

DECIPHERING THE DATA | MARCH 2022

Your step-by-step guide to SFDR



The Bright Alternative

Explore: aztec.group



AZTEC
GROUP

In alliance with

worldfavor

Introduction

The Sustainable Finance Disclosure Regulation (SFDR) came into effect on 10 March 2021, with the aim of reorientating capital flow towards sustainable finance and investment and preventing so-called greenwashing.

While SFDR has undoubtedly succeeded in sharpening the industry's focus on ESG and ensuring investors are better placed to assess the ESG and sustainability credentials of fund managers, it has also posed a number of challenges for the industry too – particularly in relation to data collection and reporting, given the absence of an industry-wide reporting framework for ESG and readily available data.

Thankfully, we're seeing moves by the industry to address these challenges (**see Convergence is Coming**). In the interim, the immediate priority for managers remains getting their operations and funds SFDR ready and compliant.

To help managers, navigate and, ultimately, succeed in the complex and evolving world of SFDR, we have developed this short step-by-step guide in partnership with ESG and sustainability platform provider, Worldfavor.



JUMP TO:



Introduction

1. **Determine whether you are in-scope**
2. **Understand your requirements**
3. **Define your fund and SFDR classification**
4. **Draft and publish your Principal Adverse Impact statement**
5. **Make your Principal Adverse Impact disclosures**
6. **Determine how you will collect data**
7. **Engage your portfolio companies**
8. **Collect data and complete your reporting**
9. **Use the data to make more informed decisions**

Conclusion

1

Determine whether you are in-scope

SFDR is an EU regulation that sets out mandatory ESG disclosure requirements for Financial Markets Participants (FMPs).

It applies to investment firms, pension funds, asset managers, insurance companies, banks, venture capital funds, credit institutions offering portfolio management and financial advisors.

SFDR follows a “comply-or-explain” principle, meaning that FMPs are obligated to comply with regulation or explain why they are not complying. The “explain” option is not available from 30 June 2021 for managers with more than 500 employees.

Although SFDR is an EU regulation, funds outside of Europe that are marketed in Europe also fall under the disclosure requirements.





2

Understand your requirements

SFDR regulation and its reporting requirements comprise of two parts; level 1 and 2, the high-level requirements of which are set out here:



LEVEL 1

came into force on 10 March 2021:

- Define how sustainability risks and adverse impacts on sustainability are taken into account.
- Define the fund as one of three classifications (article 6, 8 or 9), depending on the extent to which sustainability is a core focus.
- **From 30 June 2021** FMPs with more than 500 employees are also required to publish and maintain a Principal Adverse Impact (PAI) statement on their website (see step 4 for further information on PAIs).

LEVEL 2

applicable from 1 January 2023:

- Disclose a PAI statement – a set of 14 mandatory (+2 additional for funds in real estate) and two additional indicators that managers will need to report on, depending on the nature of the fund (article 6, 8 or 9).
- Provide further details on the content, methodologies and presentation of disclosures set out in level 1 disclosure.

Additional key dates and actions required:

1 January 2022 - 31 December, 2022: First reference period.

30 June 2023: The final date on which FMPs need to report on the 14 mandatory and two optional Principal Adverse Indicators on the previous reference period for the first time, through the PAI Statement and other disclosures under SFDR.

1 January 2023 - 31 December 2023: Second reference period.

30 June 2024: The final date by which FMPs need to report for the second time. **In addition, from this date onwards, they must compare between the first and second reference periods.**

Define your fund and SFDR classification

What needs to be disclosed under SFDR depends on the characteristics of the fund and the extent to which sustainability and ESG is a focus. The classifications are as follows:

Article 6: Non-ESG focused financial products (light-grey funds).

Article 8: Funds which promote environmental or social characteristics (light green).

Article 9: Funds which have sustainable investment as their objective (dark green).



Article 6

DISCLOSURES REQUIRED

- The manner in which sustainability risks are integrated into investment decisions.
- The result of the assessment of the likely impacts of sustainability risks.
- Consideration and usage of PAI on sustainability factors.

Article 8

DISCLOSURES REQUIRED

- Information on how and to what extent environmental and or social characteristics are met and what measures are taken to do so.
- What investment strategy the fund has to achieve the social and environmental characteristics that are promoted.
- Asset allocation of the fund including EU Taxonomy alignment.
- If an index has been designated as a reference benchmark, information on whether this index is consistent with those characteristics.

Article 9

DISCLOSURES REQUIRED

- Information on how sustainable investment is attained.
- How the designated index (the benchmark) is aligned with the objective.
- Why and how the designed index differs from a broad market index.

- Where information can be found on the methodology used for the calculation of the benchmark.
- If there is no benchmark assigned, an explanation should be given on how that objective is to be attained.
- If the financial product has reduction in carbon emissions as its objective, the issuer of that product should include information in pre-contractual disclosures on that objective and how it is aligned with achieving the long term global warming objectives of the Paris Agreement.

How the EU Taxonomy is linked to SFDR

The EU Taxonomy is a classification system for environmentally sustainable economic activities and is integrated into the SFDR and specifically article 8 or 9. These cover environmentally and/or socially sustainable investments and the periodic reporting of an article 8 or 9 fund should include EU Taxonomy alignment. The alignment should be expressed as % in turnover, capex and opex.

In October 2021 a draft RTS was published which provides guidance and templates relating to pre-contractual and periodic disclosure for article 8 and article 9. Click [here](#) for more information.



4

Draft and publish your Principal Adverse Impact statement

Managers should publish a PAI statement on their website. The information should contain both qualitative and quantitative elements, including: a description of principal adverse sustainability impacts, related and planned actions, the 14 mandatory PAI Indicators and two Additional Indicators.

The statement should also include information on, but not limited to: policies, indicators selected, data sources, due diligence and reporting practices, and the extent to which there is alignment with international standards such as the Paris Agreement.



Make your Principal Adverse Impact disclosures

Information related to PAI should be published on the manager's website, as follows:

Relevant indicators: A minimum of 16 indicators consisting of 14 mandatory (nine environmental and five social) and two additional (one out of 16 additional environmental indicators and one out of 17 additional social indicators).

Type of investment: SFDR is divided into sections for investments in investee companies, real estate investments or sovereign and supranational investments.

Sustainability area: Climate and other environmental-related or related to social and employee, respect for human rights, anti-corruption and anti-bribery matters.

The Mandatory Adverse Sustainability Indicators (applicable to investment and investee companies): See following table

| CLIMATE AND OTHER ENVIRONMENT-RELATED INDICATORS | |
|---|---|
| Greenhouse gas emissions | 1. GHG emissions |
| | 2. Carbon footprint |
| | 3. GHG intensity of investee companies |
| | 4. Exposure to companies active in the fossil fuel sector |
| | 5. Share of non-renewable energy consumption and production |
| | 6. Energy consumption intensity per high impact climate sector |
| | 7. Activities negatively affecting biodiversity sensitive areas |
| | 8. Emissions to water |
| | 9. Hazardous waste ratio |
| 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 |
| | 11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises |
| | 12. Unadjusted gender pay gap |
| | 13. Board gender diversity |
| | 14. Exposure to controversial weapons (antipersonnel mines, cluster munitions, chemical weapons and biological weapons) |

6

Determine how you will collect data



Before you start collecting data on your indicators, you will need to decide how you will collect it.

You have two options in this regard. The first is to manually collect data using a basic spreadsheet, which is obviously inherently time-consuming and inefficient, with human error also more likely.

The alternative is to use a digital tool, such as the sustainability platform available through the Aztec Group and Worldfavor alliance – see **here** for further information. This will allow you to collect, manage, aggregate and store all your valuable data in one secure place, while saving time by utilising automated functionality for data collection requests and reminders.

7

Engage your portfolio companies



It is absolutely critical that portfolio companies are engaged at the earliest opportunity. Be clear about **why** you are collecting information, how you intend to do it and provide a **clear brief** and **timeline** that helps the portfolio companies relate to the process and get prepared on time.

Remember, SFDR regulation is directed at investors and not investees (portfolio companies). This means that you, as an investor/manager, might fall under SFDR, but the companies you invest in do not. It is highly probable that they are not already measuring against your KPIs or have the information readily available in order to do this instantaneously.

It is, therefore, important that you give your portfolio companies the means and tools to report in line with your requirements. Sophisticated digital sustainability tools have in-built questionnaires, accompanied by guidance and other support mechanisms to ensure the process is as straightforward as possible for users.

8

Collect data and complete your reporting



The easiest way to collect data and track PAI indicators is by using a digital sustainability tool. A digital tool will automate and streamline the process for you, saving you and your portfolio companies time and effort, while ensuring integrity and security of the data – now and in the future.

Once you have the data available, it must be made publicly available to your stakeholders and accessible via your website.

The PAI indicators for each portfolio company need to be aggregated at fund level. The calculations are outlined in the SFDR regulations and consist of both ratios, such as intensities, and aggregation of the portfolio data based on how much has been invested in each investee.

Articles 8 and 9 require additional disclosure about the objective or characteristics of the fund, as well as EU Taxonomy data. For more information, check the **“What metrics to track” section or the disclosure templates in the RTS Draft.**

9

Use the data to make more informed decisions



SFDR may be a reporting directive, but the data generated from its requirements will also help you to gain rich insight into the performance of your fund and, ultimately, make more informed investment decisions.

Using the right tools, you will be able identify which portfolio companies represent best in class, need further support or fail to align with your values and objectives.

Conclusion

SFDR is complex regulation that will undoubtedly present fund managers with fresh challenges as the legislation itself continues to evolve and they grapple with the practicalities of implementation.

The first major reporting deadline is looming, with the 30 June 2023 being the final date by which managers must report on the previous reference period for the first time. Our advice is to ensure you are reporting ready now, which means engaging your portfolio companies at the earliest opportunity, giving them time to prepare and take ownership of their own sustainability journey. The completeness of your reporting is dependent on them.

The onus is on you, as the manager, to support your portfolio companies, providing them with the necessary guidance while ensuring the reporting process is as seamless and straightforward as possible. Utilising an intuitive digital platform that streamlines the process for all involved will be extremely helpful in this regard.



Get in touch

If you would like to discuss any of the topics in this guide, as well as how the Aztec Group can support you, please talk to either your usual contact or get in touch with:



James Gow
Chief Client Officer

Telephone: +44 (0) 238 235 5764
Email: James.Gow@aztecgroupp.co.uk

[View bio](#)





About



About the Aztec Group

Established in 2001, the Aztec Group is an award-winning independent provider of fund, corporate and depositary services, employing over 1,400 people across Guernsey, Jersey, Luxembourg, the UK and the US.

Owner-managed, the Group specialises in alternative investments, administering more than €440 billion in assets, 450 funds and 4,500 entities for a range of clients spanning the major asset classes, including real estate, private equity, venture capital, private debt and infrastructure.

Supporting over 240 alternative investment managers, the Group prides itself on its long-term partnership approach, enhancing clients' fund operations through industry-leading expertise, technology and controls, with a dedicated relationship team by their side over the life of their funds.

For further information, visit [aztec.group](https://www.aztec.group)

Contact us

James Gow

Chief Client Officer

Telephone: +44 (0) 238 235 5764

Email: James.Gow@aztecgroupp.co.uk

worldfavor

About Worldfavor

Worldfavor is the global sustainability platform that makes it easy for organizations to access and share sustainability information. We build technology to make sure companies' ESG data can be used to gain insights for making decisions that make a positive impact. Today, we're a leading platform in our field – over 22,000 organizations in 130 countries rely on our network to optimize their sustainability work and capitalize on untapped business opportunities.

Because of Worldfavor, hundreds of sustainable decisions are made every day that transform value chains spread across the globe and help shape a future where people, planet, and economy thrive together.

For further information, visit [worldfavor.com](https://www.worldfavor.com)



DECIPHERING THE DATA | MARCH 2022

The Bright Alternative

Explore: aztec.group

Private Equity Fund Services
Real Asset Fund Services
Private Debt Fund Services
Corporate Services



AZTEC
GROUP

Aztec Group is authorised to carry on financial services in the jurisdictions in which it operates.