Calling the Bluff?

The Perspective of Nordic Private Equity Firms on the Implementation of the Sustainable Finance Disclosure Regulation

A qualitative study based on a case study of Procuritas' implementation of SFDR in Polarn O. Pyret and interviews with Nordic PE firms

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Abstract

The Sustainable Finance Disclosure Regulation (SFDR) is the first mandatory ESG regulation in the EU. Since March 2021, the regulation has imposed ESG disclosure obligations for asset managers, including private equity firms, in a pursuit to increase transparency and mitigate greenwashing in the industry. The complexity of the legislation coupled with the lack of clear guidance has led to uncertainties surrounding the SFDR. The present thesis aims to illustrate the process of compliance and identify key challenges for Nordic private equity firms. In addition, the study seeks to assess whether the regulation fulfills its transparency objective and to explore additional consequences. To understand where complexities arise, a case study of private equity firm Procuritas and its implementation of the SFDR has been conducted. The study expanded its scope by examining an additional sample of 13 Nordic private equity firms to provide a more comprehensive perspective. The study finds that all firms experience interpretation difficulties, resulting in different approaches to regulation. Additionally, data collection and resources for compliance are perceived as major challenges. Despite different applications, the regulation will standardize and improve the availability of ESG information, enabling investors to compare the sustainability efforts of private equity funds, thus mitigating greenwashing. Nordic private equity firms also recognized that the SFDR provides a structured approach to ESG and that compliance with a higher article classification can increase access to capital and increase ESG awareness at the private equity fund and portfolio company level.

Keywords: Case study, ESG disclosures, Greenwashing, Nordic, Private equity, Procuritas, SFDR, Sustainability label

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Abbreviations

Abbreviation	Definition
AUM	Asset under Management
ESA	European Supervisory Authorities
ESG	Environmental, Social and Governance
EU	European Union
FA	Financial Advisor
FMP	Financial Market Participant
GP	General Partner
GHG	Greenhouse gas
LP	Limited Partner
PAI	Principle Adverse Impact on Sustainability Factors
PC	Portfolio company
PE	Private Equity
PRI	Principles of Responsible Investment
PO.P	Polarn O. Pyret
RTS	Regulatory Technical Standards
SDGs	Sustainable Development Goals
SFDR	Sustainable Finance Disclosure Regulation

Definition of Concepts

Concept	Definition
Action Plan on Financing Sustainable Growth	A plan that aims to support the EU's commitment to the Paris Agreement and the United Nations Sustainable Development Goals
Corporate Sustainability Reporting Directive	Directive to further enhance sustainability reporting by companies in the EU
ESG	Environmental, Social, and Governance; refers to the criteria used to evaluate the sustainability and ethical impact of investments and companies (in this thesis, interchangeably used with sustainability)
EU Taxonomy Regulation	EU framework to determining whether an economic activity can be classified as environmentally sustainable
Financial Advisors	Independent financial advisers, wealth managers, financial planners, or other professionals who offer investment advice to individuals or entities
Financial Market Participants	Asset managers, pension funds, insurance companies, investment firms, and credit institutions involved in the management and distribution of financial products
General Partners	Investment professionals responsible for managing and operating a private equity fund
Greenwashing	Misleadingly presenting a product, service, or company as more environmentally friendly or sustainable than it is
Limited Partners	Pension funds, endowments, insurance companies, family offices, or high-net-worth individuals that provide the majority of capital
Portfolio Company	Company in which a private equity firm has made an investment
Private Equity	This thesis focuses on Buyouts only

Sustainability	Responsible use of resources, considering environmental, social, and economic factors, to meet present needs without compromising the ability of future generations to meet their own needs (in this thesis, interchangeably used with ESG)
Sustainable Finance Disclosure Regulation	Mandatory EU ESG disclosure regulation to enhance transparency
Sustainable investment	Investment in an economic activity that contributes to an environmental objective or a social objective, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices (Article 2(17) of the SFDR)

Table of Contents

1. Introduction

The private equity industry has become a major player in the global economy. As of June 2022, this industry managed $7.3 trillion in assets under management (AUM), whereof $3.3 trillion was dedicated to Buyouts, with an additional $3 trillion in dry powder[1] (Averstad et al., 2023). With approximately 10,000 PE firms operating worldwide, the industry oversees a network of 40,000 portfolio companies (PCs), employing over 20 million individuals (Eccles et al., 2022). Given their substantial scale, the strategies and initiatives adopted by PE firms have far-reaching implications for the broader economy, including their role in addressing climate change (Morrell & Clark, 2010). Historically, the PE industry has been slow to recognize the significance of environmental, social, and governance (ESG) factors and their profound implications for long-term profitability and license to play. The industry has primarily focused on value creation by improving poorly managed private companies, emphasizing the "G" aspect of ESG (Eccles et al., 2022). Meanwhile, the environmental and social aspects have received less attention. Paradoxically, the PE industry is better positioned than public equity investors to take the lead in sustainable investing (Morrell & Clark, 2010). PE firms typically acquire majority stakes in private companies, allowing them to exert influence through board representation. They have full access to financial and sustainable data of their portfolio companies and possess longer time horizons to prioritize ESG considerations (Blackrock, 2022). Simultaneously, limited partners (LPs) who invest in PE funds are increasingly demanding more stringent ESG requirements, while portfolio companies face mounting pressure from their customers to align with ESG principles. Consequently, PE firms find themselves caught between these dual pressures (Eccles et al., 2022). On top of that, a regulatory requirement was introduced in 2021, compelling private equity firms to disclose their approach to integrating sustainability factors.

In March 2021, the European Commission (EC) enacted the Sustainable Finance Disclosure Regulation (SFDR), as part of its strategy to further connect sustainability with finance. The purpose of the SFDR is to improve transparency in the market for sustainable investment products and to prevent greenwashing (Eurosif, 2022). By 30 June 2023, all firms subject to the regulation need to report on a significant body of sustainability disclosure requirements.

[1] Refers to the uninvested capital that private equity firms have available for making investments.

1.1 Problem Formulation

The SFDR has introduced a set of unprecedented requirements for sustainability-related disclosures (Diana et al., 2021). Before the regulation, how you consider sustainability risk and impact on sustainability factors was voluntarily disclosed. PE firms subject to the SFDR are now required to classify their funds as either; default category Article 6, which only incorporates ESG risks; Article 8, which shall promote environmental and social characteristics; Article 9, which has sustainable investment as its objective. The higher the classification, the stricter the disclosure requirements.

The SFDR is supported by industry proponents for its ability to increase ESG awareness, promote sustainable investments, and enable comparability among financial products (Busch, 2023). Notably, private equity sponsors acknowledge their value in identifying weaknesses within portfolio companies and facilitating fundraising, leading to the formation of additional ESG committees (Banzaca, 2022). Moreover, compliance and higher article classification have proven to confer a competitive advantage and differentiation (Patenall, 2023). Ultimately, the SFDR fosters transparency, establishes a global risk management framework, and encourages responsible investment practices (Hittinger, 2023).

Critics raise concerns over the SFDR's applicability and its impact on non-EU funds marketed in the EU (Mankikar, 2021). The absence of clear definitions has resulted in diverse interpretations, leading to investor confusion, and working against transparency (Tucher & Auel, 2022). In a recent report, Finansinspektionen (2022), the Swedish Financial Supervisory Authority, highlighted the issue of unclear disclosure regarding Article 9. The report emphasizes the need for funds' prospectuses to provide more specific and clear information on how they contribute to sustainable objectives. Additionally, most companies are not prepared to meet the extensive data requirements imposed by the SFDR, resulting in a significant administrative burden (Conlon & O'Shea, 2021). Moreover, the absence of central supervision, and the option to ‘comply or explain[2]’, hinders the harmonization process intended by the regulation (Busch, 2023). Assessing genuine ESG integration proves challenging, posing a risk for investors who rely on the article classifications (Kenway, 2022). Furthermore, there are inconsistencies in ESG risk ratings and

[2] Either comply with a set of guidelines or standards or provide an explanation for why they have chosen not to comply.

article classifications, where certain Article 6 funds score higher in their ESG risk ratings compared to some Article 8 funds (Rust, 2022).

To date, limited academic research has been conducted on the intersection of the SFDR and private equity. Existing literature primarily focuses on the impact of the SFDR on mutual fund flows (Michl & Schmid, 2022; Becker et al., 2022) and the ambiguity of the classification system (Cremasco & Boni, 2022; Scheitza et al., 2022). While not specifically focused on the SFDR, there are contrasting studies investigating the impact of ESG disclosure requirements on fund performance in the private equity realm (Abraham et al., 2022; Pitkänen, 2022).

In conclusion, the SFDR has generated significant debate among practitioners and academia, leading to uncertainties surrounding its interpretation, purpose, and broader implications. Additionally, there has been limited focus on exploring the impact of the SFDR on private equity within academic research. Given the regulatory ambiguity, this paper seeks to explore how private equity firms navigate compliance with the new regulation and the main challenges they face. Thus, the first research question:

1. *What are the practical challenges Nordic private equity firms encounter when implementing the SFDR?*

The main objective of the SFDR is to improve transparency and thus mitigate greenwashing. Given inconsistencies in its application, therefore potentially undermining transparency, one might ask whether the purpose of the regulation will be fulfilled. Hence, our second research question:

2. *Will the SFDR fulfill its purpose of increasing transparency and mitigating greenwashing in the Nordic private equity industry?*

Given the regulation's early stage, there is limited knowledge about its other potential consequences. Thus, the last research question seeks to add perspectives on other perceived consequences that are not directly linked to the regulation's objectives but may benefit the debate on ESG disclosures in private equity markets. Consequently, our third research question is:

3. *What other consequences do Nordic private equity see with the SFDR?*

1.2 Purpose and Contribution

The purpose of this study is threefold. First, the thesis aims to explore the perspectives of Nordic private equity firms on the implementation of the SFDR to increase understanding of the challenges they encounter. Second, the thesis seeks to address whether the new disclosure regime is perceived to fulfill its intended objectives of increasing transparency and preventing greenwashing in the market for sustainable investment products. Lastly, the thesis seeks to add perspectives on other perceived consequences that are not directly linked to the regulation's objectives but may benefit the debate on ESG disclosures in private equity markets.

By increasing the understanding of the perspectives behind the application of the regulation, this paper seeks to inform the debate on ESG disclosures in private markets. While it does not seek to provide best practices, it aims to provoke critical thinking among practitioners about their compliance approaches and push them to enhance their efforts toward ESG disclosure. The study provides LPs with a deeper understanding of how PE firms address SFDR compliance. This empowers LPs to make more informed investment decisions and navigate ESG disclosures more effectively.

Secondly, the study provides policy implications by addressing practical challenges that may hinder the harmonization of ESG disclosures. By providing a better understanding of the rationales behind the application of the regulation, authorities can leverage these to improve clarity and guidelines.

Third, this paper aims to contribute to academia by extending existing literature on private markets and how it is influenced by ESG regulations. Despite the crucial role private markets play in advancing sustainable transformation, there is a noticeable lack of research in this field. Lastly, the study aims to provide a descriptive study to be used as teaching material on the intersection of private equity and sustainable finance, tailored for the Department of Finance at the Stockholm School of Economics.

1.3 Delimitation

This study is delimited to the Nordic private equity market and has taken the PE firm (GP) perspective. Thus, the study does not incorporate the perspectives of other stakeholders, such as LPs. Additionally, the study is delimited to focus on the perspectives of Nordic small and mid-cap PE firms. Further, the paper does not seek to evaluate whether individual firms' interpretation and application of the regulation is correct. Lastly, it is important to note that conclusions on its actual consequences are too early to be drawn.

1.4 Overview of Thesis Findings

The thesis's main findings can be summarized in six key statements. First, the study reveals that the SFDR is a pervasive challenge for all PE firms, regardless of firm characteristics. Second, definitions are too vague, leading to practical challenges and different interpretations regarding compliance, article classification, and data collection. The absence of guidance from authorities further exacerbates these difficulties. Third, despite challenges and interpretation differences, the regulation’s mandatory nature still improves the availability of sustainability information, leading to greater transparency and comparability of funds, thus contributing to the mitigation of greenwashing. Fourth, complying with a higher article classification may increase access to capital from LPs who are also subject to increasing reporting requirements. However, the emphasis on article classification will depend on investor sophistication. Fifth, the SFDR is perceived to increase ESG awareness at the PE fund level and PC level. Lastly, the SFDR has set a higher standard for integrating ESG in private equity. While it may pose initial burdens, the study highlights perceived benefits beyond mere compliance.

2. Literature

This section provides an overview of the literature related to the topic of the thesis. It starts by discussing the private equity model and the relevance of sustainability within this context. It then offers an overview of central EU regulations related to sustainability, with a detailed summary of the Sustainable Finance Disclosure Regulation (SFDR). Furthermore, it delves into previous academic research conducted on the subject. Finally, it outlines other significant non-EU regulations that address ESG factors.

2.1 Private Equity

2.1.1 Private Equity Model

Private equity involves direct equity investments, mainly in unlisted companies through funds structured as limited partnerships (Döskeland et al., 2018). The General Partner (GP) manages the funds, while Limited Partners (LPs) contribute capital without participating in day-to-day operations (Blackstone, 2020). LPs include institutional investors, pension funds, endowments, family offices, and high-net-worth individuals. GPs use leverage, known as a leveraged buyout (LBO), to amplify returns on investments. GPs charge a management fee of around 2% on committed capital and retain a variable share of profits called carried interest, typically 20% above the LP return threshold (Döskeland et al., 2018). Private equity funds have a typical duration of 7-10 years, divided into three stages: fundraising, investment, and harvest. During the investment period, capital is gradually deployed, and in the harvest period, investments are realized, returning cash to investors (Blackstone, 2020). Private equity firms enhance portfolio company value through financial engineering, optimizing capital structure and minimizing after-tax costs (Kaplan, 1989), governance engineering, implementing effective ownership and governance practices (Jensen, 1989), and operational engineering, leveraging industry expertise for productivity improvements and strategic changes (Bergström et al., 2007).

2.1.2 Sustainability in Private Equity

Indahl and Jacobsen (2019) discuss the emergence of PE 4.0 which prioritizes climate change, social issues, and technology disruption. In the past, managing externalities was not considered a core competence or competitive advantage in the private equity industry. During PE 1.0 in the 1980s, the primary focus was on financial engineering through high leverage. PE 2.0 in the 1990s centered around improving operational efficiencies, often achieved through changes in management. PE 3.0 in the 2000s concentrated on transformative buy and build and different asset classes. Now with PE 4.0, managing ESG risks and pursuing ESG opportunities have become crucial for value creation and long-term success in the industry. By addressing ESG factors, PE firms can reduce investment risks and enhance their resilience in the face of political and regulatory changes (Indahl & Jacobsen, 2019).

A key driver behind PE 4.0 was the evolution of sustainable finance that started in the 2000s in Europe. In Sustainable Finance 1.0, unethical companies were excluded from investments. At its initial stage, ESG has primarily focused on downside risk mitigation (Busch et al., 2021). Sustainable Finance 2.0 incorporated ESG considerations into decision-making. In praxis, this meant that Nordic PE firms aligned their strategies and value creation plans with the UN SDGs (Indahl & Jacobsen, 2019). At this stage, working with ESG is still considered a risk-mitigating but more explore it as a value-creating opportunity (Radcliffe & Solaini, 2023). In Sustainable Finance 3.0, the focus shifted to impact investments with the aim to address social deficiencies and ecological degradation (Freshfields, 2021). ESG has now become a key value-creation driver. While most private equity funds still remain in PE 3.0 and Sustainable Finance 2.0, private equity investors launched more than 330 new impact and sustainability funds between 2019 and 2022, and the cumulative value in ESG and impact funds tripled from USD 90 bn to 270 bn (McKinsey, 2023).

2.1.3 LPs' Role in Sustainability

While investors cannot directly influence real-world outcomes, they can influence the company's impact through their investment activities (Heeb & Kölbel, 2020). By providing capital, investors have the potential to influence the impact of a company by supporting or incentivizing specific activities.

The importance of ESG for LPs is one of the crucial forces pushing ESG in the private equity industry. Almost 80% use ESG as a criterion in selecting GPs with many LPs having sophisticated approaches to the evaluation of GPs' ESG capabilities (Eccles et al., 2022). As such, the ESG strategy of PE firms and disclosure practices are observed to have a key effect on access to capital (Radcliffe & Solaini, 2023). Historically, LPs relied on voluntary disclosures of ESG data to evaluate the ESG criteria.

2.2 EU Regulations

The European Green Deal strives to make the EU the first climate-neutral continent by 2050. All 27 EU Member states have committed to this goal and pledged to reduce net GHG emissions by at least 55% by 2030, compared to 1990 levels (European Commission, n.d.-b). In March 2018, the European Commission (EC) put forward a strategy to further connect finance with sustainability, known as the "action plan on financing sustainable growth" (European Commission, 2018). The action plan includes ten key actions that are divided into three categories; reorienting capital flows towards a more sustainable economy, mainstreaming sustainability into risk management, and fostering transparency and longtermism (ibid). The most central parts of the action plan will be outlined below, namely the EU Taxonomy, the CSRD, and the SFDR.

2.2.1 EU Taxonomy

Directing investments toward sustainable projects and activities is vital to meet the EU's climate and energy targets for 2030 and the objectives of the European green deal. To redirect the money, the EU taxonomy was established and entered into force in July 2020, to create a clear definition and common language of what "sustainable" means (European Commission, n.d.-d). For an activity to qualify as environmentally sustainable, it must meet 4 overarching conditions established by the Taxonomy Regulation (appendix 10.1.1). The Taxonomy establishes six environmental objectives (appendix 10.1.2), and by defining technical screening criteria for each objective, an actual list of environmentally sustainable activities has been created by the EC under the Taxonomy Regulation, to specify how activities can contribute to each objective. For an activity to be aligned with the taxonomy, it must contribute to at least one objective, meet minimum social safeguards, and not cause significant harm to any other objective (European Commission, n.d.-c).

2.2.2 Corporate Sustainability Reporting

The Corporate Sustainability Reporting Directive (CSRD) entered into force on 5 January 2023, and the first companies will be required to apply the rules for the fiscal year 2024 and publish their first reports in 2025 (European Commission, n.d.-a). The CSRD improves the requirements of the EU's Non-Financial Reporting Directive (NFRD), which lays out rules for the social and environmental information that companies must report on. The purpose of the directive is to provide investors and other stakeholders with the necessary information to assess investment risks arising from sustainability issues. The directive further aims to increase the transparency of companies' impact on people and the environment and to harmonize the disclosure of information. Until companies must comply with the CSRD, the rules introduced by the NFRD remain in force, which applies to 11,700 large public-interest companies with more than 500 employees (ibid). With the new directive, approximately 50,000 large companies and listed SMEs will be subject to the CSRD (European Council, 2022).

2.3 The Sustainable Finance Disclosure Regulation

2.3.1 Background and Purpose

The Sustainable Finance Disclosure Regulation (SFDR) 2019/2088 was introduced by the European Commission in 2019 as part of the broader sustainable finance agenda that was initiated in 2018 through the adoption of the Action plan on financing sustainable growth (European Commission, n.a.-c). The purpose of the SFDR is to improve transparency in the market for sustainable investment products and to prevent greenwashing (Eurosif, 2022). As such, the regulation aims to reduce information asymmetries between the financial intermediaries and the end investor concerning the incorporation of ESG risks and effects (Busch, 2023). This objective is reinforced by Ferriani (2023), who emphasizes that the regulation seeks to address inconsistencies in sustainability disclosure standards by implementing a unified framework.

The SFDR came into force in March 2021. To complement the existing requirements with more detailed provisions and templates, the Delegated Regulation (EU) 2022/1288 followed in April 2022. It includes regulatory technical standards (RTS) that financial intermediaries must use when disclosing sustainability-related information (Finansinspektionen, 2022). These standards and templates are effective from January 2023 (European Commission, n.a.-c). Since then, several clarifying documents have been published (Finansinspektionen, 2022).

By 30 June 2023, financial intermediaries must comply with the RTS and report on their performance for the previous reference period (the fiscal year 2022), including the PAI statement and other necessary disclosures. Financial intermediaries are obligated to issue a PAI statement every year, on the same date thereafter (Worldfavor, 2022). For a more detailed timeline, see appendix 10.1.3.

The SFDR categorizes financial intermediaries into two types: (i) financial market participants (FMPs), which include private equity funds, and (ii) financial advisers, encompassing investment and insurance advisers (Busch, 2023). Given the scope of this paper, the emphasis will be placed on FMPs.

To comply with the SFDR, FMPs must ensure sustainability transparency on their websites, in periodic reports, promotional material, and pre-contractual information, covering both the entity level (GP) and product level (various PE funds) (Busch, 2023). In addition to ESG disclosure obligations, FMPs are also obligated to classify investment products based on sustainability objectives (European Commission, n.d.-e). The SFDR introduces a self-assigned classification system for FMPs, requiring them to classify their funds as Article 9, 8, or 6, with each classification indicating a decreasing level of reporting obligations (Grunwald, A., 2022) (see appendix 10.1.4).

2.3.2 Entity Disclosure

To comply on an entity (e.g. PE firm) level, all FMPs needs to publish the information required by Article 3-5 on their websites, including how they integrate sustainability risks in their investment decision-making process (Article 3), if they consider the adverse impacts (PAI) generated on sustainability factors and how these are considered in due diligence policies (Article 4), and how their remuneration policies adhere to the integration of sustainability risks (Article 5) (Bengo et al., 2022).

2.3.3 Product Level Disclosure

Product-level disclosures include information provided in pre-contractual documents (e.g., marketing materials, private placement memorandum) and periodic reports (e.g., annual reports). One of the most central aspects of the SFDR is the classification of financial products, referred to as Articles 6, 8, or 9 (Bengo et al., 2022). In practice, Article 8 is often referred to as “light green”, and Article 9 as “dark green”. Since these terms are rather misleading when a product invests in economic activities that contribute to other than environmental objectives (Busch, 2023), this paper will refer to Article 8 or 9.

Article 6 requires FMPs to provide information on how sustainability risks are considered in investment decisions and their impact on financial returns in pre-contractual disclosures. To comply with Article 8, FMPs must provide information on how the financial product promotes and respects social or environmental characteristics, and how these characteristics are measured in pre-contractual disclosures and periodic reports. Lastly, to comply with Article 9, information on how the financial product contributes to sustainable objectives and how it is distinguished from traditional market objectives must be provided in the pre-contractual and periodic report (Bengo et al., 2022). Although the SFDR lays out the requirements for complying with the different article classifications, there are remaining challenges regarding the unclear definitions of which products are subject to Article 8 or 9, resulting in different understandings and inconsistent disclosures under these articles (Greenomy, n.d.).

2.3.4 PAI

A Principal Adverse Impact (PAI) refers to any negative effect on sustainability factors, including environmental, social and employee concerns, respect for human rights, as well as anti-corruption and anti-bribery matters, caused by investment decisions or advice (Worldfavor, 2022). Despite the need to publish a PAI statement annually on the website, PAI must be disclosed on a product level in the pre-contractual information under Article 7 (Deloitte, 2022). FMPs above 500 employees are required to report on the PAIs of investment decisions on sustainability factors. This reporting obligation also applies to Article 6 products (Busch, 2023). In the case of private equity funds, they are required to report on 14 mandatory environmental and social indicators, along with at least one additional indicator for each environmental and social issue (see appendix 10.1.5) (Verhey et al., 2021). Additionally, it should be noted that LPs may qualify for the definition of FMP. As such, LPs can demand PAI from GPs even if they have chosen to not report on PAI. Limited data availability poses a significant challenge for PAI reporting. Firms must strive to obtain data from investee companies, as stipulated by the RTS (Greenomy, n.d.).

2.3.5 SFDR and ESG Disclosures in Previous Research

Given its novelty, there exists little research on the SFDR to date. In academia, Michl & Schmid (2022) found that Article 8 mutual funds receive increased fund flows compared to Article 6 mutual funds. Complementary, Ferriani (2023) found that Article 9 mutual funds with higher Morningstar sustainability ratings experienced significant increases in net capital inflows. Additionally, Becker et al. (2022), found that following the SFDR launch, impacted funds also improved their sustainability ratings. Collectively, these findings suggest that the introduction of the SFDR effectively guides capital toward sustainable investment opportunities.

In contrast, Cremasco and Boni (2022) highlight that Articles 6 and 9 funds demonstrate similar behavior when it comes to both financial and sustainability factors. Michl & Schmid (2022) identified fund managers' opportunistic greenwashing behavior; labeling funds as "greener" without disclosing essential information before the RTS came into force in 2023. Moreover, the classification system of the SFDR is arbitrary and ambiguous, particularly for impact funds where many Article 9 classified funds fail to meet impact requirements set by the Impact Task Force[3] (Scheitza et al., 2022). Bengo et al., 2022 still see a disconnect between the SFDR and social impact measurements to assess their ESG contributions. Together these observations indicate that the SFDR currently suffers from loose boundaries, thereby impeding its ability to fully achieve its goal of ensuring transparency in sustainability claims.

In related academia, numerous studies have examined the positive effects of ESG disclosures. Hartzmark & Sussmann (2019) found that funds invest in more sustainable ways when investors have better information about a fund's sustainability. Other studies found that improving ESG disclosures result in lower cost of debt, better access to capital, and enhanced firm value (Feng & Wu, 2021; Raimo et al., 2021). Moreover, higher ESG disclosure requirements were found to be positively correlated with PE firms' fund performance, driven by ESG-focused portfolio companies (Abraham et al., 2022). Others see that closely related Corporate Social Responsibility disclosures promote green innovation and growth (Hong et al., 2020). Additionally, funds demonstrating stronger ESG alignment attract increased investor inflows (Aasheim et al., 2021; Ammann et al., 2019; El Ghoul & Karoui, 2021; Huang et al., 2020).

In contrasting views, Pitkänen (2022) argues that ESG disclosure requirements were uncorrelated with fund performance. Further, ESG disclosures may not effectively reduce information asymmetry between LPs and GPs as firms tailor their disclosures to their economic interests, which can hinder economic growth (Hassani & Bahini, 2022).

2.4 Global Initiatives

2.4.1 UN Sustainable Development Goals

The UN Sustainable Development Goals were adopted by all UN Member states in 2015, as part of the 2030 Agenda for Sustainable Development (United Nations, 2023a). The SDGs are an urgent call for action by all countries, to end poverty, protect the planet, and improve the lives and

[3] The Impact Taskforce (ITF) is a global initiative that brings together businesses and investors to promote discussions and recommendations on impact transparency, integrity, and trust for G7 governments and industries.

prospects of everyone, everywhere (United Nations, 2023b). The SDGs consist of 17 Goals with 169 targets (appendix 10.1.6), addressing the global challenges.

2.4.2 UN Principles for Responsible Investments

The UN Principles for Responsible Investments (PRI) was launched in 2006 by UNEP Finance Initiative and the UN Global Compact. The PRI provides a voluntary framework that can be used by investors to incorporate ESG issues into their decision-making and ownership practices and has attracted a signatory base of over 1,500 investment institutions with approximately USD 62 trillion in AUM (UN Global Compact, n.d.). The PRI is independent and not associated with any government, and it is supported by, but not part of, the UN (PRI Association, n.d.-a). The principles were developed by investors, and by implementing them, signatories contribute to fostering a more sustainable global financial system (PRI Association, n.d.-b). For a list of principles, see appendix 10.1.7.

3. Methodology

This section starts by outlining the methodology of this paper, followed by a description of the data collection process and a discussion of the research quality, focusing on the reliability and validity of the chosen methodology.

3.1 Research Design and Methodology

Given the novelty and limited research on the chosen subject, the method is based on a qualitative approach to enable nuanced descriptions of the studied phenomenon (Ahrne et al., 2015). The initial step involved conducting a case study to enhance the exploratory nature of the study, offering a descriptive perspective on the phenomenon under investigation and identifying essential themes to shape the interview questions in the subsequent section. According to Denscombe (2017), a case study methodology is effective to highlight a general theme by investigating a specific one. To give a representative view of the industry, themes identified in the case study were used to guide semi-structured interviews with 13 Nordic private equity firms. The interviews followed a semi-structured approach to enable a deeper understanding of the respondents' attitudes, by allowing open answers (Bell et al., 2018). Semi-structured interviews are suitable for exploring intangible and abstract concepts (Kvale & Brinkmann, 2009; Bryman & Bell, 2015). This approach enabled the interviews to have a clear structure while still allowing for additional insights or nuances mentioned by the interviewees (Bryman & Bell, 2017).

3.2 Data Collection

3.2.1 Pre-study

To establish the relevance of the chosen topic within the private equity industry, a preliminary study was conducted involving one limited partner and two private equity firms (appendix 10.2.1). The interviews were open discussions about the intersection of ESG and private equity to identify current challenges. From the pre-study we could confirm that the SFDR is topical to the industry, thus confirming its relevance and need for further examination.

3.2.2 Case study

Primary data was collected through semi-structured interviews with employees at Procuritas and Polarn O. Pyret (PO.P) (appendix 10.2.2). The responsible Partner for the PO.P acquisition was interviewed to gain insights into the investment rationale and the impact of the SFDR on the PE firm. An interview with Procuritas' Head of ESG provided a detailed perspective on the firm's ESG practices and the implementation of regulatory requirements. Lastly, the Sustainability & Quality Director at PO.P was interviewed to understand collaboration and data collection processes within PC firms. The primary data sources were then complemented with written sources, including sustainability reports, annual reports, and press releases.

3.2.3 Interviews

Semi-structured interviews were conducted to collect primary data and assess the key themes developed during the case study. To enhance the robustness of our findings, we adopted a dynamic approach to interviewing Nordic PE firms. As subsequent participants began corroborating the answers provided by the initial respondents, we reached a point where our sample size was considered adequately secure for analytical generalization (Yin, 2014), resulting in 13 additional interviews (see appendix 10.2.3)

The interviews were conducted between March and April 2023, utilizing video meetings. The duration of the interviews ranged from 30 to 45 minutes, allowing for comprehensive discussions with the participants. To ensure accuracy and facilitate referencing, all interviews were recorded with the participant's consent and subsequently transcribed, following the reliability criterion (Yin, 2014). To ensure transparency and accurately reflect the perspectives of the interviewees, a draft of the interview results was shared with the participants, allowing them to review their quotes and suggest any revisions. This process aimed to rectify any factual inaccuracies that may have arisen from misinterpretation. It is important to note that although interviewees were given the chance to refine their quotes, their involvement did not extend to influencing the overall direction or content of this paper. The integrity and independence of the research remained paramount throughout the entire process.

3.3 Research Quality

3.3.1 Validity

Construct validity ensures an accurate representation of concepts in qualitative research (Creswell & Poth, 2017). In this case study, the interviews were designed to directly address the specific constructs of interest, ensuring a focused approach.

Internal validity refers to the accurate representation of causal relationships in a study's findings. While qualitative research has been criticized for its perceived lack of rigor and potential biases (Yin, 2014), it offers valuable insights. In this study, primary data was collected from internal resources, and the semi-structured approach provided flexibility in exploring research questions. Given the study's focus on understanding firm perspectives, internal validity is considered acceptable within this context.

External validity in qualitative research pertains to the generalizability of results to a broader population (ibid). To enhance external validity, a diverse sample of private equity firms was intentionally selected, considering factors such as organizational size and investment strategies, (ibid). However, it is important to acknowledge the study's focus on exploring the perspectives of PE firms. While a single perspective from a portfolio company will be presented to illustrate the SFDR process, no generalizations can be based on portfolio companies' perspectives.

3.3.2 Reliability

To enhance reliability, it is crucial to consider factors that can influence the consistency and replicability of research findings (Nowell et al., 2017). These factors include the setting of the interviews, the interpretation of the researchers, and the relationship between the respondents and interviewers. In this study, a structured approach was employed, involving both researchers in all interviews and individual interpretation of the results before consolidation. Furthermore, to uphold participant confidentiality, certain interviewees were anonymized at their request and quotes were not connected to the individual firms. While anonymization may limit traceability and replication, it strengthens the study's construct validity. Anonymity enables participants to express their opinions freely, facilitating a candid exploration of their perspectives (Tolich & Davidson, 1999).

4. Case Study

This section starts by providing an overview of Procuritas and the development of its ESG practices. Subsequently, the section delves into an overview of Polarn O. Pyret (PO.P), with a primary focus on their sustainability profile. Then the practical role of PO.P in the SFDR implementation is outlined followed by how Procuritas works with the regulation. The case study concludes by presenting the challenges and benefits encountered in Procuritas' implementation of the SFDR. The sources of information include interviews with Procuritas' investment and ESG team, PO.P's ESG team, as well as internal documentation and data unless explicitly stated otherwise.

4.1 Background

4.1.1 Overview of Procuritas

Procuritas is a Swedish buyout fund with a focus on Nordic companies. Its investment strategy is to acquire a majority share in small to mid-sized companies (Enterprise value of EUR 25m - EUR 100m) with significant growth opportunities. Procuritas' focus is service consolidations, digital consumers, software, and niche industrials. They support acquired companies through M&A, digital growth, ESG enhancement, and operational improvements. Since its inception in 1986, they have raised seven funds whereof their latest and largest fund VII closed in April 2023 at EUR 407 million in capital committed (see appendix 10.3.1 for fund overview). Fund VII is an Article 8 fund, meaning that it promotes environmental and social characteristics but does not commit to making sustainable investments. The majority of Procuritas capital comes from Nordic and international life insurance companies, pension funds, family offices, and funds of funds.

4.1.2 Sustainability at Procuritas

"I have worked with private equity investments for about 18 years and sustainability was not a central issue on my desk when I started. In 2006 it was more about direct environmental risks, e.g., in property assets. But it has gradually become much more important." (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

The first investment for Procuritas with a clear ESG angle was made within fund V in 2014. The company, Fidelix, helped buildings lower their energy usage via building management systems and related building automation products. Procuritas identified that its pitch extended beyond just providing an economic solution for its customers. Not only did Fidelix save costs related to energy usage but also helped its customers to become more resource efficient.

Over the holding period of Fidelix, the sustainability aspect of investments became more prominent in the industry which benefited the company and strengthened its competitive position. No longer was a superior product and/or service offering enough, but a clear sustainability contribution was needed to reap the benefits of a higher valuation.

"The consideration of long-term sustainability needs is gaining prominence and becoming a crucial aspect of decision-making, as opposed to being relegated to a mere side issue. Although it may still be partly non-financial, other values (sustainability linked) are being factored in, and they are increasingly being assigned monetary value in a customer's purchasing decision." (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

At the same time as the capital markets began asking questions about Procuritas' commitment to sustainability, the objectives of LPs evolved. While financial returns remain a primary goal, societal responsibility is increasingly becoming a requirement for investments. To keep up with the expectations of investors, Procuritas began its tracking of ESG in 2012. In 2015, Procuritas took a significant step towards integrating ESG factors into its investment decision-making process by signing the United Nations Principles for Responsible Investment (UNPRI). The move marked the first structured approach of ESG considerations into Procuritas' investment analysis, mandating a continuous reporting process on PCs and their sustainability improvements. In the years that followed, a materiality assessment tool was implemented, an ESG portfolio tool kit was developed, and ESG data of the PCs was collected via a new digital ESG reporting system, among others. External ESG due diligence has now become a market standard.

As the sustainable financial landscape matured, the SFDR launched at the beginning of 2021. Previous emphasis on UNPRI at Procuritas was shifted towards the SFDR for a better alignment with current regulatory requirements, and a more suitable framework for adhering to the standards that the firm imposes on itself and its PCs. In 2022, Procuritas demonstrated its commitment to ESG by hiring a dedicated ESG specialist who is responsible for ensuring alignment with the SFDR and expanding Procuritas' ESG initiatives. For a more detailed timeline of Procuritas' ESG development, see appendix 10.3.2. For Procuritas' sustainability focus, see appendix 10.3.3.

The initial PC that demonstrated a clear ESG contribution proved to be a profitable investment. In 2021, Fidelix was sold to Assemblin AB, a Swedish technical installations and service solution provider backed by private equity firm Triton. This successful exit allowed Procuritas a return exceeding 4x the initial investment.

4.1.3 Overview of Polarn O. Pyret

Polarn O. Pyret (PO.P) is a Swedish premium retailer of baby and childrenswear, founded in 1976 and with headquarters in Stockholm, Sweden. PO.P distributes its products through online, proprietary, and franchise stores in 12 markets, with a total of SEK 670m in net sales. PO.P operates in a premium segment where the target audience is adults making purchases for their kids. Durable clothes have been the cornerstone of PO.P since its inception, which has translated into the motto that each garment should be worn by at least three children, requiring high-quality products that can be passed down.

"Sustainability has been a part of our DNA ever since inception in 1976. Even then, there was an idea that garments should be produced with high quality and that they should be able to last a long time. Already in the 80s, we started introducing organic cotton in our products, to have a minimal impact on the environment in the products we develop." (Terese Persi, Sustainability & Quality Director, Polarn O. Pyret)

4.1.4 Sustainability at Polarn O. Pyret

The Sustainability & Quality Department at PO.P consists of three full-time employees who manage sustainability work together with different departments. They develop the sustainability strategy and KPIs, which are then implemented by the management team in their respective areas. Monthly meetings are held with the Sustainability Steering group, led by the Sustainability & Quality Manager, who reports directly to the CEO (appendix 10.3.4).

PO.P's sustainability strategy has played a crucial role in the company's success (appendix 10.3.5). They have an elaborate sustainability strategy comprising how to run a sustainable business, ensure a leading offer of sustainable products, reduce the usage of resources and emissions, and respect and secure human rights. To support their strategy, PO.P has made strategic investments in sustainability platforms like Worldfavor[4] and TrusTrace[5], as well as a new ERP[6] system, to efficiently collect and verify data. To reduce the number of clothes consumed and their impact on the environment, PO.P works with innovation and design, offering different repair, rental, and secondhand solutions, as well as reducing the number of new seasonal products by shifting focus to classics. In recent years, PO.P has reduced the number of suppliers to increase control and influence over the supply chain. Careful screening and due diligence based on social, environmental, and quality standards are included in the selection process for new suppliers.

In addition to its sustainability strategy, PO.P. has identified eight prioritized SDG goals (appendix 10.3.6) that are integrated into its sustainability work. Since activities throughout the value chain are affected by industry standards and legislation, PO.P follows several policies that govern decisions. These include a Code of Ethics, Personnel-related Policy, Code of Conduct, Animal Welfare Policy, Anti-Corruption Policy, Human Rights Policy, and Environmental and Climate Policy.

4.1.5 Previous Ownership

From 2012 to 2021, PO.P was under the ownership of Retail and Brands AB (RNB), a Swedish fashion company that was publicly listed at the time. RNB had a portfolio of brands operating in the Nordic region. However, when it came to their sustainability ambitions, PO.P faced limitations within the group. In 2021, as part of a wind-up process, PO.P was sold to Procuritas.

"When we were part of RnB, we had a joint sustainability reporting for the group, where we felt that we did not fully align with the other companies but still had to be in the same sustainability report. When we became independent, we released our first own sustainability report and could choose what we wanted to report on, and think is important. It has been a huge boost in what we can communicate." (Terese Persi, Sustainability & Quality Director, Polarn O. Pyret)

[4] Sustainability platform to access, share, and leverage sustainability data.
[5] Supply chain transparency and material traceability for global fashion and apparel brands.
[6] Enterprise resource planning system is a type of software to manage day-to-day business activities.

4.2 Procuritas Acquisition of Polarn O. Pyret

Procuritas acquired a majority position in PO.P on 11 March 2021, for a purchase price of SEK 330 million on a cash and debt-free basis. Procuritas identified a strong commercial case in PO.P seeing multiple attractive value creation levers.

Firstly, PO.P was the leading childrenswear brand that was at the forefront of sustainability. PO.P works extensively with quality and sourcing to create long-lasting products.

"As an engineer, I think it's very important to consider life cycle analysis. It was quickly apparent that PO.P is working very hard on the content of their products. However, ensuring long product durability and a natural process to pass the product to the next owner is essential. We cannot continue consuming fast fashion for short time or single use." (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

Secondly, with a focus on their core products and a lower fashion degree, PO.P reduced product risk, leading to greater predictability in sales. Consequently, they were able to optimize their supply chain and inventory levels, resulting in a more favorable cash flow profile.

Thirdly, PO.P operates in the premium market segment, where the primary customers (parents) are less price sensitive. This allows for a less cyclical business and customers willing to pay a premium for a more sustainable product.

"We believe that the market can price such a product and that there is a segment of parents who would rather pay a premium for a good product that can be resold after a few months of use, than buy a cheaper product that is discarded." (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

Lastly, Procuritas identified an opportunity to optimize the number of physical stores and transform PO.P into an omni-channel[7] player to tap into the growing online market.

"Besides betting on customers valuing higher quality, the other bet was on PO.P's store-heavy business, where many do not believe that stores will exist in the future, but we believe that stores

[7] Provide customers with a seamless and unified brand experience, regardless of which channel they use.

and online have a common future." (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

4.3 How Procuritas Works with the SFDR

The latest Procuritas fund VII was chosen to be classified as an Article 8 fund. This decision was taken by the partners and the ESG team. As such, the fund promotes environmental and social characteristics. The other active funds, IV, V, and VI will not have an article classification, but PAI indicators are still collected for all PCs regardless (see appendix 10.3.7).

To comply with the SFDR, Procuritas published website disclosures, shared pre-contractual disclosures with investors, included periodic reporting in the annual report, and reported on its PAI indicators. The ESG team at Procuritas collaborates closely with the partner group and advisors to compile the necessary disclosures. For the second part of the SFDR compliance, the PAI indicators from the PCs are collected and aggregated at a fund level. In practice, the head of ESG at Procuritas requests 14 mandatory and 2 chosen PAI indicators from the PCs (see appendix 10.3.7). These are then reported in the sustainability platform Worldfavor. Procuritas provides written guidance on how to report data to the PCs and a personal walk-through of the various KPIs when needed. Once the data is submitted, Procuritas' team members will review its validity. The PCs are required to report annually via Worldfavor. Procuritas utilizes the PAI indicators to assess the initial and annual performance of its PCs, enabling it to monitor the companies' ESG enhancements and identify investments that may be exposed to uncontrollable PAI. The collected data is published annually as part of the PAI statement on the website and in the sustainability report. This report is not only intended for external communication but also for internal discussion. The PAI data, along with other selected ESG KPIs, forms an integral part of Procuritas' sustainability strategy. In this strategy, the investment team works closely with the ESG team to identify targeted ESG enhancements based on the data. These improvements are then presented to the board of the portfolio companies for consideration. The board takes responsibility for communicating and overseeing ESG actions. An ESG update should be provided during each board meeting of the PCs. This update is intended to measure the progress of the PCs in achieving ESG goals and to identify areas that may require further improvement.

4.4 PO.P's role in the SFDR Implementation

PO.P became a part of Procuritas fund VI, which is not subject to any article classification. Procuritas, even though not required, has opted to prioritize ESG alignment and PAI collection across all its funds, irrespective of the article classification. The SFDR only pertains to FMPs, thus PO.P itself is not required to comply. PO.P's involvement with the SFDR is centered around the data collection process, whereby Procuritas has requested the company to report on PAI indicators as part of its standard annual reporting requirements.

"I have talked a bit with the head of ESG at Procuritas and we annually report some KPIs to Worldfavor's sustainability reporting, and much is due to the legislation (SFDR) as far as I understand. So, I know it exists, I know we report KPIs to it, but I am not familiar with exactly what it contains and how it works." (Terese Persi, Sustainability & Quality Director, Polarn O. Pyret, Head of ESG, Procuritas, 21.4.2023)

For PO.P, collecting and reporting the data is not experienced a major challenge. Many PAI indicators overlap with KPIs that have been part of PO.P's sustainability strategy and previous reporting. Nonetheless, the biggest challenge for PO.P lies in adjusting their reporting timeframe and format.

"As our organization operates on a fiscal year-end that does not align with the calendar year, some of the data required for Procuritas' annual reporting may not be readily available. The main challenge lies in how we manage data and the timeframe within which data needs to be reported. This requires some additional effort from our side." (Terese Persi, Sustainability & Quality Director, Polarn O. Pyret, Head of ESG, Procuritas, 21.4.2023)

The ESG team at PO.P is responsible for collecting PAI indicators. To do so, they work collaboratively with relevant departments to gather the required data. For more complex PAI calculations, such as GHG emissions, the data is sent to an external consultant for compilation. Finally, the data is inputted into the Worldfavor platform. Due to the misalignment between Procuritas' reporting on a calendar year and PO.P's reporting from September to August, two instances of Worldfavor are running. One platform is for PO.P's own sustainability reporting, and the other is for Procuritas' reporting requirements, including PAI indicators. The discrepancy in time periods requires some duplication of effort. However, the team is confident that they can competently manage even the PAI indicators that are new to PO.P.

"The information we report to Procuritas is not considered out of scope or irrelevant, nor does it require a significant amount of additional work beyond what we are already doing. Instead, it aligns well with our current practices." (Terese Persi, Sustainability & Quality Director, Polarn O. Pyret, Head of ESG, Procuritas, 21.4.2023)

4.5 Procuritas' Challenges with the Implementation of SFDR

One significant challenge that arises in the implementation of the SFDR framework is the lack of clarity regarding the specific requirements and reporting procedures.

"We have brought in several consultants to help us with this, to understand the requirements for becoming an Article 8 compliant business. It is not easy to get an answer to this, making it even harder for us to implement it in a simple or clear way. Even the experts do not have a definitive interpretation." (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

The lack of clear guidelines has led Procuritas to rely on emerging best practices, interpretations from peers, software tools, and other resources that can clarify the process of compliance. Especially the interpretation of the definition and calculation of PAI indicators proves to be a challenge. Despite the European Supervisory Authority (ESA) publishing Annex 1[8] in April 2022, trying to clarify the methodology for PAI interpretation and measurement, Procuritas still felt the need to seek legal and consulting advise to interpret these requirements.

"There is a KPI that requires companies in high climate impact sectors to report their energy usage. The challenge arises when trying to determine which energy usage falls within the high climate impact sector of economic activities. I asked lawyers for their interpretation of this requirement, and they clarified that only energy usage related to high climate impact sector activities needs to be reported. However, it's difficult to determine which energy usage qualifies, as it is not common for companies to make such a breakdown of energy usage, and meticulously

[8] Clarification document published April 2022 by ESA on template principal adverse sustainability impacts statement.

map different economic activities to energy consumption." (Linda Leifsdotter, Head of ESG, Procuritas, 10.3.2023)

To expect companies to review an extensive list to assess whether their energy usage falls under the classification of being in a high-impact climate sector is impractical and a time-consuming process that finds little support in practice. The ESA has outlined a theoretical framework, but its practical implications prove to be more challenging. Not only is the definition of some PAI indicators ambiguous and leads to much interpretation, but also the quality of data suffers from complex measures. Especially, scope 3 GHG emissions is a metric that heavily depends on proxies and deals with the indirect emissions that are not owned or controlled by the reporting company. This becomes particularly challenging for companies with lengthy and intricate value chains. Obtaining precise data and creating reliable estimates for scope 3 GHG emissions is a demanding task, especially because it in most cases constitutes the largest proportion of a company's carbon footprint. However, not all PAI indicators are difficult to measure. Some of the social objectives are more straightforward, where a simple yes or no answer suffices (see appendix 10.3.7).

Besides the lack of accurate data, time must be invested into collecting all the information, guiding, and assisting the PCs in the calculation of PAI indicators. There is a risk that complying with the SFDR could become overly bureaucratic and burdensome. Even with the use of digital data collection platforms such as Worldfavor, the head of ESG still has a significant amount of legwork to do. For the collection of required data, many people still need to get involved, as PAI reporting affects multiple divisions in a company. Procuritas believes this workload peaks in the initial stage, as PCs require more guidance. In addition, ESG maturity and industry are also expected to influence the workload. Once praxis is developed, PAI indicators will become a natural part of the overall reporting process, and the burden on the ESG professional is expected to lessen.

After collecting data from PCs and compiling it into an aggregated PAI report at the fund level, it's important to determine its purpose beyond disclosure. Otherwise, PAI may be viewed as merely an administrative task, increasing the risk of it being overlooked or undervalued. To avoid excessive bureaucracy, it's essential to balance the need for information with practicality when complying with the SFDR requirements.

“One potential disadvantage about PAI reporting is that it can take focus away from actually making a difference. It can become all about reporting and not enough about action.” (Linda Leifsdotter, Head of ESG, Procuritas, 10.3.2023)

4.6 Procuritas’ Perceived Benefits of the SFDR

Despite the challenges that arise with the interpretation and quality of data, the SFDR has the potential to bring about numerous positive consequences, according to Procuritas. The adoption of a unified framework, though it may initially be difficult to interpret, will ultimately lead to greater comparability among PE funds and PCs. Over time, as processes become more streamlined and the challenges of interpretation are addressed, data quality is likely to improve.

“I often say that even if we feel like our KPIs are not particularly good and the quality of our data is not consistent, we still need to start somewhere because what gets measured gets done. […] We need to act based on what we have or can obtain, and then we can refine it over time.” (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

Procuritas sees that reporting under the SFDR not only has the potential to improve data quality but can also increase awareness at both the PE firm and PC levels. By requiring reporting on specific aspects related to sustainability, the SFDR can motivate companies to move beyond empty phrases and act towards achieving sustainability goals.

“Reporting under SFDR can have a practical benefit as well. For example, if a company reports on its annual carbon emissions and sees that they are increasing every year, this realization can lead to active measures and efforts to reduce emissions. SFDR reporting can therefore help companies become more sustainable and take action to address ESG issues.” (Linda Leifsdotter, Head of ESG, Procuritas, 10.3.2023)

To comply with a higher article classification, pre-contractual disclosure must clearly define the environmental and social characteristics promoted (Article 8) or contributed (Article 9) by the fund and specify how they will be measured. In addition, the disclosure must elaborate on the asset allocation towards objectives and taxonomy-aligned activities. Periodic disclosure is also required, which involves frequent follow-up on whether the objectives set out have been fulfilled and what the asset proportion looks like in terms of taxonomy alignment. These detailed reporting requirements, in addition to the standard website disclosures about integrating sustainability risks into investment decisions, can help investors make informed decisions about the environmental and social impact of the financial products they invest in. As such, having unrealistic claims will become apparent, leading to greater transparency, and thus preventing greenwashing.

"It will no longer be possible to simply claim that something is an impact investment without being able to clearly demonstrate it. This information should be included in the pre-contractual disclosure document and should explain how the investment contributes to an environmental or social objective. This will provide greater transparency in the financial industry and make it clearer which investments are truly impact investments." (Linda Leifsdotter, Head of ESG, Procuritas, 10.3.2023)

The SFDR applies not only to GPs but also to LPs, who are now seeking out GPs that can deliver the necessary PAI data and are aligned with their own sustainability goals. In Procuritas' latest fundraising, the SFDR was a common theme in meetings with investors. Procuritas has a positive view that investing time and resources into understanding and complying with the SFDR will lead to better access to LPs capital.

"I believe that it contributes to our success because it helps our portfolio companies' success - and it drives investor interest. […] I am fully convinced that if we work hard in this area, it will pay off. There are many other things that are much more uncertain, but this is an area that will still be relevant in three years, and even more so than today. Investing in this area is a no-brainer." (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

Further, Procuritas believes that a higher article classification can increase access to capital, too.

"If you have an Article 8 Plus[9] fund, which means that you have a portion of the fund dedicated to sustainable investments, it can be beneficial. […] There are many people who want to invest in impact companies, so having some portion of sustainable investments can help attract more capital." (Linda Leifsdotter, Head of ESG, Procuritas, 10.3.2023)

[9] Article 8 classification, whereas a certain percentage is allocated to contributing to environmental and social characteristics.

Not only does the SFDR affect access to capital for private equity funds, but also for PCs. This is evident in the case of PO.P, where its relevance and ability to secure financing has improved, provided other variables (state of the market, the financial strength of the company, etc.) remain constant.

"If PO.P were to issue a bond, it can be a bit dull and challenging to market a retail bond. However, a retail bond that has a clear sustainability label is easier to finance. Why is that? I think that the SFDR has at least marginally influenced the capital market to prioritize such assets. All things being equal, I would say that the SFDR has certainly helped companies like P.OP access capital. Of course, it is challenging to measure and distinguish this effect precisely because everything is continually changing." (Johan Conradsson, Co-Managing Partner, Procuritas, 13.4.2023)

5. Analytical framework

The upcoming section provides a summary of the key themes identified in the case study and are structured around the research questions. Since the themes are based on the perspective of only one firm, these will be assessed in semi-structured interviews with other Nordic private equity firms in the next chapter.

5.1 Practical Implications of the SFDR

5.1.1 Interpretation of the SFDR

The lack of clarity regarding the specific requirements and reporting procedures is a significant challenge. Due to the absence of clear guidelines, Procuritas relies on emerging best practices, software tools, and other resources that can clarify the process of compliance. Procuritas has been in contact with consultants and lawyers trying to get a better understanding of how to align with the correct article classification. However, there are still unanswered questions, such as whether funds closed prior to the SFDR are subject to the regulation and if PAI reporting is mandatory to comply with Article 8. The case study thus implies that there is ambiguity in the interpretation and application of the SFDR.

5.1.2 Data Collection

For Procuritas, the PAI indicators have played a significant role in the SFDR implementation. PAI indicators, particularly their definition and calculation, are a challenge. Obtaining accurate data and reliable estimates is difficult, where the data quality seems to suffer from complex measures. However, Procuritas expressed that the data collection process varies between PCs and is dependent on the PC's level of ESG maturity. Although PO.P has demonstrated a high level of ESG maturity and reported on most KPIs before the SFDR, they still experienced challenges in measuring some of the PAI indicators.

5.1.3 Resources

Procuritas invests considerable time in interpreting and calculating PAI indicators and supporting PCs in the data collection process. Procuritas utilizes the Worldfavor platform to collect and compile the data on a fund level. Nevertheless, external help is needed for certain PAI calculations, creating an additional financial burden. In addition, a growing emphasis on sustainability combined with more demanding regulations has resulted in hiring the Head of ESG.

5.1.4 LP Pressure

While this case study has focused on the GP perspective, some LPs are subject to the SFDR as well. In practice, this means that LPs are now looking for GPs who can deliver the necessary PAI indicators for their holdings and who are aligned with their own sustainability goals. In Procuritas' latest fundraising, the SFDR was a frequently discussed topic. Consequently, the downward pressure on GPs from LPs is perceived to influence GPs' adoption of the SFDR.

5.2 Transparency and Greenwashing

5.2.1 Transparency and Comparability

Procuritas perceives that the SFDR standardizes ESG reporting, enabling easier comparisons of financial products. With greater availability of information and a structured reporting framework, investors will have greater access to comparable data to make more informed capital allocations. Despite current challenges, Procuritas believes that the SFDR will contribute to its purpose of harmonizing sustainability disclosures in the long term.

5.2.2 Greenwashing

The lack of clarity of definitions and reporting requirements could imply the potential emergence of greenwashing due to the varying approaches to the regulation. However, Procuritas believes that investors will be able to discern from what claims are supported and which are not, because of the extensive disclosure requirements.

5.3 Other Perceived Consequences of the SFDR

5.3.1 Article Classification and Access to Capital

Procuritas believes that the SFDR will have an impact on their future fundraising, as they have experienced an increased interest in sustainability from LPs. The growing interest in impact and sustainable investments could imply that having a higher article classification will increase access to capital.

5.3.2 ESG Improvements

Considerable time and other resources are invested for compliance purposes, which raises the question of whether a disclosure regime can affect the investment strategies and ESG work of PE firms. Procuritas sees that the SFDR spreads awareness on a fund level and PC level and will serve as a basis for ESG discussions and improvements. Therefore, reporting under the SFDR can serve as a catalyst for positive change within a company's operations.

5.3.3 Perception of the SFDR

Despite challenges in the implementation of the SFDR, Procuritas is confident that the regulation will have a positive impact in the long term. In addition, Procuritas believes that the SFDR will not only increase access to capital for PE funds with a higher article classification but also steer investments toward portfolio companies with a stronger ESG profile.

6. Interview Results

The following section provides a summary of the opinions held by 13 Nordic private equity firms regarding the SFDR. The objective is to examine how a broader set of firms consider the themes identified in the case study to develop a better understanding of the implementation of the SFDR and its perceived consequences. Due to some firms requesting anonymization, quotes in the following section are referenced based on article classification on the latest fund, and not to individual companies.

	Latest Private Equity Buyout Fund						
Company	**Fund**	**Size[1] (EURm)**	**Vintage Year**	**Classification**	**Report on PAI**	**ESG professional[2]**	**Strategy**
Trill Impact	I	900	2021	9	Yes	Yes	Impact
Alder	II	133	2018	9	Yes	Yes	Impact
Altor	V	2 500	2019	8	Yes	Yes	Generalist
FSN	VI	1 800	2021	8	Yes	Yes	Generalist
Axcel	VI	807	2021	8	Yes	Yes	Generalist
Polaris	V	690	2021	8	Yes	Yes	Generalist
Procuritas	VII	407	2022	8	Yes	Yes	Generalist
Litorina	V	265	2017	8	No	No	Generalist
eEquity	IV	141	2021	8	No	No	Niche
Adelis	III	932	2021	6	Yes	Yes	Generalist
Fidelio	II	320	2018	6	No	No	Generalist
Segulah	V	212	2016	6	Yes	No	Generalist
CapMan	XI	190	2019	N/A	Yes	Yes	Generalist
Impilo	N/A	590	2021	N/A	No	No	Niche

1) For funds where size has been provided in SEK, fx EUR/SEK 11.31 has been used
2) Refers to at least one employee working exclusively with ESG

Of the 13 interviewed PE firms, two firms had an Article 9 classification on their most recent PE buyout funds, six firms had an Article 8 classification, three firms had an Article 6 classification, and two firms did not classify their funds.

Nine PE firms report on PAI indicators, regardless of their classification. PAI indicator collection is mandatory for Article 9 firms, while two Article 8 funds do not report any PAI data. Two Article 6 funds and one unclassified fund has chosen to report on PAI.

6.1 Practical Implications of the SFDR

6.1.1 Interpretation of the SFDR

All interviewed PE firms expressed some challenges in the interpretation and application of the SFDR. With little precedent to go on, there is a considerable degree of uncertainty about how to comply with the new disclosure regime. All firms have involved external advisors in helping them to understand what exactly is required.

"The (SFDR) templates look very straightforward, but actually they are not. And we have had lawyers and consultants involved. It's been a lot of people involved in what looks like a fairly straightforward template." (Article 8)

Other actors in the investment chain, such as lawyers, auditors, and LPs, have also needed to adapt to the new regulatory requirements, which has created additional challenges and complexities.

The SFDR has undergone several changes since it was first introduced, including the addition of new disclosure requirements, clarifications on certain aspects, and changes in implementation deadlines. PE firms have thus struggled to stay up to date on the latest changes to comply with the regulation.

“There is still some room for interpretation and the local authorities are providing more information as the process unfolds.” (Article 8)

Despite the need to adjust the SFDR to improve its effectiveness, PE firms hope for a more stable and predictable regulatory environment to reduce their workload and complexion of the regulation, and that the SFDR will contribute to a future more unified framework.

"There are currently several different sustainability initiatives in place, leading to a somewhat fragmented landscape. We hope that these efforts will ultimately converge into a standardized framework for the industry. This would make it easier for asset managers and investors to align their efforts and comply with consistent requirements.” (N/A)

Further, despite understanding how to comply with the new regulatory standards, the important distinction of what Article to comply with has been a key question for PE firms.

“When talking to others in similar situations such as our peers and LPs, there is a sense of ambiguity or confusion about where the line is drawn between Article 8 and Article 9.” (Article 6)

To comply with a higher article classification, there is a need to dedicate a certain percentage (Article 8 plus) or completely (Article 9) to sustainable investments. However, the lack of a proper definition of sustainable investment has brought challenges.

"We have come up with a framework which we believe is in line with the guidance of what sustainable investment means, but we could be challenged on that since there is no fixed definition. We have been on the side of caution, only allowing a small proportion to be called sustainable investments since we know firms and funds have been called out for calling things sustainable when they are not." (Article 8)

In connection to where to draw the distinction between article classifications, and the definition of sustainable investments, one firm expressed that the ambiguity of the SFDR may lead to non-compliance, which would result in consequences not known yet.

"Meeting the targets you set in terms of the percentage of sustainable investments, I wish that would be clear. If you set a percentage of sustainable investments that you aspire to achieve in the fund, what happens if you do not? What are the actual consequences of that?" (Article 8)

But not all private equity firms view the vagueness of the SFDR negatively. Some see it as an opportunity to encourage innovative interpretations that are deemed suitable.

"There is a fair amount of ambiguity, particularly surrounding Article 8, but I think the existing ambiguity has actually been beneficial. […] Where we need to make our own judgments, there is considerable room for interpretation, which has been deliberately left open. The purpose of this regulation is to encourage the finance industry to be innovative in finding solutions that are suitable." (N/A)

6.1.1.1 Article Classification of the Latest Fund

Most firms based their choice of article classification on ESG maturity and whether sufficient structures were in place to comply with the classifications, while some firms based their decision on where they aspire to be, and others made more conservative choices, waiting for the regulation to mature.

The least ambiguity was expressed by firms with Article 9 funds, where the choice of article classification was a foregone conclusion based on the firms' impact focus. While some Article 8 funds considered an Article 9 classification, the incongruence between the specified criteria for the higher classification and the commitments made during fundraising, resulted in firms opting for the lower classification due to perceived challenges in changing commitments in retrospect. Moreover, some firms made the interpretation that you must be compliant with the Article 9 requirements when making an investment, which gave rise to perceived inconsistencies with the investment strategy.

On the contrary, the greatest ambiguity expressed by most firms concerned the Article 8 classification, where firms' motivations and interpretations of specific requirements varied extensively between firms. Most firms expressed that sustainability is already an integral part of the investment process and that the Article 8 classification was a natural step to communicate and structure current efforts and an opportunity to develop it further, while some perceived current sustainability practices and communication to be the determinant of which classification you should have.

"*It's what you do and communicate that determines which article classification you should have. If you do anything about sustainability and communicate about that (which I think everyone does) you are Article 8." (Article 8)*

Another common incentive was elevated requirements and questions from LPs, where an Article 8 classification was sometimes seen as a necessity to attract new investors.

"Now, with the regulatory requirements becoming stricter in 2023 and the need to attract a wider range of investors, it is almost a requirement to be an Article 8 fund rather than 6. We have noticed that LPs almost demand a fund to be an Article 8. It's a kind of stamp of approval." (Article 6)

Among the firms opting for a more conservative approach and the lower Article 6 classification, it was not necessarily the firms' actual sustainability practices that determined their chosen classification, but rather when the fund was raised and whether sufficient structures were in place to be fully compliant with the requirements for a higher classification. Several funds were raised before March 2021, and the argument of changing strategy in retrospect occurred, especially for funds less active and for PCs with insufficient reporting structures. Furthermore, the lack of internal expertise and resources to fulfill the requirements for a higher classification restricted some firms in their choice of article classification, resulting in a more conservative approach. One firm also mentioned that it is a formal decision that needs to be taken by the management group, although practices are in place to comply with a higher classification.

"No one has had the time to fully understand the regulatory framework yet. [..]. Naturally, a good understanding of the framework and regulations is required to classify investments properly. It is not enough to simply say "Now we have an Article 8 fund". It requires preparation and planning, and a clear strategy must be in place." (Article 6)

Although arguments differed between firms, it was apparent that all interviewed PE firms have the ambition to comply with at least the Article 8 classification going forward, where some made bold commitments, and some chose a more conservative approach, either because funds were not currently covered by the regulation, or the expressed need for clarity and guidance to ensure compliance.

6.1.1.2 Article Classification of Previous Funds

The biggest challenge has been regarding funds less active or close to harvesting, where the incentives for implementing new reporting requirements have been less apparent.

There are different reasons why most firms chose an Article 6 classification for previous funds. The most common one is that the funds are already closed and fully invested and that classifying these funds is a technicality rather than something that creates value.

"The earlier funds will be classified as Article 6 because they are not very active and when we did the fundraising, we didn't make any promises to investors on sustainability so we can't start to change the investment strategy there." (Article 8)

Since a higher classification oftentimes implies additional work for the PCs to collect the necessary data, some firms wanted to avoid additional pressure on the PCs that were not aware of these requirements at the point of acquisition.

"The reason we did that is that we felt that it is a bit difficult to impose such requirements on PCs for funds that have already been launched." (Article 8)

On the contrary, some firms recognized the need for, or the value of, classifying previous funds as Article 8. While some firms argued that there is less value in classifying closed funds, others argued that it is still a marketed product that can be sold on the European secondary market, thus subject to the regulation.

"When SFDR was introduced, there was a debate about whether pre-existing funds needed to be classified. However, the regulator (financial authority) has said to us that all funds must be classified, as SFDR is a disclosure requirement. This means that all funds currently on the market must be classified, even if their marketing materials cannot be changed. While pre-contractual disclosures do not need to be updated, it is necessary to provide a disclosure about the fund's classification." (Article 8)

Several PE firms have pre-existing funds registered in geographical areas outside the European Union, such as Jersey or Guernsey. These firms have considered such funds to be exempt from compliance with the SFDR. Similarly, for funds with a different structure than the typical limited partnership, firms interpreted that they were also exempt from the SFDR.

6.1.1.3 PAI Reporting

In general, FMPs with over 500 employees are required to publish a PAI statement, while it is optional for those with fewer than 500 employees. However, firms not reporting on PAI must provide a statement explaining their reasoning. Due to the ambiguity of the definition of 500 employees - whether it applies only to employees at the PE firm or includes all employees of PCs - PE firms have interpreted the requirement differently.

For Article 9 funds, reporting on PAIs is mandatory and more extensive. However, many Article 9 funds have already reported on most of the KPIs requested in the PAI statement before the SFDR. As a result, collecting additional indicators is less burdensome.

Many PE firms recognize the relevance of collecting PAI data for their business. Despite adding to the overall ESG data collection required, they find the information valuable for measuring improvements. While some KPIs may not be material for all companies, they understand that each KPI is material for some companies.

Some PE firms collect PAI data in response to requests from their LPs, irrespective of the fund classification.

"Even though we do not currently have an Article 8 or 9 fund, we still have to disclose the PAI indicators as our investors are obligated to do so. Therefore, we gather this data to comply with their requirements." (Article 6)

While some PE firms collect PAIs solely to comply with regulations or LP requirements, others have already begun integrating them as a screening tool to identify potential targets. These firms anticipate that PAIs will not only be for compliance purposes but that other stakeholders such as customers will also start to demand PAI information.

Most PE firms share the opinion that Article 8 funds and PAI reporting are intercorrelated. Legal advisors have been involved to express their views on when there is a need to report on PAI. The consensus is that one can comply with Article 8 requirements without reporting on PAI.

Further, one PE firm expressed that they are not mature enough to report on all the KPIs that PAI stipulates and take the necessary action. Another PE firm stated that PAI collection puts a reporting burden on PCs, with the risk of becoming purely an administrative task with limited value-add.

"It's clear that this applies not only to our existing PCs but also to all the new companies we acquire. We invest in companies that are at different levels of size and maturity, it may therefore be challenging to obtain the required details of sustainability data and KPIs for some of these companies." (Article 6)

6.1.2 Data Collection

For four funds, the process of collecting necessary data and producing a PAI statement has been relatively straightforward. This has been observed particularly in cases where the fund had a dedicated ESG professional with significant prior experience within the ESG domain before joining the PE firm. Such individuals may already have a deep understanding of the applicable regulatory requirements and have worked with data collection procedures. Consequently, they are often better equipped to navigate the complexities of SFDR compliance and experience it as less of a challenge.

The perceived complexity of collecting data and producing a PAI statement is often related to the maturity of the PCs. More established companies may require a brief education period to set up the necessary data collection processes, while younger companies may need more guidance in generating the required data. However, the ability to obtain relevant data for PAI reporting can also be impacted by the ownership stake in PCs, as noted by two private equity firms. Minority owners may face additional challenges in collecting data due to the lack of a mandate to drive their own agenda.

"This year, the report includes information on PAI. However, we are still missing some data for this year, which has been challenging to obtain, particularly when we are a minority shareholder. In such cases, we have to rely on estimates instead." (*Article 8)*

PE funds have raised concerns about the interpretability of certain PAI indicators. The definitions provided are vague and do not clearly specify what should be included in the calculation. Additionally, some questions have been oversimplified, which poses the risk of missing crucial nuances.

"The question about compliance with the Global Compact 10 principles is not a simple yes or no answer. Also, there's ambiguity regarding activities that negatively affect biodiversity as it is not clear if we're referring to the value chain or only our own operations, and there's no specific definition of biodiversity other than key biodiversity area." (Article 8)

Reporting on GHG emissions has proven to be particularly challenging due to the varying scope levels. As a result, all PE firms have sought the assistance of external consultants to help navigate this issue. The more intricate your value chain is, the more estimates must be used to report on e.g., scope 3 GHG emissions[10]. The quality of the data is hence not entirely accurate, and the granularity of data differs between PCs. Further, one PE firm elaborated that the quality of data is often dependent on how easily the reporting entity (PC) can obtain data from its suppliers.

[10] Emissions that are not produced by the company itself, and not the result of activities from assets owned or controlled by them, but by those that it's indirectly responsible for, up and down its value chain.

"I am aware that several of our PCs are facing difficulties in obtaining data on the proportion of renewable energy they use. Even if they do manage to acquire this information, the process can be cumbersome, as it is dependent on the energy supplier having made significant progress in their own sustainability efforts to provide such data." (Article 6)

Not only are some PAI hard to interpret and obtain, but there is also a problem that many PCs do not have the necessary competence to report on PAI in a correct manner.

"They (PCs) may not have the expertise to determine the answers. For example, when asked "Are we having a negative impact on biodiversity?" everyone might say, "No, of course not." In such cases, a third party may be needed to assess or ensure that the necessary expertise is available to make such determinations." (Article 6)

Additionally, the PAI statement should be disclosed at an aggregated fund level. Firms find that aggregating the numbers misses the point of collecting it as data becomes more obscure with less transparency. A fund could balance out a PC with for e.g., poor board gender diversity, with great board diversity in other PCs. On a net fund level, it may still appear good. In addition, not all PAI indicators are relevant for all PCs, as some are very industry specific.

"Some of the metrics are not very informative. For example, the unadjusted gender pay gap is only measured at an aggregate level. I do not think that number provides much value, especially when it's aggregated to a fund level. […] For instance, last year's number might be different from this year's due to the sale and purchase of companies or improvements in data collection processes. It does not really say anything about how much progress we are making towards gender equality." (Article 8)

Another idea that came up among respondents was the upcoming EU directive on CSRD, which will require PCs to report on sustainability matters starting in 2025. Three respondents noted that if CSRD had been implemented before the SFDR, some PCs would have had ESG reporting structures in place. This could have made collecting PAI data easier, as PCs would already be accustomed to it.

6.1.3 Resources

All PE funds have noted that complying with the SFDR is a time-consuming process. Creating different disclosure documents, collecting data, and formalizing ESG strategies can all be burdensome tasks. Furthermore, complying with the regulation may not be a one-time task, as new requirements are added, and old ones are updated.

"We invested substantial time and effort in producing the relevant disclosures. The process involved very lengthy discussions with auditors and legal advisors. Notably, there are many nuances one needs to consider when phrasing the content for the disclosures, as the overall language needs to be extremely consistent between the precontractual and periodic disclosures." (Article 9)

Nonetheless, all respondents believe that in the long term, after fulfilling all the SFDR requirements, it will be a matter of iteration. The demanding work lies in the first round, where you need to figure out exactly what needs to be done and spend time with legal counsel and auditors to ensure compliance. However, once the process is established, it will be easier to update and maintain the necessary documentation, making compliance less burdensome in the future.

Complying with the SFDR not only requires time and effort but also demands financial resources. Many PE funds had already invested in data collection platforms before the SFDR was introduced. However, the need for third-party assistance, such as legal counsel, auditors, or consultants, adds to the costs. One PE firm estimates that ensuring accurate data can cost tens of thousands of Euros. Furthermore, measuring carbon emissions often falls on the PCs, which can become a financial burden for them, making them reluctant to report on it.

In response to the challenges posed by the SFDR, two PE funds have hired ESG specialists recently to help them navigate the new requirements (six funds already had ESG specialists; five funds do not have ESG specialists). However, some funds believe that extensive recruitment is not necessary to comply with the SFDR, as a significant portion of compliance involves setting up the process, which can then be automated with the help of platform tools.

"From a short-term perspective, it may seem like a waste of time and a nuisance, and many people may feel frustrated with it. But the truth is, without these frameworks, we will not be able to achieve sustainability in the long run." (Article 8)

6.1.4 LP Pressure

Since Article 9 investors are more interested in sustainability, they often have numerous requirements, pertaining not only to the investment process but also to the measurement of PAI indicators and other aspects. Consequently, most LP requirements were seen in general terms, rather than SFDR-specific.

While this study has taken the PE firm perspective, the SFDR also applies to some LPs, causing downward pressure on the PE firm from investors who in turn need to compile data on their investments.

"LPs are also governed by the SFDR. This adds an additional layer of complexity to an already complex situation. As a result, we may have an LP with 40 PE funds who need to produce a PAI statement including these funds. They contact us requesting data points to support their PAI statement. In some cases, our investors may also have an investor, a Fund of Funds. [...] Fortunately, we are positioned at the bottom of the chain" (Article 8)

The downward pressure has even incentivized Article 6 funds to collect PAI data for their LPs. Most firms expressed that LPs have started to request more data, which has imposed pressure on GPs to meet minimum sustainability requirements. While some firms have received SFDR-specific requests, others found that LPs have not yet aligned with the SFDR and are still following their own templates and KPIs. Some firms also expressed that investors are unsure of the regulation and have been less interested in the reporting and article classification itself, but rather to ensure that something is being done.

"I think in a year my answer might be different, but right now I think they are still playing catch up." (Article 8)

Furthermore, investor characteristics seemed to be a determinant of sustainability and reporting appetite, where respondents experienced a higher demand from large and institutional investors and less from investors such as family offices. Additionally, a fund's level of sustainability focus had a positive correlation with investors' inquiries regarding the SFDR. Worth noting is that the SFDR is an EU regulation, making it less central for investors outside the EU.

"We have noticed an increased interest, particularly from larger LPs, especially those in our latest fund, and institutional investors such as banks and university endowments." (Article 6)

6.2 Transparency and Greenwashing

6.2.1 Transparency and Comparability

The difficulties in the interpretation and application of the SFDR as described in section 6.1 has resulted in different approaches to the regulation, indicating that the article classification itself may not fully represent how sustainable the underlying investments are. However, most firms expressed that the regulation provides a structured way for sustainability disclosures and that it creates a common language where investors will have greater access to data, as well as know what to expect and where to find it. The SFDR increases the availability of information and since the templates are standardized, it consequently increases transparency and enables comparability between funds for investors who evaluate and base their investment decisions on what is being disclosed, rather than the classification itself.

"To ensure investors are diligent and well-informed, the documents have been prepared using a standardized template. This helps prevent generic or irrelevant information from being included. Instead, the template requires specific and targeted responses that are presented in a concise, easy-to-read format. As an investor, you can quickly compare the characteristics of different funds and make informed decisions based on your priorities. This transparency helps investors make more informed decisions and ultimately benefits the market as a whole." (Article 8)

6.2.2 Greenwashing

The interviews shed light on several aspects of the risk of increasing greenwashing, although most firms believed that in the long term, the regulation will help mitigate false sustainability claims.

The views on the Article 8 and 9 classifications differed, where Article 9 was associated with less risk of greenwashing, compared to Article 8. Several funds expressed that the current bar for the Article 8 classification is low, enabling funds with varying sustainability work to obtain the classification, risking "empty words" and greenwashing.

"My initial impression is that it's relatively simple to classify as an Article 8. The requirements for what needs to be measured are quite flexible, and I think that could imply that there is a wide spread in engagement and actions taken among the Article 8 entities." (Article 8)

In contrast, the requirements are much more stringent for Article 9 funds, which has led to funds being downgraded for unsupported claims. Consequently, greenwashing is significantly more difficult with an Article 9 classification, with a substantial reputational risk at stake for those who engage in it.

"There have been previous scandals where financial companies have been taken to court for greenwashing. When we saw last year that many Article 9 funds were downgraded, it became clear that perhaps things have not been so great - that you've previously been able to get away with a lot, to make assertions that fail to materialize. I believe this can tighten things up in many ways." (N/A)

Although there is a need for stricter requirements to mitigate greenwashing, some firms saw the risk of the regulation restricting the enthusiasm of working with sustainability in a creative and inspiring way, from the fear of being called out for making the wrong statements.

"Currently, people are worried about the consequences of their choice of statement. Companies need to have the courage to stand up for their ambitions and efforts. I think that the concern can be positive to prevent greenwashing, by setting clear demands on goals and demanding detailed follow-ups. But it will be negative if we stop companies from daring to take ambitious steps forward." (Article 9)

Despite initial concerns, all firms acknowledge that the SFDR is effective in mitigating greenwashing by imposing strict reporting requirements that make it difficult to make unsupported claims and limit false marketing of financial products.

“Without the structure, we would see a lot of greenwashing, which is one of the biggest obstacles to achieving sustainability. We need to spend the time now to get proper data, transparency, and clear definitions so that we can avoid making meaningless claims and establish trust. It may be a painful process, but it will pay off in the end.” (Article 8)

6.3 Other Perceived Consequences of the SFDR

6.3.1 Article Classification and Access to Capital

All firms expressed that article classification will impact future fundraising and that a higher classification will increase access to capital. As mentioned in section 6.1.4, some LPs are subject to the SFDR, which will make them more inclined to invest in funds that can provide the necessary data and are aligned with their own sustainability objectives.

"There is certainly more capital available if a fund is classified as at least an Article 8, even more, if classified as Article 9. This is an important factor, and there is a greater priority for such types of investments. I believe that the higher a fund is classified, the better access it has to capital." (Article 8)

On the same note, Article 6 funds may be left out, as investors seek investments that can deliver on a higher standard of sustainability and reporting requirements. The industry thus believes that an Article 6 classification may limit the ability to raise funds, which is expected to become more apparent as the regulation matures.

"One of our largest investors has around 50 PE investments. Their idea is that next time they will double their allocation to the 25 investments that meet their minimum sustainability requirements and dump the other 25. This was a huge criterion for them, almost on par with fund performance. It's like a license to play in this field." (Article 8)

The importance of the article classification will depend on the level of investor sophistication. Some investors are expected to earmark capital to a certain article classification, which will put emphasis on the classification itself. However, for more sophisticated investors who rather care about the information disclosed, the classification will be less relevant.

"The more sophisticated investors don't care whether it's article 6, 8, or 9. They want to know if you have a good and solid ESG strategy for the fund and that you work with the companies in a systematic way." (N/A)

6.3.2 ESG Improvements

Generally, the PE funds don’t see that the SFDR affects their investment strategies. It has rather led firms to re-evaluate their ESG strategies and question the purpose of their actions. It has sparked discussions and pushed ESG higher up on the agenda.

"Does one choose other investments because of SFDR? Maybe not. But does one choose to work with PCs in a different way? Yes, that could happen, that the active ownership looks different." (Article 6)

While the SFDR may not directly lead to investors choosing different investments, it may lead to a change in how they work with their PCs. The focus may shift towards active ownership and engaging with companies to improve their ESG practices, which could lead to a positive impact eventually. As data quality will improve, most firms aspire to use the data to structure one’s ESG approach and to set targets.

“The idea is to use the information and, above all, to help companies understand what this information means and how it can be useful.” (Article 6)

As of now, the PAI data is mostly included in the annual sustainability reports of PE firms to provide investors with a more comprehensive understanding of how they approach sustainability. However, the SFDR's formalization of existing ESG frameworks, its alignment with ESG due diligence, and its encouragement of sustainability initiatives make it a valuable addition to fostering future improvements in ESG practices. Nonetheless, one PE fund has expressed concerns that relying too heavily on external assistance for PAI reporting may diminish the incentive to implement actual improvements.

"I see a risk that people become so afraid of the complexity of these regulations that they do not see the big picture and the reason for working with them. They try to make quick fixes by hiring consultants to do all the work, without really understanding what it is. They can get nice numbers, but it becomes unclear what they are going to use them for?" (Article 9)

Overall, it is challenging to determine whether the increased ESG awareness at the PC level is due to the SFDR. While PCs may not be aware of the regulation, they are interested in the PAI data and its insights. Most PE firms note that the general pressure for ESG improvements at the PC level comes from customers' increasing sustainability demands. They seek help from PE firms to structure their ESG work, where the SFDR can be a good starting point.

6.3.3 Perception of the SFDR

The SFDR provides a common approach and structure for reporting on ESG, promoting harmonization and consistency across the industry. It also serves as a framework for assessing ESG risks and opportunities and preparing PCs for new regulatory and customer demands. While it has sparked discussions and increased focus on ESG in the PE industry, it is only one part of many sustainability regulations. Investors will not solely focus on the SFDR but will consider it together with other evaluation schemes such as the PRI score. Upcoming regulations like the CSRD will require more reporting and compliance, where the SFDR can serve as a foundation for the establishment of reporting practices.

For impact funds, the Article 9 classification is a valuable distinction that has brought clarity to its purpose. Its stringent requirements serve as a stamp of approval, differentiating these funds from others in the industry.

"Having an Article 9 classification gives us a lot of credibility and puts us in the top percentile of sustainable investors. The classification is a key differentiator and defines how prudently we handle and work with impact and ESG topics internally. This level of prudency is naturally

something we would like to reflect and communicate when engaging with external parties, such as investors, target companies, and external service providers.” (Article 9)

While the SFDR has brought increased transparency and regulation to ESG reporting, there are also potential downsides to such formalization. One firm noted that there is a risk that the level of detail required may become burdensome for smaller companies, making it difficult for them to comply. There is a risk that investors may shy away from using the Article 9 label out of fear of being stripped of it, or because it will narrow their investment universe too much. However, if the definition is too loose, it may result in more greenwashing problems, undermining the purpose of the SFDR in the first place. Therefore, it is essential to strike a balance between regulation and practicality to ensure the effectiveness of the SFDR.

Although compliance with the regulation has been a challenging process, it has ultimately led to a more robust ESG framework. The SFDR has incentivized PE firms to take ESG factors into account and integrate them into their investment decisions. As the industry continues to mature in terms of ESG, PE firms are expected to further embrace ESG practices and improve their compliance with the SFDR.

”I believe that the SFDR will help to establish a common language within the market and curb the issue of greenwashing. It's going to require financial institutions to hire experts who can comprehend and apply this new system, ultimately increasing the overall understanding across the industry. This will lead to the development of more impactful strategies, preventing greenwashing and promoting sustainable investments. I truly believe that it will have a significant effect and steer finance toward sustainable investing. With this new classification system in place, investors will be able to distinguish between genuinely sustainable investments and those that are not. This will encourage more investments in sustainable ventures, and slowly but surely, we will see money moving in the right direction. Essentially, the system is creating a framework for the market to work better, even though the process may be challenging and confusing right now.” (Article 8)

7. Discussion

The following section presents a discussion structured around the research questions outlined in section 1.2. The discussion is based on previous literature, findings from the case study, and interview results. The final conclusions are presented in section 8.

7.1 Practical Implications of the SFDR

The first research question relates to how Nordic private equity firms interpret the SFDR and what difficulties they encounter related to the implementation.

The literature, case study, and interviews shed light on numerous challenges related to comprehending and implementing the SFDR. Given that the SFDR is the first mandatory ESG regulation for private markets, all stakeholders encounter difficulties in interpreting the disclosure regulation. Consequently, different applications have emerged, including retroactive classification of funds, classification limited to funds closed post-2021 (SFDR implementation), and arguments made to exempt themselves from SFDR obligations.

Interpretation extends beyond the determination of the appropriate article classification; there is also ambiguity regarding which entities are required to report on PAI. The 500-employee rule lacks clarification regarding the specific employees to be considered. Does it encompass all employees under the fund's employment, merely the ownership percentage of employees in the fund, or solely employees at the PE firm? The motivations behind the decision to report or not on the PAI indicators varied, including ethical considerations, external pressures, and the perceived burden of compliance. One key issue that arises in this discussion is whether implementing disclosure regulations is justified when the involved parties have the discretion to determine the extent of the information they reveal. As demonstrated by Hassani and Bahini (2022), allowing GPs to select what information to disclose can lead to a situation where self-interest becomes the driving force. As a result, this behavior can exacerbate information asymmetries between LPs and GPs, consequently eroding transparency. However, a valid point for not disclosing the PAI indicators is the challenges associated with it. While aggregating PAIs at a fund level may initially appear beneficial in providing an overview, it presents practical challenges. The composition of funds frequently changes due to new platform investments, add-on targets, and exits. As PAI reporting is only disclosed once a year, data may be unrepresentative of the current fund composition. Moreover, it provides an opportunity to mask the negative impact of one poorly performing PC with the positive impact of another.

Like any new regulation, the SFDR initially entails a substantial time and cost burden. Nonetheless, the PE firms shared the perspective that the workload of SFDR compliance will lessen in the future. A recurring theme in the interviews was that individuals with an ESG background found compliance with the regulation to be comparatively easier. Conversely, smaller funds lacking a dedicated ESG professional faced a higher burden. While all funds sought external advice, the integration of an ESG team within PE firms has the potential to streamline compliance efforts and drive sustainable and responsible investment practices.

Most surveyed firms reported increasing pressure from LPs to align with new sustainability guidelines. However, the industry did not have a clear view on whether the increasing data requests are solely driven by the SFDR, as many investors still adhere to their own templates. It was however apparent that the level of reporting requirements is influenced by investor profile and whether LPs are subject to the SFDR or not, as those who are, will need to compile data on similar terms.

7.2 Transparency and Greenwashing

The second research question addresses whether the SFDR will fulfill its purpose of increasing transparency and mitigating greenwashing in the Nordic private equity industry.

The SFDR is generally perceived to increase transparency and comparability, by expanding the availability of information in a structured and standardized way. These findings align with the SFDR's objective of mitigating greenwashing, as greater transparency makes it more challenging to make unsupported sustainability claims. However, difficulties in obtaining the right measures and differences between firms’ approaches to data collection may challenge the comparability of individual measures. However, as seen in Procuritas’ PAI statement, it does not necessarily undermine transparency, as they have chosen to disclose their interpretation and methodology for PAI calculations.

The Article 9 classification is perceived to be the strongest contributor to the distinction between sustainable investments and those that are not. Before the RTS came into effect in January 2023, one potential risk associated with the Article 9 classification, reflected by Scheitza et al. (2022) was the misconception that it is synonymous with "impact". Michl & Schmid (2022) underscored concerns regarding greenwashing within the SFDR framework, emphasizing the deceptive use of its self-labeling feature to attract investors. However, the RTS is expected to mitigate some of these concerns by establishing stricter templates and requirements under each classification.

To conclude, the different article classifications' ability to mitigate greenwashing relies on FMPs to consider the regulation as a tool for making informed decisions by revising pre-contractual disclosures and periodic reporting. The article classifications should hence not be seen as a label for simplification purposes, as article classification is not synonymous with the level of ESG work. Instead, the article classifications' primary value for investors lies in its ability to standardize and increase the availability of information, informing investors about the level of disclosure they can expect and where they can find it.

7.3 Other Perceived Consequences of the SFDR

The last research question addresses other perceived consequences of the SFDR by Nordic private equity firms.

All GPs interviewed believed that a higher article classification leads to greater access to capital. This is in line with previous studies in the adjacent mutual fund industry, where higher article classifications have led to increased capital inflows (Michl & Schmid, 2022; Becker et al., 2022; Ferriani, 2023). To ensure future capital commitments, all private equity funds are striving to at least comply with the Article 8 requirements in future funds. However, the level of emphasis on the article classification itself will depend on the level of investor sophistication. Less sophisticated investors may rely more on the classification itself (labeling effect), whereas more informed investors will base their decisions on the actual information disclosed.

Another highlighted perceived benefit is how the SFDR can be used to improve the operations of both GPs and PCs. The main contribution of the SFDR is not yet in changing investment strategies, but rather that it pushes ESG higher up on the agenda and provides a structured approach to the incorporation and consideration of ESG. Although most PE firms did not perceive the SFDR as having altered their investment strategy, future implications, as highlighted by Hartzmark & Sussman (2019), suggest that increased sustainability disclosure could prompt GPs to increase their investments in ESG initiatives. In this scenario, the SFDR would effectively redirect capital towards sustainability, as it encourages and incentivizes investments that align with ESG principles. The SFDR, being a regulation, receives significant attention and holds a high priority. It obliges GPs to discuss ESG at the fund level and communicate data requirements to PCs, thus creating awareness. Additionally, greater availability of data will also enable ESG improvements if incorporated strategically, which can be leveraged as a competitive advantage for the forerunners. Firms with dedicated ESG professionals demonstrated an advantage in their ability to identify the value of ESG beyond compliance. By embracing ESG principles and establishing internal ESG capabilities, PE firms can not only meet the compliance requirements of the SFDR, but also adapt to the evolving sustainable finance landscape. This proactive approach can enable firms to effectively respond to investor demands and attract a wider range of investors.

Although the SFDR has posed challenges in its initial stage, the interviewees agree on its potential to reach its intended objectives. While some clarity is still needed for the Article 8 classification, it is mainly perceived as a question of maturity and iteration. Regardless of the chosen article classification, the joint value of the SFDR lies in increased structure and awareness regarding ESG, that it provides a common language and reinforces that sustainability will play a role in the private equity industry.

8. Conclusion

8.1 Concluding Remarks

This thesis has aimed to explore the perspectives of Nordic private equity firms on the implementation of the SFDR, if it is perceived to fulfill its purpose of increasing transparency and preventing greenwashing, and uncovering other perceived consequences.

Our findings show that the SFDR has posed several challenges to all private equity firms. The challenges pertained to the interpretation of definitions and requirements, complexities in data collection, time and cost burden of compliance, and mounting pressure from LPs to adhere to the new disclosure regime. The Nordic private equity industry did not share the same interpretation of the regulation, but all firms encountered some challenges, regardless of firm characteristics. Nordic private equity firms, despite facing practical challenges and varying interpretations, maintain a belief that the SFDR will achieve its intended goal of enhancing transparency. This conviction stems from the requirement for private equity firms to complete standardized templates, disclosing their integration of ESG factors into investment decisions, as well as their ESG ambitions. Such measures aim to hinder greenwashing, enabling investors to make better-informed decisions regarding capital allocation. Another perceived consequence of the regulation was that the growing emphasis on ESG highlighted the need for higher article classifications to secure future capital. Further, challenges regarding the regulation have led to more time spent discussing ESG, hiring ESG professionals, and incorporating ESG into the investment process. The mandatory nature of the SFDR has thus increased awareness around ESG at both PE firm and PC levels and supplied a structured approach to ESG.

The Nordic private equity industry shares an optimistic view on the value of the regulation and expressed the industry's need for such regulations to move in the right direction. The SFDR has the potential to accelerate the transition towards PE 4.0, as it forces FMPs to incorporate ESG risks in their investment strategy. In this way, the SFDR plays a key role in manifesting ESG principles into the private equity industry, elevating the importance of sustainability considerations in investment decisions.

8.2 Limitations of Thesis and Areas for Further Research

The exploratory and descriptive nature of this paper limits the ability to test for independent and dependent variables. Future research should examine the relationship between different perspectives and independent variables such as firm characteristics, previous ESG involvement, and type of LP, by conducting a quantitative study with a larger sample size.

As this study focused on the GP perspective, the discussion of access to capital is one-sided. Future studies should examine the perspectives of other stakeholders involved in the SFDR. Specifically, investigating LPs' role and influence in the fundraising process could provide a more comprehensive understanding.

Additionally, this study relied on interviews with ESG professionals, which may have limited the perspectives presented. To give a more nuanced picture of the industry, future studies should thus include views held by other key personnel at private equity firms.

Lastly, due to the recency of the SFDR, and in particular the RTS, this paper has been limited in its ability to draw conclusions on the regulation's actual consequences. Future studies should hence test whether the identified consequences, such as increased transparency, access to capital, and ESG awareness hold true. Elaborating on the aftermath of the SFDR would provide important insights for policymakers in measuring the broader effects of individual regulations' impact on capital markets. On the same note, future studies should explore whether portfolio companies that have been subject to PAI reporting will benefit from the adoption of the CSRD (applicable from 2024).

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10. Appendix

10.1 Literature

Figure 10.1.1 EU Taxonomy: Four Overarching Conditions

	Taxonomy Regulation
	The four basic conditions for economic activities in the Taxonomy Regulation
1	Substantial contribution to one of the six environmental objectives
2	No significant harm on any of the other five environmental objectives
3	Compliance with minimum (social) safeguards
4	Compliance with technical screening criteria specifying points (1) and (2)

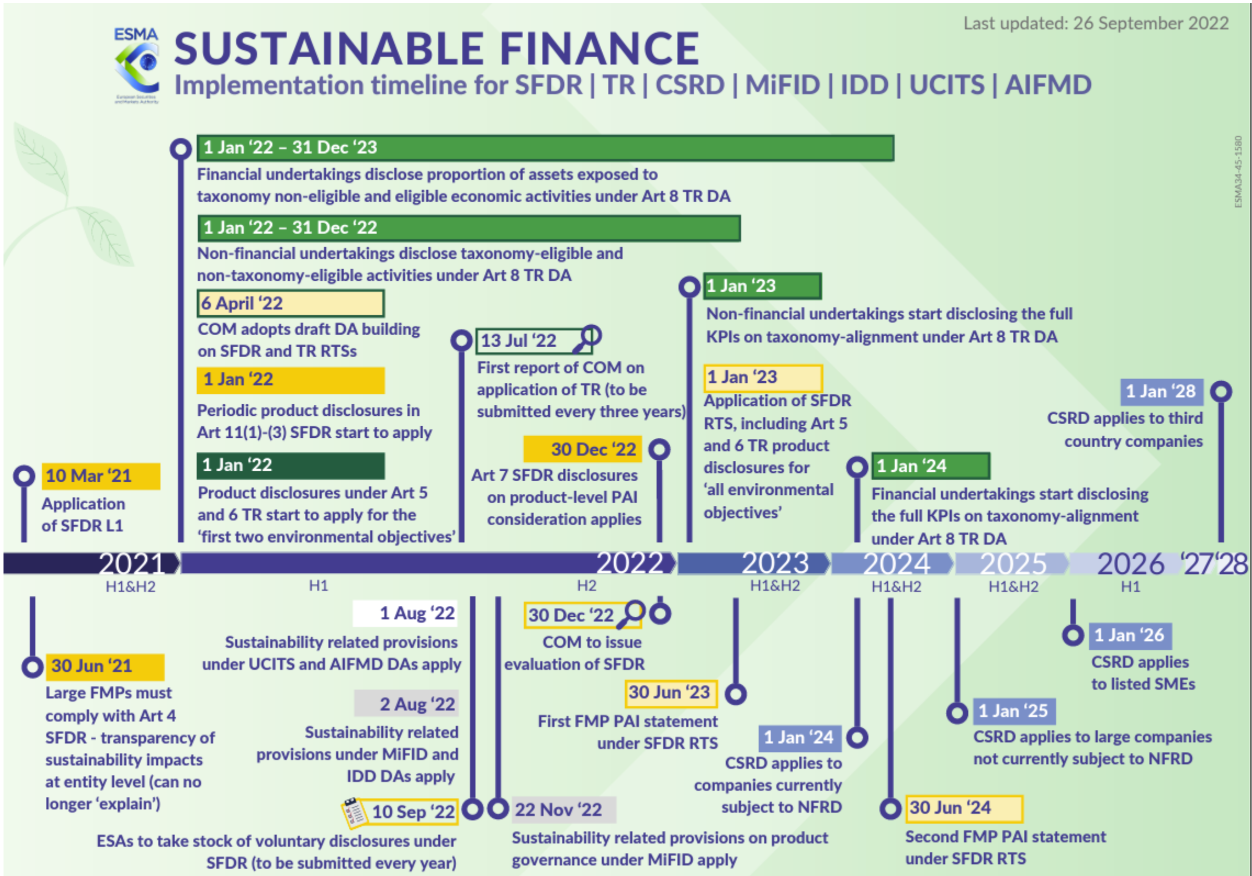
Source: European Commission Taxonomy Regulation (EU) 2020/852

Figure 10.1.2 EU Taxonomy: Six Environmental Objectives

	Taxonomy Regulation
	Six Environmental objectives
1	Climate change mitigation
2	Climate change adaption
3	The sustainable use and protection of water and marine resources
4	The transition to a circular economy
5	Pollution prevention and control
6	The protection and restoration of biodiversity and ecosystems

Source: European Commission Taxonomy Regulation (EU) 2020/852

Figure 10.1.3 Implementation Timeline for SFDR



Source: European Securities and Markets Authority 2022

Figure 10.1.4 SFDR Articles

Breakdown of the articles part of the SFDR regulation

Entity disclosures	Article 3	Publish on their website information about their policies on the integration of sustainability risks in their investment decision-making process
	Article 4	Publish on their websites whether they do consider or not the adverse impacts generated on sustainability factors and the due diligence policies adopted with respect to those impacts
	Article 5	Publish on their websites information on how remuneration policies are consistent with the integration of sustainability risks
Product level disclosures	Article 6	Provide in pre-contractual disclosures information on how sustainability risks are integrated into investment decisions and the impacts of sustainability risks on the returns of the financial products
	Article 7	Provide in pre-contractual disclosures a clear and reasoned explanation of whether and, if so, how a financial product considers principal adverse impacts on sustainability factors
	Article 8	Provide in pre-contractual disclosures and periodic reports information on how the financial product promotes and respects social or environmental characteristics and the methodology used for measuring social or environmental characteristics
	Article 9	Provide in pre-contractual disclosures and periodic reports information on how the financial product contributes to the achievement of the sustainable objective and how the sustainable goal stands out from a traditional market objective

Source: EU Sustainable Finance Disclosure Regulation (SFDR) 2019/2088, simplified explanations by Bengo, I., Boni, L., & Sancino, A. (2022)

Figure 10.1.5 SFDR PAI Statement Template

Indicators applicable to investments in investee companies							
Adverse sustainability indicator		Metric	Impact [year n]	Impact [year n-1]	Explanation	Actions taken, and actions planned and targets set for the next reference period
CLIMATE AND OTHER ENVIRONMENT-RELATED INDICATORS						
Greenhouse gas emissions	1. GHG emissions	Scope 1 GHG emissions				
		Scope 2 GHG emissions				
		Scope 3 GHG emissions				
		Total GHG emissions				
	2. Carbon footprint	Carbon footprint				
	3. GHG intensity of investee companies	GHG intensity of investee companies				
	4. Exposure to companies active in the fossil fuel sector	Share of investments in companies active in the fossil fuel sector				
	5. Share of non-renewable energy consumption and production	Share of non-renewable energy consumption and non-renewable energy production of investee companies from non-renewable energy sources compared to renewable energy sources, expressed as a percentage of total energy sources				
	6. Energy consumption intensity per high impact climate sector	Energy consumption in GWh per million EUR of revenue of investee companies, per high impact climate sector				
Biodiversity	7. Activities negatively affecting biodiversity-sensitive areas	Share of investments in investee companies with sites/operations located in or near to biodiversity-sensitive areas where activities of those investee companies negatively affect those areas				
Water	8. Emissions to water	Tonnes of emissions to water generated by investee companies per million EUR invested, expressed as a weighted average				
Waste	9. Hazardous waste and radioactive waste ratio	Tonnes of hazardous waste and radioactive waste generated by investee companies per million EUR invested, expressed as a weighted average				
INDICATORS FOR SOCIAL AND EMPLOYEE, RESPECT FOR HUMAN RIGHTS, ANTI-CORRUPTION AND ANTI-BRIBERY MATTERS						
Social and employee matters	10. Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises	Share of investments in investee companies that have been involved in violations of the UNGC principles or OECD Guidelines for Multinational Enterprises				
	11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	Share of investments in investee companies without policies to monitor compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises or grievance/complaints handling mechanisms to address violations of the UNGC principles or OECD Guidelines for Multinational Enterprises				
	12. Unadjusted gender pay gap	Average unadjusted gender pay gap of investee companies				
	13. Board gender diversity	Average ratio of female to male board members in investee companies, expressed as a percentage of all board members				
	14. Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)	Share of investments in investee companies involved in the manufacture or selling of controversial weapons				

Adverse sustainability indicator			Metric	Impact [year n]	Impact [year n-1]	Explanation	Actions taken, and actions planned and targets set for the next reference period
Indicators applicable to investments in sovereigns and supranationals							
Adverse sustainability indicator			**Metric**	**Impact [year n]**	**Impact [year n-1]**	**Explanation**	**Actions taken, and actions planned and targets set for the next reference period**
Environmental	15.	GHG intensity	GHG intensity of investee countries				
Social	16.	Investee countries subject to social violations	Number of investee countries subject to social violations (absolute number and relative number divided by all investee countries), as referred to in international treaties and conventions, United Nations principles and, where applicable, national law				
Indicators applicable to investments in real estate assets							
Adverse sustainability indicator			**Metric**	**Impact [year n]**	**Impact [year n-1]**	**Explanation**	**Actions taken, and actions planned and targets set for the next reference period**
Fossil fuels	17.	Exposure to fossil fuels through real estate assets	Share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuels				
Energy efficiency	18.	Exposure to energy-inefficient real estate assets	Share of investments in energy-inefficient real estate assets				
Other indicators for principal adverse impacts on sustainability factors							
[Information on the principal adverse impacts on sustainability factors referred to in Article 6(1), point (a) in the format in Table 2]							
[Information on the principal adverse impacts on sustainability factors referred to in Article 6(1), point (b), in the format in Table 3]							
[Information on any other adverse impacts on sustainability factors used to identify and assess additional principal adverse impacts on a sustainability factor referred to in Article 6(1), point (c), in the format in Table 2 or Table 3]							

Source: EU Sustainable Finance Disclosure Regulation; Delegated Regulation (EU) 2022/1288 of 6 April 2022

Figure 10.1.6 UN SDGs 17 Goals

Source: UN Sustainable Development Goals

Figure 10.1.7 UN PRI Principles

The six Principles for Responsible Investment

Principle 1	We will incorporate ESG issues into investment analysis and decision-making processes.
Principle 2	We will be active owners and incorporate ESG issues into our ownership policies and practices.
Principle 3	We will seek appropriate disclosure on ESG issues by the entities in which we invest.
Principle 4	We will promote acceptance and implementation of the Principles within the investment industry.
Principle 5	We will work together to enhance our effectiveness in implementing the Principles.
Principle 6	We will each report on our activities and progress towards implementing the Principles.

Source: UN Principles for Responsible Investment

10.2 Method

Figure 10.2.1 Interview List Pre-study

Pre Study Interviews

Company	Name	Title
Procuritas	Linda Leifsdotter	Head of ESG
Litorina	Thirza Hamrin	Partner, CFO & Head of ESG
AP6	Anna Follér	Head of Sustainability

Figure 10.2.2 Interview List Case study

Case Study Interviews

Company	Name	Title
Procuritas	Linda Leifsdotter	Head of ESG
Procuritas	Johan Conradsson	Partner
Polarn O. Pyret	Terese Persi	Sustainability & Quality Director

Figure 10.2.3 Interview List Nordic Private Equity Firms

Interviews

Company	**Name**	**Title**
Trill Impact	Dan Le	Impact Analyst
Alder	Eva Normell	Sustainability Officer
Altor	N/A	N/A
FSN	Rebecca Christine Svensøy	General Counsel & Head of ESG
Axcel	Sarah Hempel	Head of Sustainability
Polaris	Martin Bang-Löwgren	Head of Sustainability
Litorina	Thirza Hamrin	Partner, CFO & Head of ESG
eEquity	N/A	N/A
Adelis	N/A	N/A
Segulah	Anna Zetterlund	CFO & Head of ESG
Fidelio	N/A	N/A
Capman	Anna Olsson	ESG Director
Impilo	Martin Fagerlund	Partner & COO

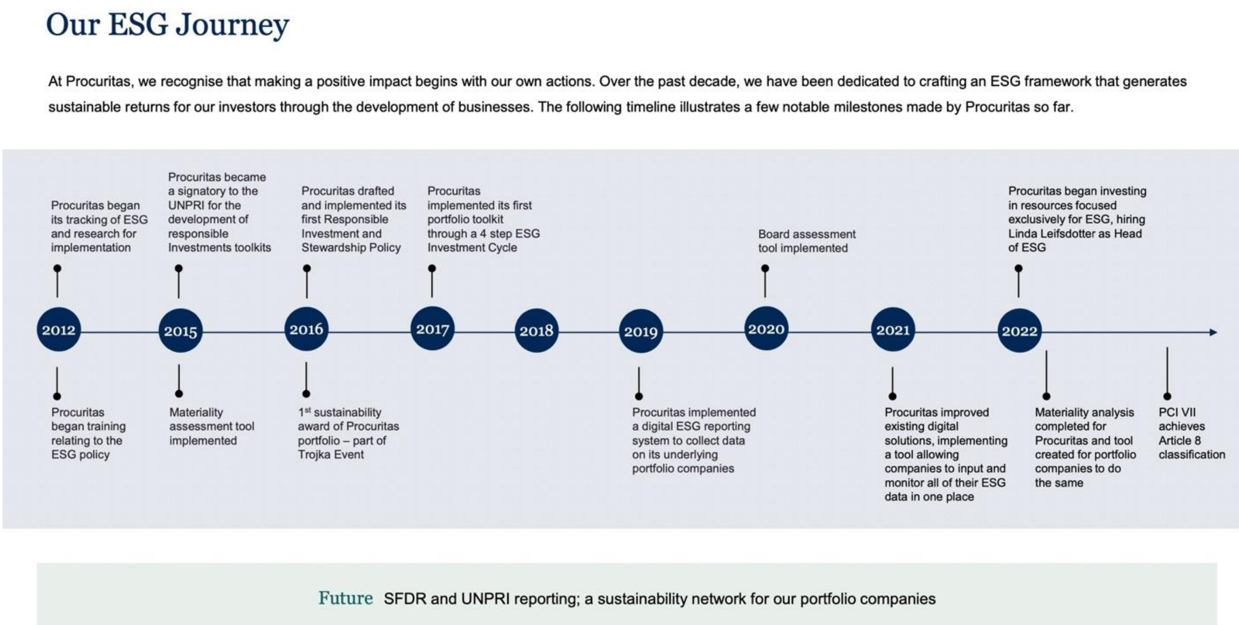
10.3 Case study

Figure 10.3.1 Overview of Procuritas Funds

Fund name	Period	SFDR classification	Size[1]	Status
PCI VII	2022 - present	Article 8	407M EUR	Active
PCI VI	2017 – present	Not declared	318M EUR	Fully invested
PCI V	2012 – present	Not declared	210M EUR	Fully invested
PCI IV	2008 – present	Not declared	139M EUR	Fully invested
PCI III	2003 – 2013	Not declared	227M EUR	Realised
PCP II	1998 – 2007	Not declared	103M EUR[2] (963M SEK)	Realised
PMIC	1990 – 2004	Not declared	27M EUR[2] (240M SEK)	Realised

Source: Procuritas Sustainability Report 2022

Figure 10.3.2 Procuritas Sustainability Timeline

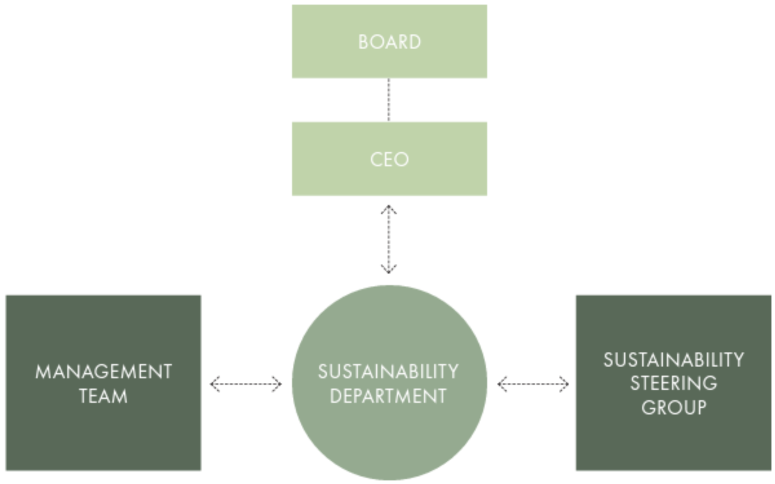


Source: Procuritas Sustainability Report 2022

Figure 10.3.3 Procuritas Sustainability Focus

Source: Procuritas Sustainability Report 2022

Figure 10.3.4 Polarn o. Pyret Organizational Structure



Source: Polarn o. Pyret Sustainability Report 2021/2022

10.3.5 Polarn O. Pyret Sustainability Strategy

Source: Polarn o. Pyret Sustainability Report 2021/2022

Figure 10.3.6 Polarn o. Pyret UN Sustainability Development Goals

Source: Polarn o. Pyret Sustainability Report 2021/2022

Figure 10.3.7 Procuritas PAI Statement

Principal Adverse Impact (PAI) Indicators

The table consists of Principle Adverse impact indicators in accordance with the Sustainable Finance Disclosure Regulation. The reporting is mandatory for PCI VII as this is an article 8 fund. However, we have chosen to monitor these indicators for all our funds.

	PCI IV[4]	PCI V[5]	PCI VI[6]	PCI VII[7]
Scope 1 GHG emissions (tCO_2e)[1]	91	0	277	176
Scope 2 GHG emissions (tCO_2e)[1]	0	41	226	17
Scope 3 GHG emissions (tCO_2e)[1]	2180	12279	13423	762
Total GHG emissions (tCO_2e)[1]	2270	12320	13926	956
Carbon footprint (tCO_2e/MEUR)[2]	30	827	73	9.4
GHG intensity of investee companies (tCO_2e/MEUR)[3]	12.5	273	96.8	14.9
Is your company active with the fossil fuel sector?	No 100%	No 100%	No 100%	No 100%
Share of non-renewable energy consumption and production	0%[8]	18%[9]	Not avaliable[10]	59%[11]
Energy consumption intensity per high impact climate sector (GWh/MEUR)	Not relevant	0.083[9]	Not avaliable[10]	0.14[11]
Does the company negatively affect protected areas and/or areas of high biodiversity value?	No 100%	No 100%	No 100%	No 100%
Tonnes of emissions to water generated by investee companies per million EUR invested, expressed as a weighted average (t/MEUR)	0	0	0	0
Tonnes of hazardous waste generated by investee companies per million EUR invested, expressed as a weighted average (t/MEUR)	0	0	0.34	5
Has the company been involved in violations of the UNGC principles or OECD Guidelines for Multinational Enterprises?	No 100%	No 100%	No 100%	No 100%
Does the company have policies to monitor compliance or grievance /complaints handling mechanisms to address violations of the UNGC principles or OECD Guidelines for Multinational Enterprises?	No 100%	No 50% Yes 50%	No 50% Yes 50%	No 33% Yes 67%
Average unadjusted gender pay gap weighted by the individual size of each investment	0%	3%	1.4%	-0.7%
Average ratio of female to male board members weighted by the individual size of each investment	25%	15%	2.2%	5.1%
Is your company involved in the manufacture or selling of controversial weapons?	No 100%	No 100%	No 100%	No 100%
Do you own, lease or manage sites located in, or adjacent to, areas of high water stress and doesn't have a water management policy?	No 100%	No 100%	No 100%	No 100%
Total number of convictions for violation of anti-corruption and anti-bribery laws	0	0	0	0

CO2 data in the table has been reported by the portfolio companies directly (DSI, Medtanken, Netcontrol, Nordic Biomarker, Pierce, Polarn & Pyret, Låssenteret, We Select and Werksta) or has been estimated by an external consultant (Frendy, Cutters, Nature Planet, Strandberg Guitars, SEM and Team Olivia). Emission categories included in scope 3 emissions vary between portfolio companies, i.e. Medtanken, Nordic Biomarker and We Select only cover business travel in their scope 3. All other data have been reported by the portfolio companies directly. Where applicable, data has been adjusted to present the share of ownership Procuritas has in each portfolio company.

1. Calculated in accordance with:
$$\sum_{n}^{i}\left(\frac{\text{current value of investment}_i}{\text{investee company's enterprise value}_i} \times \text{investee company's Scope(x) GHG emissions}_i\right)$$
2. Calculated in accordance with:
$$\frac{\sum_{n}^{i}\left(\frac{\text{current value of investment}_i}{\text{investee company's enterprise value}_i} \times \text{investee company's Scope 1, 2 and 3 GHG emissions}_i\right)}{\text{current value of all investments (€M)}}$$
3. Calculated in accordance with:
$$\sum_{n}^{i}\left(\frac{\text{current value of investment}_i}{\text{current value of all investments (€M)}} \times \frac{\text{investee company's Scope 1, 2 and 3 GHG emissions}_i}{\text{investee company's €M revenue}_i}\right)$$
4. Team Olivia
5. Pierce and SEM
6. DSI, Frendy, Cutters, Nature Planet, Medtanken, Netcontrol, Polarn & Pyret, Låssenteret, Strandberg Guitars and Werksta
7. Nordic Biomarker, We Select and Werkst
8. Lack of available data: Norway and Denmark are excluded from Team Olivia's energy data (Sweden included)
9. Lack of available data: Germany, United States, and China are excluded from SEM's energy data (Sweden included)
10. Lack of available and reliable data for the whole portfolio: KPI not disclosed
11. Lack of available data: China is excluded from Nordic Biomarker's energy data (Sweden included)

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38

Source: Procuritas Sustainability Report 2022