Sustainability Regulation of Private Equity Funds

The EU Sustainable Finance Framework, Fund Governance and Fund Economics

Research question: Does the EU Sustainable Finance Framework effectively redirect capital towards sustainable PE funds and influence how portfolio companies are managed and transformed?

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Insight 1
Private equity combines capital, control and time, making it structurally well suited to transformation.

Insight 2
Disclosure is necessary for informed investment decisions and for limiting greenwashing, but is structurally insufficient to steer capital in closed-end private equity on its own.

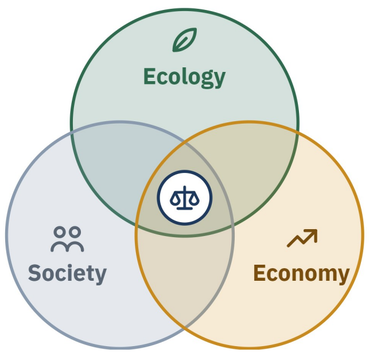
Insight 3
Effective PE regulation must combine simpler information rules with Fund Governance, Fund Economics and investor-side incentives.

Guiding idea
From disclosure to governance and incentives.

Sustainability is broader than ESG

Externalities
→ why regulate?

Brundtland (1987): meeting present needs without compromising future generations' ability to meet theirs.



This study understands sustainability across three dimensions: ecology, society and economy.

E = Environmental · **S** = Social · **G** = Governance – not economic sustainability

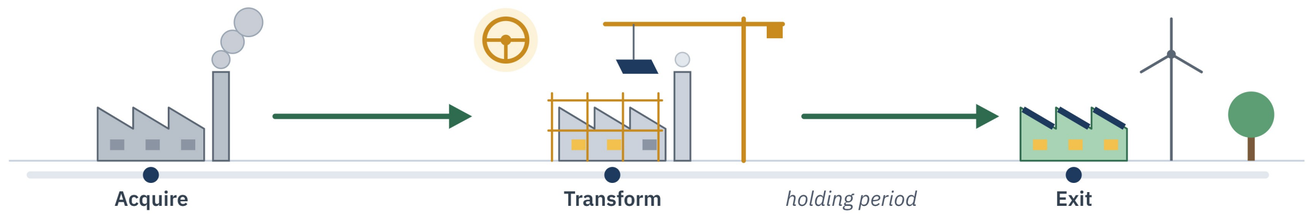
EU ESG regulation operationalises selected environmental, social and governance priorities; ESG is therefore not synonymous with the broader concept of sustainability.

→ PE: structurally suited to transformation

Capital
scale & dry powder

Control
active ownership · expertise

Time
closed-end capital · medium- to long-term horizon

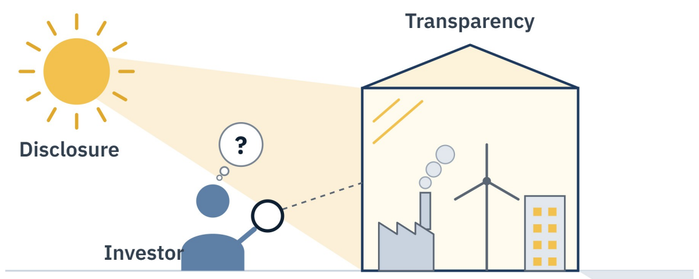


Static – already sustainable
Invest in companies that are already sustainable.

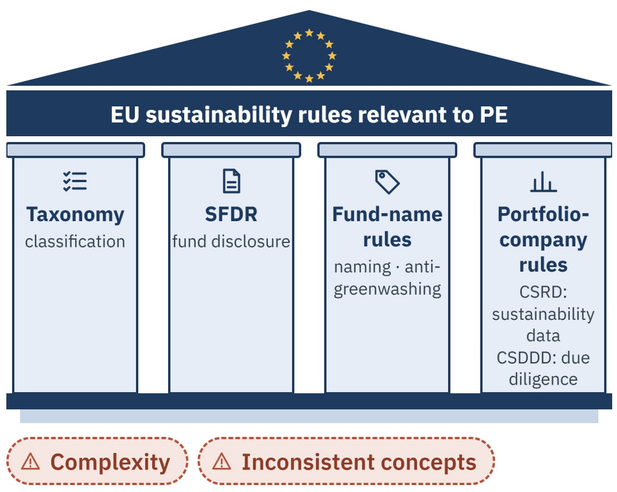
Dynamic – transformation during ownership
Transform initially non-sustainable companies during the holding period.

The information model

Information asymmetry
→ why disclose? Akerlof's "market for lemons"



"Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."
Louis D. Brandeis, 1914



⚠ Complexity · ⚠ Inconsistent concepts · ⚠ Information overload

EU Sustainable Finance reforms underway – including SFDR 2.0

→ PE reality check

No continuous market pricing
ESG information cannot be continuously reflected through a public market price.

No redemption on demand
LPs cannot routinely discipline the manager by redeeming their investment.

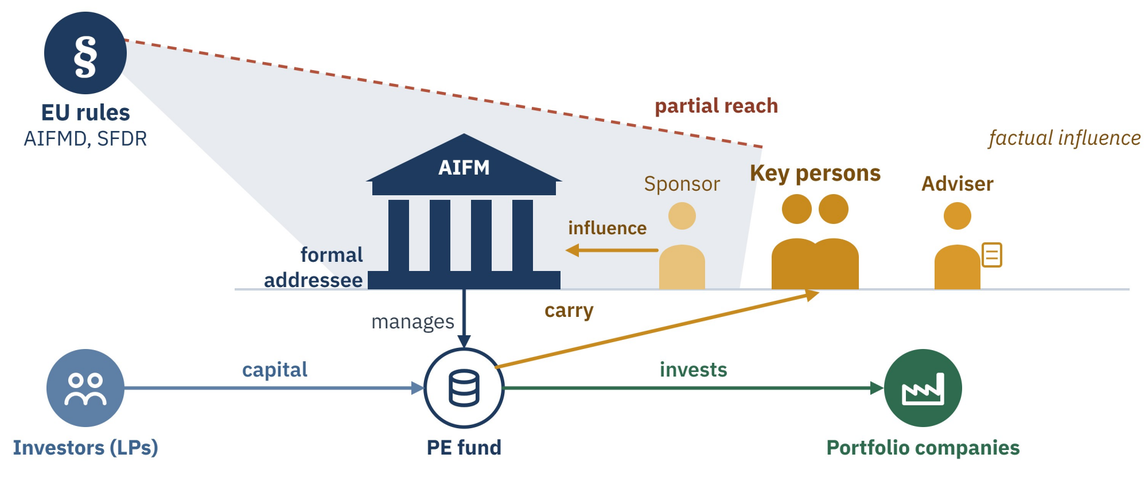
Delegated management / passive LPs
Investors deliberately delegate investment decisions to PE management. The principal–agent structure therefore relies heavily on incentive alignment rather than continuous investor control.

Disclosure rules are necessary for informed investment decisions and for identifying and limiting greenwashing. But information alone does not necessarily redirect capital towards sustainable PE funds.

LPs continue to respond to return, risk, fiduciary duties and regulatory constraints, while fund managers remain driven by the fund's economic incentive structure.

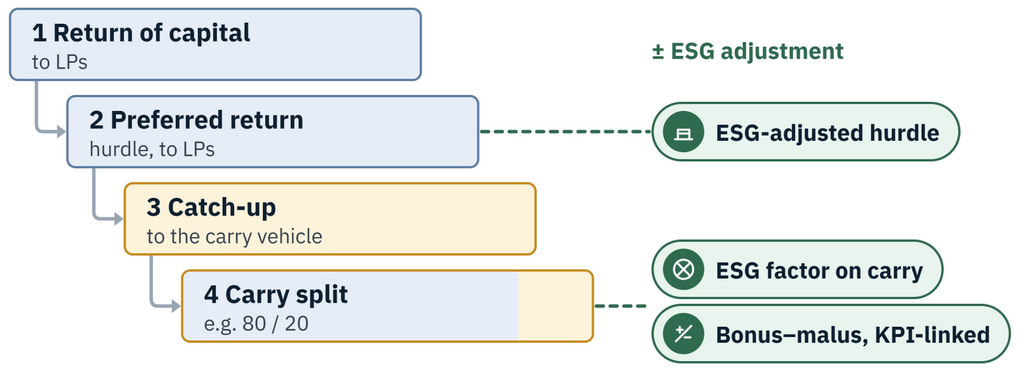
Fund Governance

The regulatory framework focuses on the AIFM, while factual influence may sit with key persons and advisers.



→ Fund Economics

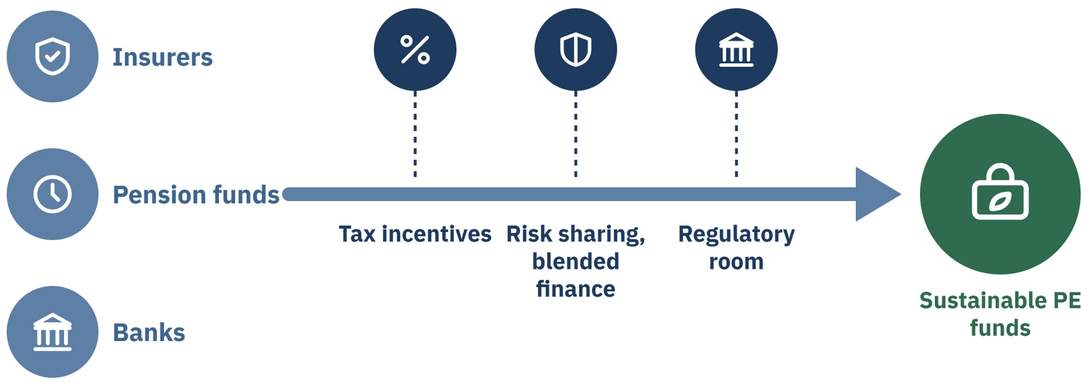
⚠ Principal–agent problem → why align incentives?



Financial success remains a precondition. Sustainability modifies incentives; it does not replace financial performance.

Possible policy levers

principals

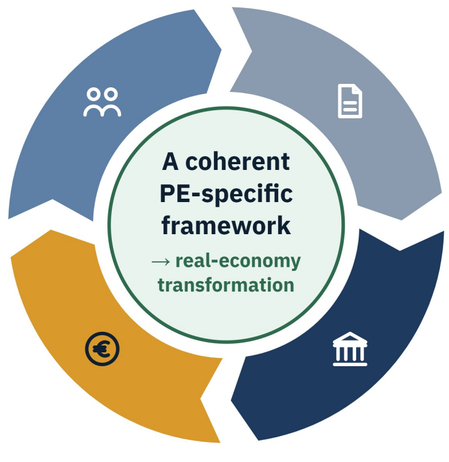


Investors respond to return, risk, fiduciary duties and mandates.

→ Conclusion

Investors / public policy
principals
Incentives, risk sharing, regulatory room

Fund economics
agents
Carry linked to measurable sustainability goals



Information
Clear, comparable, anti-greenwashing

Fund governance
Reach the actual decision-makers

References. Pigou 1920; Akerlof 1970; Jensen and Meckling 1976; Brandeis 1914; WCED 1987 (*Our Common Future*); Reg. (EU) 2019/2088 (SFDR), 2020/852 (Taxonomy); Dir. (EU) 2022/2464 (CSRD); ESMA fund-names guidelines 2024; Commission SFDR proposal 2025.

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