinary teams include sustainability practitioners, economists, engineers, corporate strategists, accountants and financiers, working together to help clients navigate the complex and fast-evolving climate change and sustainability agenda. Contact KPMG today to find out how we can help support your organization.

Our services include:

SFDR advisory

- ESG readiness assessment
- House/fund level strategy
- Product governance
- Product launch

Gap analysis

- Full firm review and analysis
- External analysis
- Peer analysis
- Risk identification and register

ESG integration

- Investment strategy and process
- Marketing material integration
- ESG due diligence, implementation and optimization

ESG training

- Upskilling current staff
- Quarterly new staff training
- Bespoke training specific to firm policy, asset class and jurisdiction

Our advisory, audit and tax teams serve:

Investment managers, wealth managers, family offices, fund administrators and service providers that focus on mutual funds, hedge funds, private equity funds, infrastructure funds and real estate funds, and institutional investors, including pension funds and sovereign wealth funds.

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Accolades

KPMG teams take a holistic view of SFDR, integrating perspectives gained from working with investors, managers, regulators and service providers to help clients make informed decisions that can drive their businesses forward in times of uncertainty. Our suite of services and tools are tailored to help KPMG clients develop and execute their optimal strategy.

KPMG's leadership in climate-related services has been recognized by key analysts. For example:

- KPMG was named a **global market leader by ALM Intelligence in their latest Pacesetter research entitled ESG: Environmental, 2023-2024**. The report notes that, "KPMG ESG consultants are transformation, measurement, and reporting specialists that help organizations: assess and design an ESG strategy, embed ESG across all operational aspects, measure progress, communicate the organization's ESG goals to stakeholders, and help clients proactively consider future transactional events and how to make them transformational for the organization."[15]
- KPMG has been named a **global market leader by Verdantix in the report "Green Quadrant: Climate Change Consulting 2023"**. The report states: "KPMG stands out for its climate risk strategy and emissions data assurance capabilities." It goes on to note that "Through the use of its proprietary Climate IQ multi-industry risk management tool to help firms assess both physical and transitional climate risks, KPMG helps firms understand and project the impact of climate change on their business."[16]
- KPMG has been named a **global market leader in the HFS Horizons report entitled "Data Modernization Services, 2023".** The report notes that KPMG "applies industry knowledge alongside data management and governance capabilities to deliver data estate modernization ready for complex AI and analytic solutions". It adds that, "KPMG delivers 'data for value,' driven by data literacy and culture building, automation and productivity, insight generation, assets and new business models, and metric transparency."[17]

HFS horizons
Choosing the best provider for data modernization services, 2023
Horizon 3 Market Leader
Ecosystem Transformation
Creating New Sources of Value
KPMG

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PACESETTER
ESG: ENVIRONMENTAL 2023-2024

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[15] "ESG: Environmental, 2023-2024", ALM Intelligence, Pacesetter Research, 2023.
[16] "Green Quadrant: Climate Change Consulting 2023", Verdantix, June 2023.
[17] "Data Modernization Services, 2023", HFS Horizons, May 2023.

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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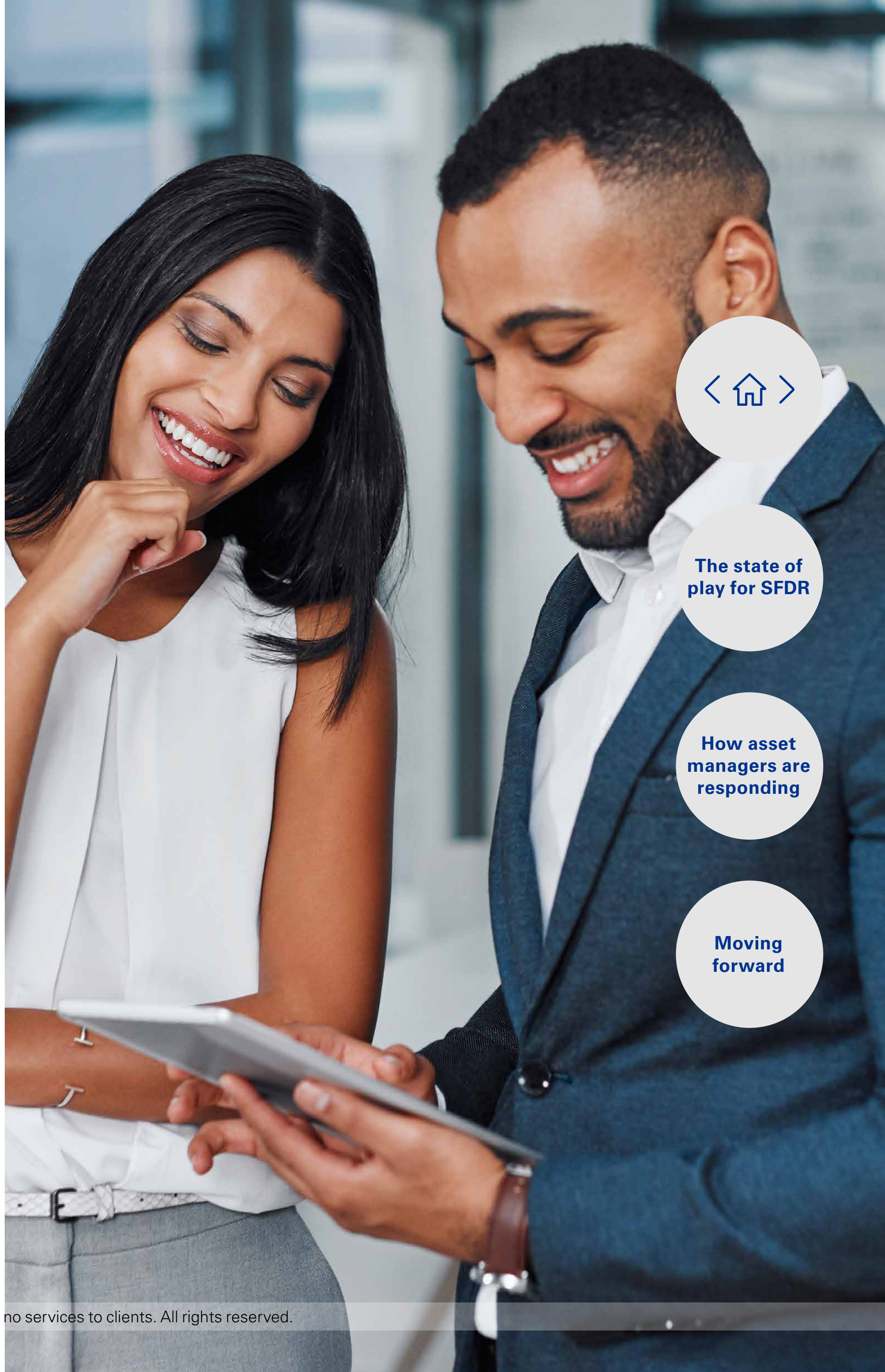

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