SFDR for venture capital funds: an opportunity in disguise

Extreme weather events across Europe have brought the climate emergency to the fore. In this common struggle, the European Union is setting global standards for climate policy right down to its capital markets. The Sustainable Finance Disclosure Regulation (SFDR), which is directly relevant for venture capitalists, was introduced by the EU to promote sustainable investments and increase transparency on the financial markets. Under this regulation, asset managers have to evaluate sustainability risks on their investments' value as well as provide information about the adverse sustainable impacts of their investments on environmental, social and governance (ESG) indicators. Depending on their ESG exposure, funds are now divided into three categories: Article 6 (traditional funds), Article 8 (part of the portfolio is focused on sustainable investments) and Article 9 funds (full focus on sustainable investments).

SFDR compliance opens up new opportunities for VCs

Green startups have been on the rise for years and after many success stories it is now also clear to investors that green can also mean profitable. A growing number of VCs have recognized this, in less than a year the number of funds categorized as Article 8 and 9 increased from 23.6% to 28.6% and reached EUR 3.32 trillion in assets at the end of 2021. These funds understand that being branded as environmentally and socially sustainable will not only help them attract the right startups, but also the best employees who care and are committed to putting their skills to a good end.

SFDR compliance demonstrates a real commitment to sustainability

The importance of sustainable finance in addressing the climate crisis is widely understood. According to a recent PwC report, 72% of wealth managers are considering fully phasing out product launches that are not ESG compliant, and most aim to do so by 2024. The new disclosure requirements help asset managers demonstrate their genuine ESG ambition and commitment. At the same time, this gives their investors who want to act and align their sustainable strategies comfort.

Thanks to the harmonized regulation, investors can better assess the effects and risks of their financial products. The transparency imposed allows them to anticipate the negative externalities of their potential investments, such as water pollution or deforestation. At the same time, risks from climate change on one's own portfolio are examined.

Becoming an Article 9 fund

Funds that choose to implement the more stringent SFDR requirements to qualify as Article 9 funds initially face an increased workload for themselves and their portfolio companies. The development of an ESG policy is still comparatively easy. A robust ESG strategy that identifies ESG risks for all relevant sectors and defines metrics against which future investments can be evaluated, as well as post-investment reporting, is more complex. Here it is important to quickly build up new skills in house or to source them externally.

Choosing to become an Article 9 fund currently allows VCs to stay one step ahead of the competition. The result will be that funds can demonstrate financial, environmental and social successes while reducing future liability risks. The sustainable revolution in the financial markets has begun.