



# SFDR REPORTING

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# A Detailed Guide to SFDR Reporting

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# What is the Sustainable Financial Disclosure Regulation(SFDR)?



 [The Sustainable Finance Disclosure Regulation](#) (SFDR) is a set of European Union (EU) regulations that require asset managers and other financial market participants to publicly disclose ESG information around their investment decisions and financial products.

The regulation was conceived by the European Sustainable Investment Forum ([Eurosif](#)) in 2019 to set specific and measurable ESG disclosures, allowing investors to compare the sustainability profiles of businesses.

## To Whom Does SFDR Reporting Apply?

[SFDR](#) requires all financial market participants (with more than 500 employees) within the [EU](#), or those marketing funds to [EU](#) investors, to make principles-based ESG disclosures. It applies across all asset classes and includes those operating in the private equity space.

 [Click here to learn more about Regulatory Technical Standards](#)



**SFDR** is broken down into product level and entity-level disclosures, i.e. disclosures on a holistic level of a firm's entire portfolio, and disclosures on each product or fund within a portfolio. These multi-level disclosures are highly beneficial to investors, making **SFDR reporting** a well-rounded and rigorous tool for determining ESG investing options.

## What are the Regulatory Technical Standards (RTS)?

In **April 2022**, the European Commission adopted its Regulatory Technical Standards (**RTS**) that laid the groundwork for how SFDR reporting is to be undertaken.

RTS is essentially a collection of templates or worksheets that the EU has given financial market participants as direct guidance on how to implement **SFDR**.



## What are SFDR's Disclosure Requirements?

Financial market participants in the **EU** are obligated to disclose information on their sustainability practices (firm-level) and their financial products (product-level). Additionally, they must also provide a Principal Adverse Impacts (**PAI**) statement at both the firm and product level.

The PAI statement consists of a list of mandatory and voluntary sustainability indicators (such as greenhouse gas emissions, human rights and waste management) that have to be taken into consideration when making investment policies and decisions.



# Fund Classifications Under SFDR

## Article 6 Funds

Funds that do not integrate sustainability factors into the investment process, and can include investments excluded by ESG funds e.g. tobacco or thermal coal companies



Must at least disclose a Sustainability Risk Report that shows how ESG risk factors affect current investments and how these risk factors are integrated into future and current investments coal companies

## Article 8 Funds

Funds that promote and integrate ESG into their investment process



Must at least benchmark themselves against other products promoting similar characteristics

## Article 9 Funds

Funds that have a core objective of sustainable investment



Must at least use benchmarks to measure their contributions to their stated environmental or social objectives

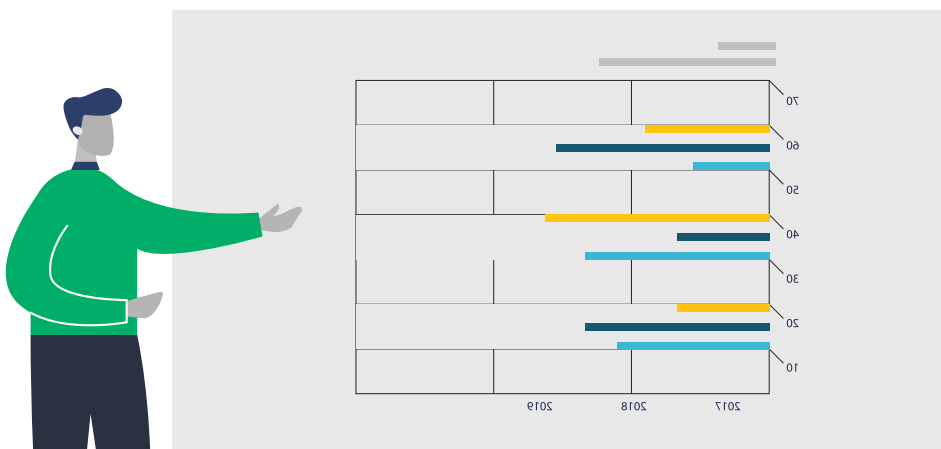
# What are SFDR's Product-level Disclosures?

**Product-level disclosures** are disclosures that are specific to each fund that an asset manager markets to investors. Different disclosures are required for different funds based on what label the asset manager places on them.

Under **SFDR**, each fund falls under either **Article 6, 8, or 9** product classifications. Each article level has different disclosure requirements.

Classifying funds in this way provides a benchmark against which asset managers can:

- 01 classify their funds.
- 02 justify this classification against comparable classified funds in the industry. This can be done with the help of the EU's Regulatory Technical Standards.



## What are Article 6 Products?

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**Article 6** products are funds that neither have a sustainable investment objective nor investment in assets with environmental or social benefits.

**Article 6** funds must disclose a Sustainability Risk Report that shows how ESG risk factors affect current investments and how these risk factors are integrated into future and current investments, as well as a Remuneration Policy which must be consistent with the SR Report.

## What are Article 8 Products?

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**Article 8** products are funds that promote investments with positive ESG principles alongside other non-ESG traits.

**Article 8** products should benchmark themselves against other products promoting similar characteristics.

## What are Article 9 Products?

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**Article 9** products are funds that have a core objective of sustainable investments that contribute to an environmental or social objective as per the EU Taxonomy guidelines. **Article 9** products should use benchmarks to measure their contributions to their stated environmental or social objectives.



# What are SFDR's Entity-level Disclosures?

SFDR's entity-level disclosures cover all the investments of a firm.

This means that there is no discrimination between the different funds or product a firm offers; the disclosures provide an overview of a portfolio's overall ESG performance. Entity-level disclosures include the Principle Adverse Impact (PAI) indicators, Sustainability Risk Report, and Remuneration Policy (see more on this below).

## Principle Adverse Impact Indicator (PAI) Report

PAI reports are a quantitative view of how the activities of a firm's investments affect ESG factors. The PAI contains 64 indicators, and depending on the type of firm you are, 16 or 18 are mandatory. Two additional indicators must be selected, one additional climate and one additional social/governance indicator. The Regulatory Technical Standards specify how each indicator must be calculated and displayed.





## How is Data Collected for PAI Reporting?

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Data needs to be collected quarterly for the annual PAI reports. In other words, data needs to be collected quarterly for at least 20 indicators across all investments.

Each indicator is calculated using different data points. For example, to calculate an indicator showing the average scope 1, 2, and 3 carbon emissions of portfolio companies, you would need the scope 1, 2, and 3 carbon emissions data of every company invested in, as well as the total value of all investments. That's already four data points for one indicator!

A significant feature of the PAI indicator reports is the historical comparison with previous years. This retrospective view acts as an incentive for companies to improve and reduce their negative impact on ESG factors over time.

 [Click Here To Access SFDR's PAI Indicators Template](#)

## Sustainability Risk Report

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The Sustainability Risk Report is reported annually. It shows how ESG factors impact investments (i.e. the sustainability risks of investments) and how these risks are integrated into the decision making process for current and prospective investments.

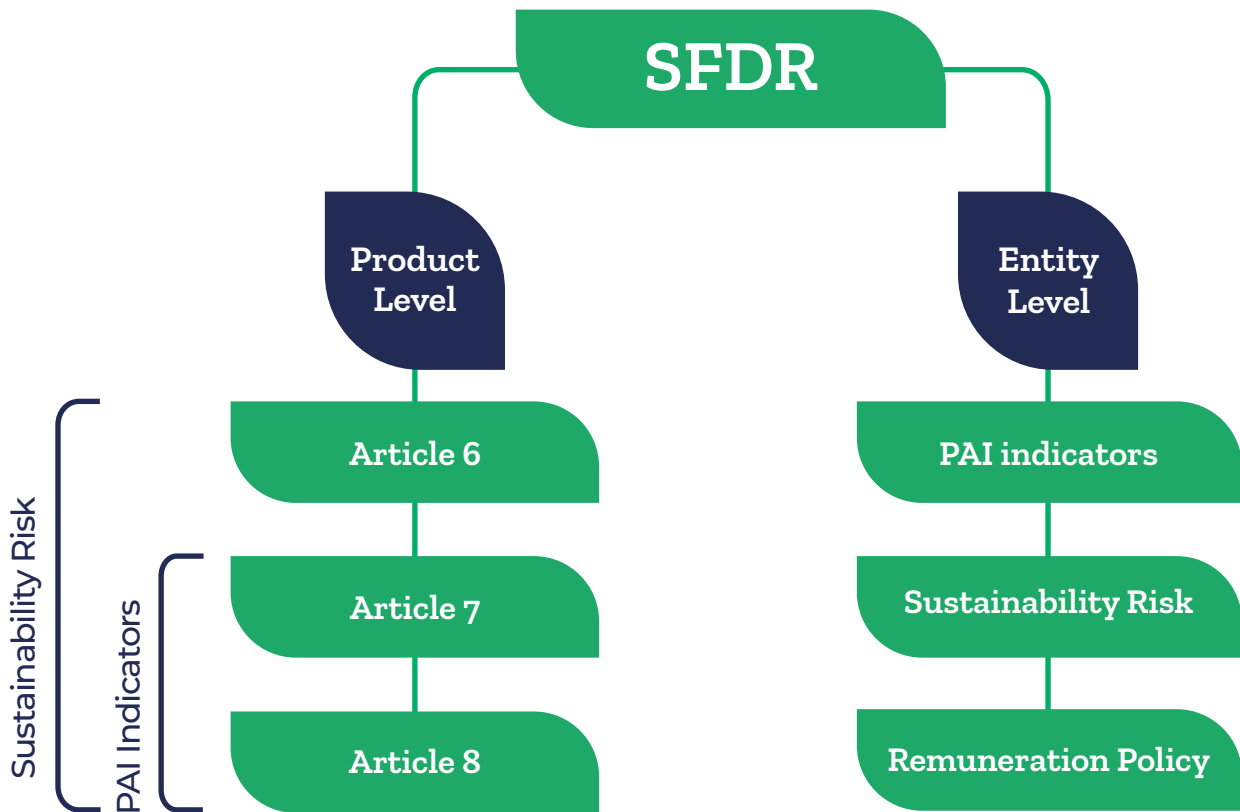
## Remuneration Policy

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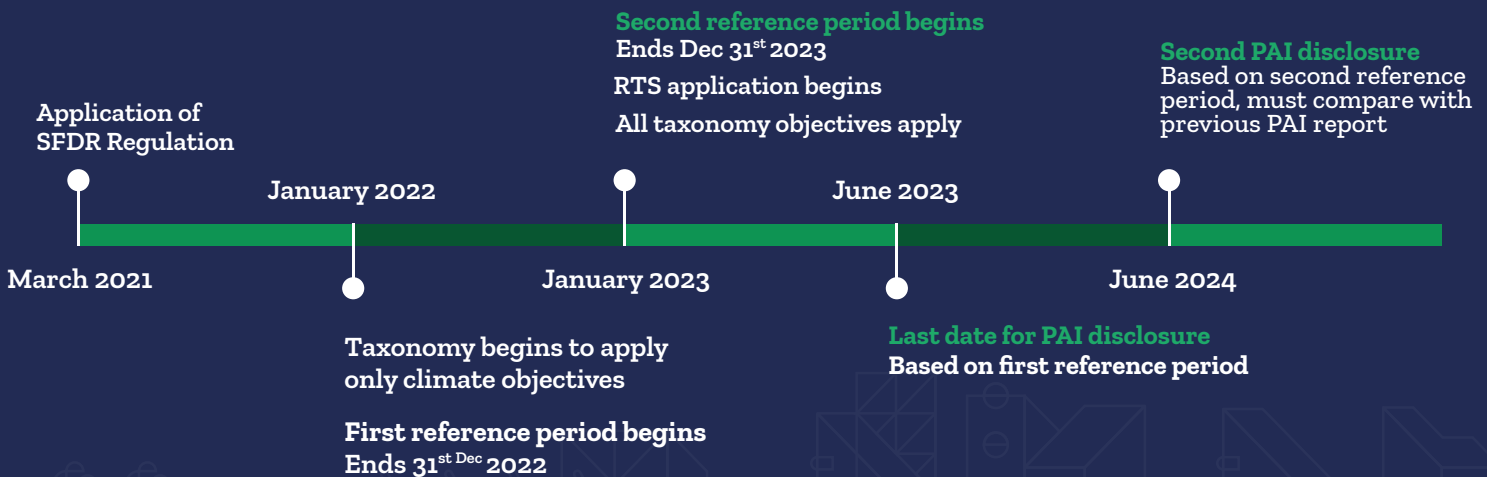
Sustainability Risk is defined as "an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of an investment" as per SFDR article 2(22).

Financial market participants and financial advisers must include information on how their remuneration policy is consistent or inconsistent with the Sustainability Risks. They are required to publish this information on their websites.





# What is the **SFDR** Disclosure Timeline?




# SFDR and Other Governance Structures

SFDR complements other EU governance structures on sustainable finance. Its Regulatory Technical Standards on ESG disclosures play a significant role to enhance the efficacy of the regulation.

SFDR is also complemented by the European Green Deal (which aims to see the bloc carbon neutral by 2050) and the EU's "green taxonomy" (an industry-based classification system of what can and cannot be marketed as a sustainable product).

## What is the EU Taxonomy?

 The [EU Taxonomy](#) defines sustainable activity in the context of the European Green Deal. Sustainable activity is any activity that makes a substantial contribution to a stated environmental objective and does not significantly harm other environmental objectives.



# What are the EU Taxonomy's Objectives?



Climate Change Mitigation



Climate Change Adaptation



Sustainable Use and Protection of Water and Marine Resources



Transition to a Circular Economy



Pollution Prevention and Control



Protection and Restoration of Biodiversity and Ecosystems

## When Will the EU Taxonomy Objectives Apply?

As of **January 2022**, only the Climate Change Mitigation and Climate Change Adaptation objectives apply to SFDR. However, from **January 2023**, all objectives will apply.

## What Does it Mean For an Objective to Apply?

This means that funds classified under Article 8 and 9 under SFDR (more on these fund classifications below) must disclose the percentage of their fund that is aligned with the EU Taxonomy. Taxonomy Alignment (TA) is usually expressed through the aligned fund's turnover.

Being aligned with the Taxonomy is different from simply reporting ESG activities under SFDR, as the taxonomy further divides activities into "Transitional Activities" and "Enabling Activities."

 [Click here to learn more about the EU Taxonomy.](#)



## What are Transitional Activities?

These are activities for which low-carbon alternatives are not yet available and that have greenhouse gas emission levels that correspond to the best performance in the sector or industry.

## What are Enabling Activities?

These are activities that directly enable others to make a substantial contribution to an environmental objective.

## Who does Taxonomy Alignment apply to?

Taxonomy alignment applies to all Article 8 and 9 funds. TA disclosures are required for all Article 8 products that promote e/s characteristics regardless of whether they commit to partially investing in sustainable investments.

# SFDR Reporting Templates

- 👉 [Article 8 pre-contractual disclosure technical standards](#)
- 👉 [Article 9 pre-contractual disclosure technical standards](#)
- 👉 [Article 8 periodic disclosure technical standards](#)
- 👉 [Article 9 periodic disclosure technical standards](#)



# What are the Consequences of Violating SFDR?

Non-compliance with SFDR may result in fines and penalties implemented at the national level. There are three categories of violations. To put things into perspective, Category 2 fines in the Netherlands can be up to €2.5M or five per cent of net turnover, while Category 3 fines can extend to €20M.

## How Can You Meet SFDR's Reporting Requirements?

As a private capital investor, you will need to complete all entity-level and product-level requirements by following the [Regulatory Technical Standards \(RTS\)](#).

Once you have created reports through the processes outlined in the RTS, you must follow the RTS on how to disclose said reports pre-contractually, periodically, or on your website. All this must be done within the SFDR disclosure timeline outlined in the graphic above.

Arguably, the most challenging disclosure is the Entity Level Principal Adverse Impact (PAI) Report, because the amount of data that needs to be collected and the methodology by which that data must be processed and presented is extremely precise.

Automating SFDR's indicators would allow firms to simplify this process. Managing sustainability information in the



cloud, rather than through manual mechanisms such as spreadsheets, keeps this data secure, accessible and easier to analyze and benchmark.

## How can ESGTree's Comprehensive SFDR Reporting Tool Help Private Equity Firms?

SFDR reporting requirements are vast and heavy. One would need large amounts of data collection and a significant amount of time to process, analyze, and generate the necessary reports. These barriers, along with the violation penalties mentioned above, make it challenging for investors to leverage SFDR to their advantage. Firms would be better off sourcing a seamless ESG and SFDR automation tool to transform a reporting burden into a value creation exercise.

Years of research and product development have allowed ESGTree to build an advanced ESG benchmarking system built specifically with private equity firms in mind. ESGTree's entirely customizable data platform allows investors to collect, monitor, analyze, and benchmark portfolio company performance based on the exact indicators and requirements that are critical to them.

ESGTree Automates the Principal Adverse Impacts (PAI) reporting & SFDR & EU Taxonomy alignment on both product & entity levels.

This ensures that our clients stay ahead of this important regulation.

# ESGTree Dashboard

**PAI Calculations**

Reporting Period: 2022

PAI Indicators	Associated Portfolio Company Indicators with codes	Equation	Unit of Measure	Aggregate Calculated Figure	Aggregate Calculated Figure (last year)	Explanation	Actions, Plans and Targets	Actions
Scope 1 GHG emissions	PAI-PC-5 - What are your scope 1 GHG emissions	<a href="#">Click to view</a>	Metric tons (t)	100 Metric Tonnes	120 Metric Tonnes	Reduced scope 1 emissions from the previous reference period have been achieved	An emphasis on online work has taken place & will continue to take place to reduce scope 1 emissions by 5% every reference period	<input checked="" type="checkbox"/> <input checked="" type="checkbox"/>
Scope 2 GHG emissions	PAI-PC-6 - What are your scope 2 GHG emissions	<a href="#">Click to view</a>	Metric tons (t)	70 Metric Tonnes	90 Metric Tonnes	Reduced scope 2 emissions from the previous reference period have been achieved	Emphasis on shifting energy consumption to more sustainable sources will continue every reference period to reduce scope 2 emissions by 10% every reference period	<input checked="" type="checkbox"/> <input checked="" type="checkbox"/>
Scope 3 GHG emissions	PAI-PC-7 - What are your scope 3 GHG emissions	<a href="#">Click to view</a>	Metric tons (t)	30 Metric Tonnes	15 Metric Tonnes	Increased scope 3 emissions from necessary long distance air travel	No actions have been taken. Actions planned are to ensure resources are available on-site to remove the necessity of employee travel. Reduce scope 3 emissions by 5% every reference period	<input checked="" type="checkbox"/> <input checked="" type="checkbox"/>
<b>Total GHG emissions</b>	PAI-PC-5 - What are your scope 1 GHG emissions PAI-PC-6 - What are your scope 2 GHG emissions PAI-PC-7 - What are your scope 3 GHG emissions	<a href="#">Click to view</a>	Metric tons (t)	200 Metric Tonnes	225 Metric Tonnes	Total GHG emissions have reduced from previous reference period due to actions taken	In addition to above, investee companies will be educated on reduction of GHG emissions to promote sustainable investments	<input checked="" type="checkbox"/> <input checked="" type="checkbox"/>

**Optional Indicator 1**

Indicator	Indicator Components	Metric	Type	Select
Emissions	Emissions of inorganic pollutants	Tonnes of inorganic pollutants equivalent per million EUR invested, expressed as a weighted average	Quantitative	<input checked="" type="radio"/>
	Emissions of air pollutants	Tonnes of air pollutants equivalent per million EUR invested, expressed as a weighted average	Quantitative	<input type="radio"/>
	Emissions of ozone depletion substances	Tonnes of ozone depletion substances equivalent per million EUR invested, expressed as a weighted average	Quantitative	<input type="radio"/>
Energy performance	Investments in companies without carbon emission reduction initiatives	Share of investments in investee companies without carbon emission reduction initiatives aimed at aligning with the Paris Agreement	Quantitative	<input type="radio"/>
	Breakdown of energy consumption by type of non-renewable sources of energy	Share of energy from nonrenewable sources used by investee companies broken down by each nonrenewable energy source	Quantitative	<input type="radio"/>
Water, waste and material emissions	Water usage and recycling	Average amount of water consumed and reclaimed by the investee companies (in cubic meters) per million EUR of revenue of investee companies	Quantitative	<input type="radio"/>
		Weighted average percentage of water recycled and reused by investee companies	Quantitative	<input type="radio"/>
	Investments in companies without water management policies	Share of investments in investee companies without water management policies	Quantitative	<input type="radio"/>
	Exposure to areas of high water stress	Share of investments in investee companies with sites located in areas of high water stress without a water management policy	Quantitative	<input type="radio"/>
	Investments in companies producing chemicals	Share of investments in investee companies the activities of which fall under Division 20.2 of Annex I to Regulation (EC) No 1831/2003	Quantitative	<input type="radio"/>

To learn more about ESGTree, visit our website at

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