January 2024

The state of play on SFDR implementation in European private healthcare funds

A review of the implementation status of SFDR in 102 of Europe's largest private healthcare funds managed by 79 asset managers.

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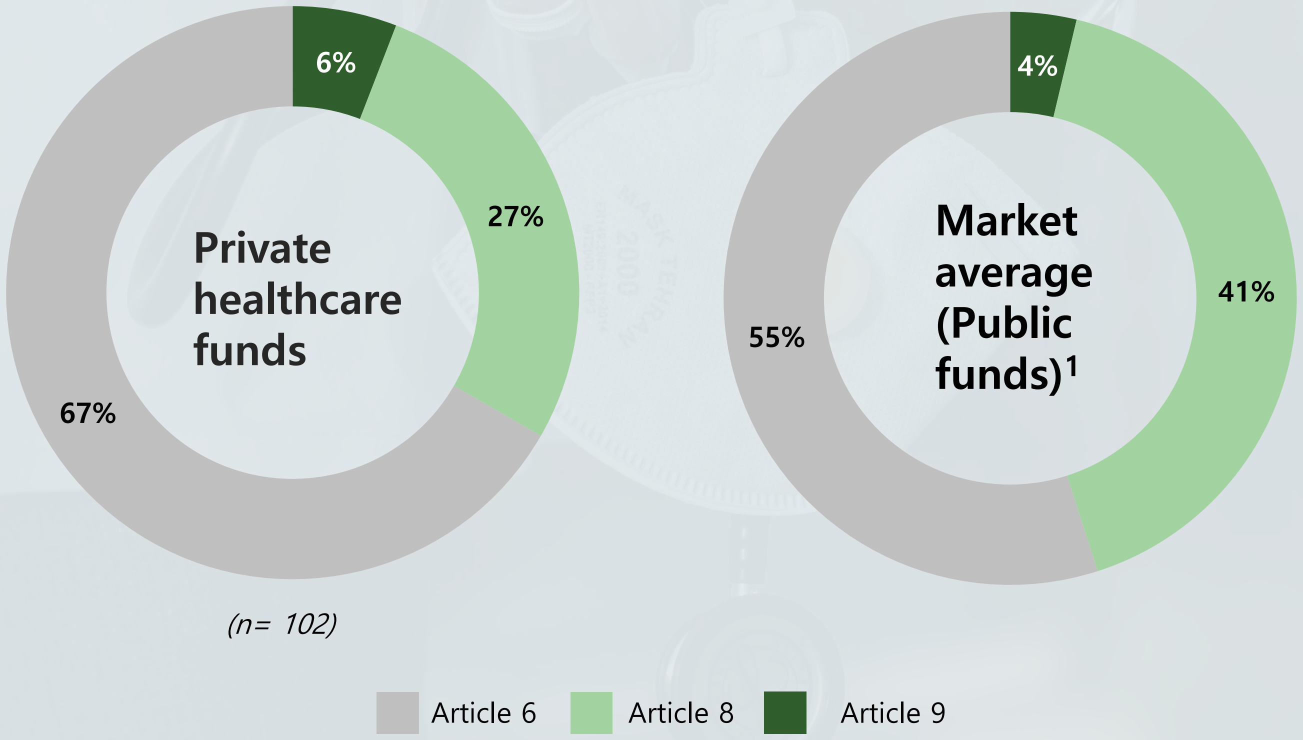
Private healthcare funds trail public funds when it comes to promoting sustainability

SFDR fund type breakdown

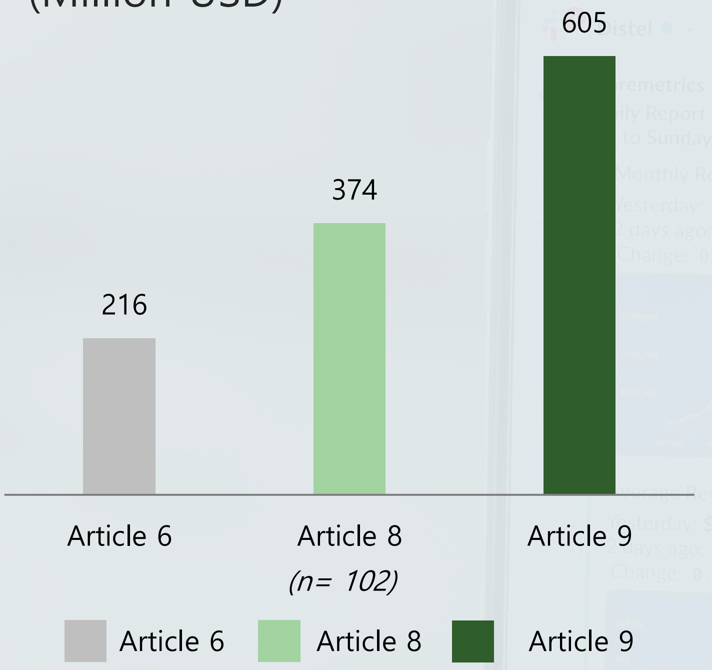


1) "SFDR Article 8 and Article 9 Funds: Q3 2023 in Review" (Morningstar, 2023)

Approximately 2/3 of the largest private health care funds included in the study do not promote sustainability characteristics or pursue a sustainable investment objective. Private markets in general tend to trail public markets on sustainability disclosures. The research suggest that the gap is most substantial for so-called Article 8 funds.

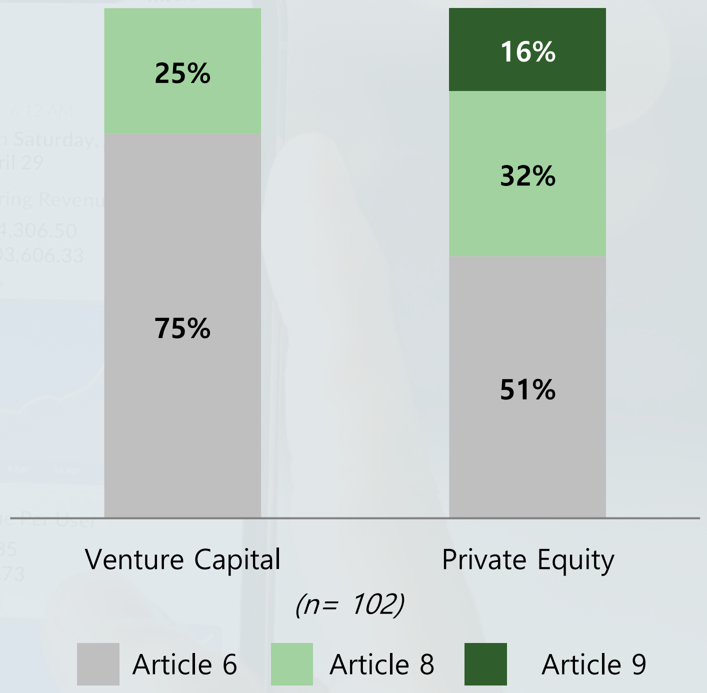
Size of fund and asset class appears to be correlated to the funds' SFDR classification

Average asset under management (AUM)[1] by SFDR fund type
(Million USD)



[1] Excludes 23 funds that do not have AUM information (Article 6: 21, Article 8: 2)

SFDR fund type by asset class

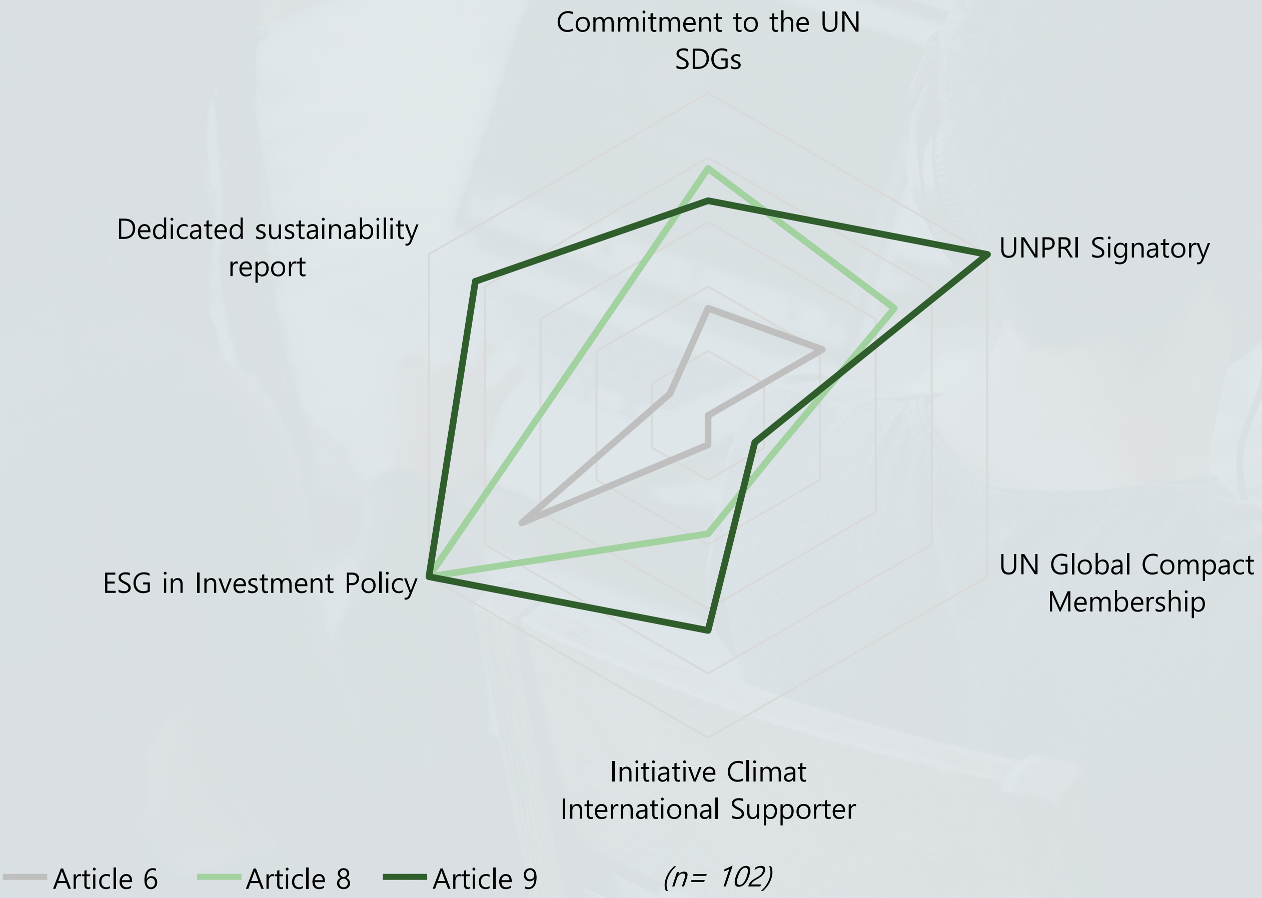


Article 8 and 9 funds are bigger than Article 6 funds measured by average AUM, suggesting that size may be one parameter in determining SFDR fund classification.

There is a higher representation of Article 8 and 9 funds in Private Equity vs. Venture Capital, suggesting that asset class may also play a role in SFDR fund classification.

Article 8 and 9 funds are more common among asset managers with established commitments to sustainability at the firm-level

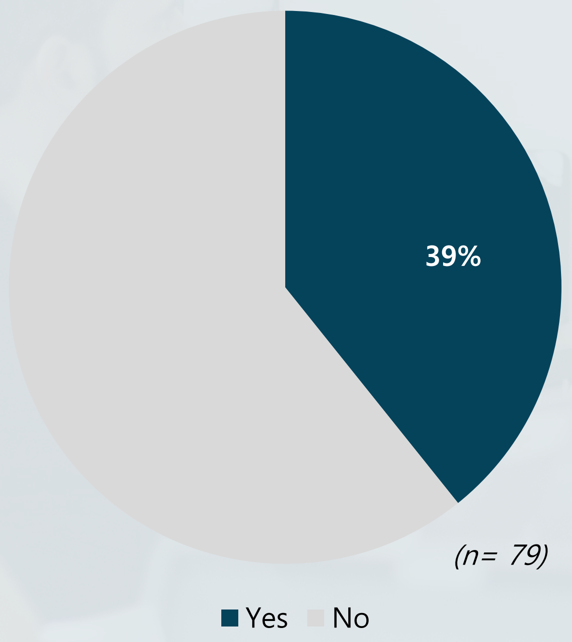
Share of SFDR fund types by asset managers' sustainability commitments



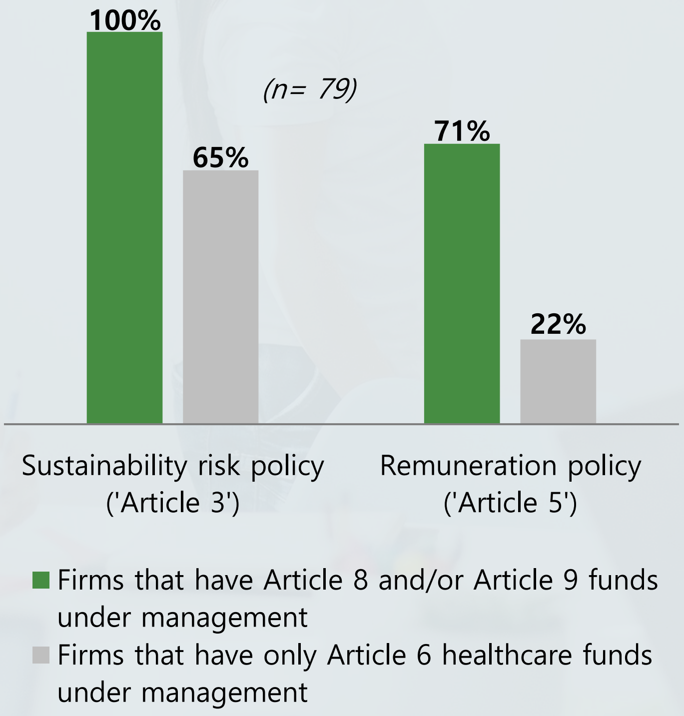
The research suggests that asset managers with established sustainability commitments at the firm level are more likely to offer Article 8 and 9 healthcare funds. Integration of ESG factors into investment policies and commitment to the UN Principles for Responsible Investment (UNPRI) at the asset manager level appear to have the strongest correlation with Article 8 and 9 funds.

Two years into implementation, asset managers of private healthcare funds still have notable SFDR disclosure gaps

% of asset managers which meet key mandatory disclosure requirements at entity-level – all SFDR fund types



% of asset managers which meet key mandatory disclosure requirements at entity-level – by SFDR fund type



All asset managers are required to disclose information about their policies on sustainability risks ('Article 3') and remuneration policies ('Article 5') on their websites. Less than half of asset managers of healthcare funds currently do.

The disclosure gap is biggest for asset managers with no Article 8 or 9 healthcare funds under management. Disclosure of remuneration policies is the most significant gap, even for asset managers with Article 8 and 9 funds under management.

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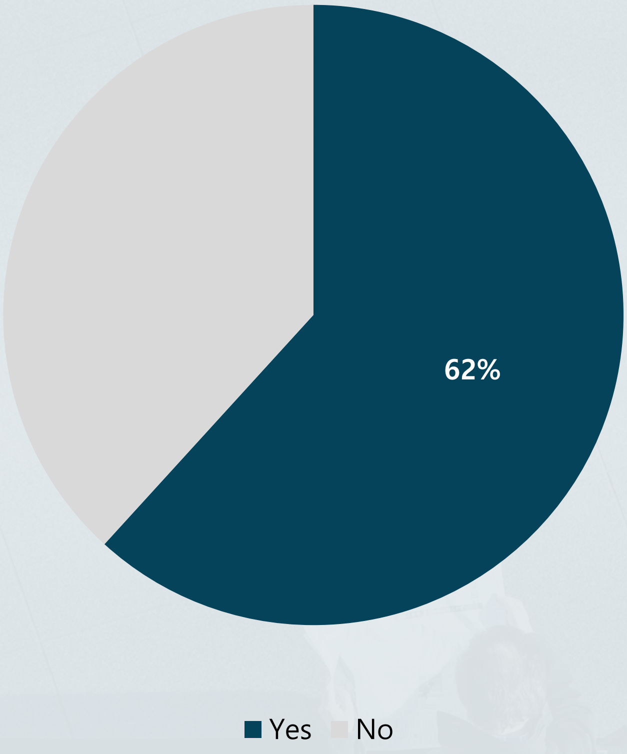
A significant share of Article 8 and 9 funds do not publicly disclose their sustainability characteristics, objectives and methodologies

% of Article 8 and 9 funds with publicly available product disclosures on the asset manager website ('Article 10')



(n= 34)

Our research found that only 62% of the funds that are classified as Article 8 or 9 disclose detailed information about their promotional characteristics and/or their sustainable investment objectives and methodologies on the asset managers' public websites ('Article 10'). It should be noted that some asset managers may offer this information behind closed investor portals, in which case it is not considered as a public disclosure in this graph.

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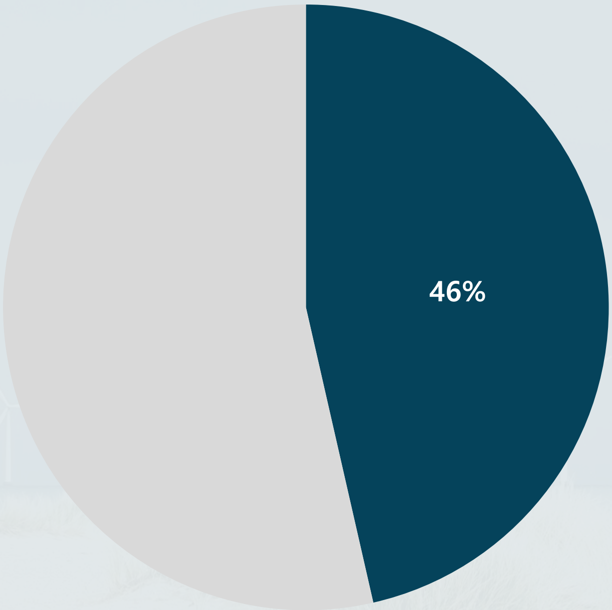
Less than half of asset managers with Article 8 and 9 funds under management consider PAI in their investment decisions

% of asset managers with Article 8 and/or 9 funds under management who consider PAI in their investment decisions



■ Consider PAI in the investment decision ■ Do not consider PAI in the investment decision

(n= 28)

Of the 28 asset managers with Article 8 and 9 funds under management, 46% confirm that they consider principle adverse impacts of their investment decisions at the entity-level. Of the 34 Article 8 and 9 funds identified, only three have explicitly opted into PAI disclosure at the product-level.

What could be stifling progress towards sustainability disclosure in private healthcare funds?

"The inherently good bias"

Healthcare asset managers and the companies they invest in may struggle with what we refer to as the "inherently good bias". The bias, which we also commonly come across in climate tech investment and start-ups, happens when investors and companies with a tunnel-vision focus on solving a significant societal problem fall become blind to other potentially material sustainability impacts, risks or opportunities.

Low disclosure preparedness among healthcare companies

We find that some healthcare asset managers are more hesitant to classify their funds as Article 8 or 9 because the companies they invest in are ill prepared to meet the disclosure requirements that will follow with such classifications. This resonates with the 2023 KPMG ESG Assurance Maturity Index, which finds that healthcare companies in private markets are the least prepared for forthcoming ESG disclosure and assurance requirements[1].

Lack of promotional characteristics that fit a healthcare context

One common barrier we have come across is that asset managers of healthcare funds often struggle to identify relevant "characteristics" that fit the nature of the health care businesses they invest in. Climate and environmental characteristics are often the easiest to measure, but not always the most material. Other material impacts, such as quality, product safety and business integrity tend to be highly regulated and difficult to promote and measure over time, beyond a strong compliance focus.

Absence of a social taxonomy for sustainable investments

In the 2021 draft recommendation for a future "Social Taxonomy"[2)], healthcare investments was identified as a relevant focus area for investors with a social sustainable investment objective. Even so, our research uncovered only a handful of Article 9 funds – 6 of 102 in total – and some asset managers we speak to tend to opt out of Article 9 due to fears of "impact washing" and lack of clear principles and criteria for what a "sustainable healthcare investment" would look like.

The research suggests that asset managers of the largest European healthcare funds have yet to fully embrace sustainability and SFDR. There can be many reasons for this, but our experience suggests that at least four key factors could be at play.

1) Road to readiness – KPMG ESG Assurance Maturity Index 2023 (KPMG, 2023)
2) Draft Report by Subgroup 4: Social Taxonomy – Platform on Sustainable Finance (July 2021)

How we did it

The findings presented in this brief is the result of research carried out between May and December 2023, which investigated 102 of the largest European private healthcare funds managed by 79 asset management firms. The research is based on publicly available information only, meaning that information which is not available on the asset manager's website or other public channels have not been considered. Specifically, funds that disclose no information on SFDR via the asset manager website or other public channels have by default been categorized as Article 6 funds.

For more information about the study or for additional insights, please reach out to Raison Consulting via info@raison-consulting.com.

About Raison Consulting

Raison is a specialised sustainability and ESG consultancy that works with investors and fund managers such as private equity firms, venture capital, institutional investors, private foundations, and other active owners to drive sustainable transformations at fund and asset level. Raison helps our clients manage their sustainability impacts, risks and opportunities across the full investment cycle, from raising capital to deal sourcing and due diligence to portfolio company engagement and exit. Raison is founded by two Partners – Mette Dalgliesh Olsen and Peder Michael Anker Jorgensen – with +35 years of combined experience helping companies and investors deliver business value and societal impact through superior sustainability performance.