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Mastering SFDR:

a complete guide to upgrade your funds

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Introduction

Talks about the Sustainable Finance Disclosure Regulation (SFDR) have been going on for over five years. But if you ask around, you will notice that there is still a lot of confusion about what needs to be done. Understandably.

The regulation is complicated and it demands quite a lot of preparation from all types of stakeholders, from 3-people asset management teams to the largest banks in Europe. Comes this guide: we use a pragmatic approach to explain exactly what you need to do in order to comply with SFDR and hopefully thrive in the next years, when demand for sustainable finance readiness will continue to grow.

Who can benefit from this guide

Any FMP whose teams are wrapping their head around SFDR requirements in order to be compliant with the regulation and meet the deadlines.
But also, any FMP who is managing funds under SFDR's Article 6 ("mainstream") and, at any point in time, would like to either launch a new fund under Article 8 or 9 or "upgrade" one of their existing financial products.

Content table:

Basics of SFDR	4
Who SFDR applies to	4
The SFDR timeline	5
The reporting requirements	6
What Articles 6, 8 and 9 really entail	6
How reporting requirements differ between the articles	7
Examples of PAI statement requirements	8
Summary of requirements per entity or financial product	8
Steps for upgrading your fund from Article 6 to Article 8 or 9	9
Benefits of upgrading from Article 6 to Article 8 or 9	9
More resources to prepare for SFDR	10
How Datia can help	10
About Datia	11

Glossary:

EBA: European Banking Authority

EIOPA: European Insurance and Occupational Pensions Authority

ESAs: European Supervisory Authorities (EBA, EIOPA and ESMA)

ESMA: European Securities and Markets Authority

FMPs: Financial Market Participants

PAI: Principal Adverse Impacts

RTS: Regulatory Technical Standards

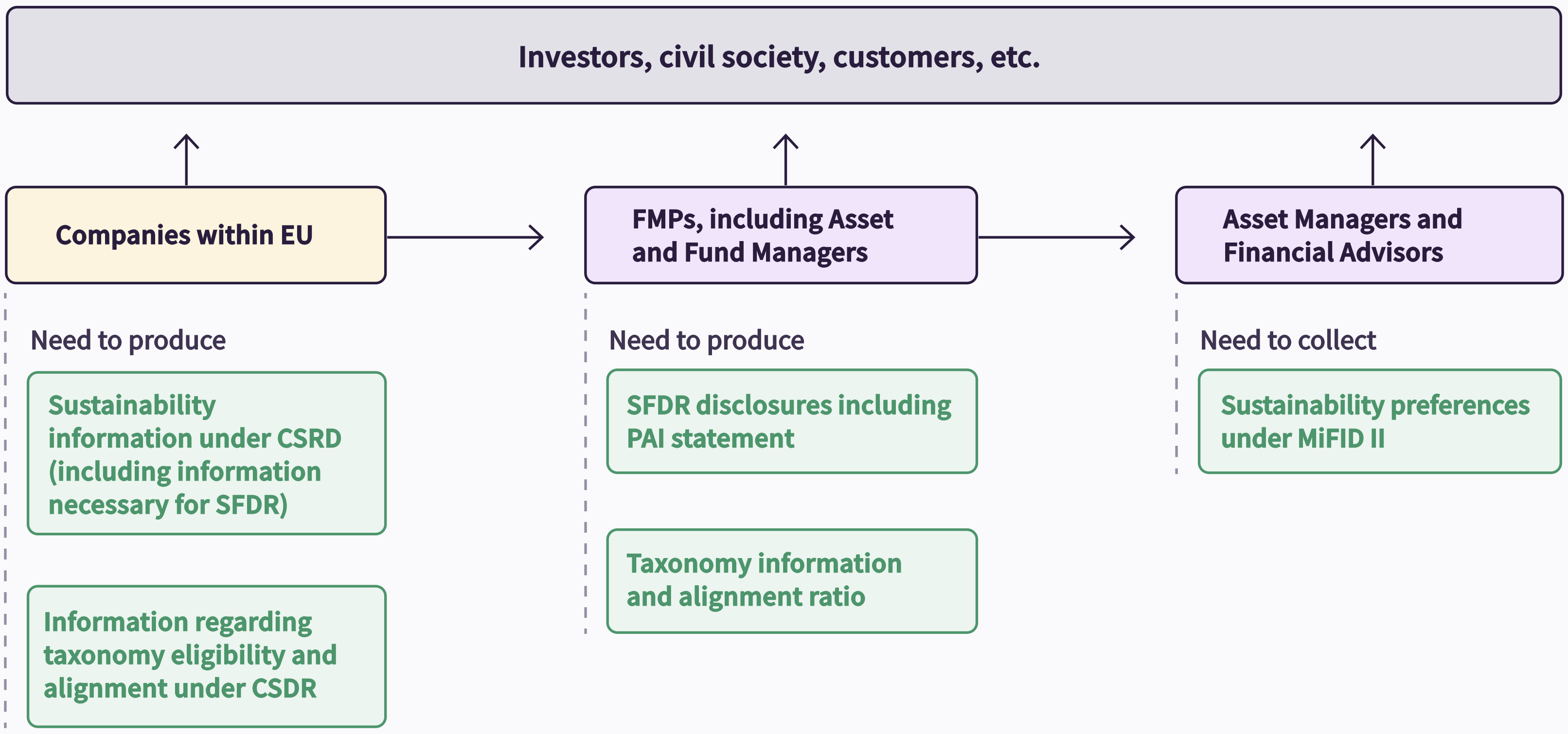
SFDR: Sustainable Finance Disclosure Regulation

Basics of SFDR

SFDR, the disclosure regulation, sustainable finance regulation, etc. The list of ways to call it in our day-to-day work is long. All these nicknames refer to the European regulation called Sustainable Finance Disclosure Regulation, a cornerstone in the EU Green Deal and Sustainable Finance Action Plan.

Similar to many other regulations under these initiatives, the SFDR is a tool to drive transparency in the financial sector by standardizing public reporting regarding financial products and entities, and to ultimately direct capital towards sustainable activities. In symbiosis with other EU regulations, the SFDR is kick-starting big changes in the corporate and financial landscape in the European Union.

How sustainability information will flow in the European market:



Who SFDR applies to

SFDR applies to Financial Market Participants (FMPs) in the European Union, for example:

- investment firms;
- insurance companies;
- asset managers;
- pension funds;
- institutions who offer portfolio management services.

This covers a large share of the financial markets in the EU, enforcing transparency in large parts of the investments space. In addition to the list above, the SFDR also applies to non-EU investment managers or advisors marketing their products to EU customers. This means that SFDR, in addition to affecting EU FMPs directly, will potentially indirectly affect non-EU asset managers and investment firms as well. In other words, the regulation is targeted towards European products and/or services, as opposed to entities.

The SFDR timeline

The SFDR was adopted by the European Union back in 2019. The regulation has then been implemented using a phased approach. These phases are often referred to as Level 1 and Level 2. Each level created additional requirements and/or further clarifications to SFDR through delegated acts, sometimes referred to as Regulatory Technical Standard (RTS).

The Level 2 regulation, or second reference period, came into effect on January 1st 2023. Besides the requirements of the Level 1, this new phase of the regulation expects FMPs to disclose on how they manage sustainability risks and impacts in the investment process.

What exactly does your fund need to do and when:

Jan 1 2022

1st REFERENCE PERIOD (2022)
Gather sustainability data of your investments, following the level 1 RTS. The data collection can be retroactive. Or explain why PAI indicators are not considered*.

Dec 31 2022

Jan 1 2022

2nd REFERENCE PERIOD (2023)
Now Level 2 RTS applies. FMPs are obliged to gather data and publish PAI statements for the second year in a row.

Jun 30 2023

DEADLINE
Publish the PAI statements of the previous reference period (Jan 1 2022 - Dec 31 2022), or an explanation of why PAIs are not considered.

Jun 30 2023

Jun 30 2024

DEADLINE
FMPs must publish the PAI statements of the 2nd reference period (Jan 1 2023 - Dec 31 2023), including comparison between 1st and 2nd periods.

* FMPs bigger than 500 employees are obliged to publish a PAI statement. FMPs with fewer than 500 employees can opt out from publishing a PAI statement, but they need give a public explanation.

The reporting requirements

With the SFDR being a disclosure regulation, *it only requires FMPs to report. I might come as a surprise to many, but that is all SFDR requires*. On paper, no changes need to be made to a firms' pre-existing investment strategy. The idea is not to enforce the entire market to change their investment process towards adopting sustainability or ESG criteria, however some hope that the increased transparency will have exactly that effect through competition in the financial markets.

However, SFDR does enforce a great increase in transparency about how FMPs are currently dealing with sustainable finance. The reporting requirements vary based on which SFDR article the entity or product decides to follow. *The expectations increase in correlation with sustainability claims of the product*.

The SFDR requirements are made to two different levels:

- **Entity level:** Information on Principal Adverse Impacts
- **Product level:** Sustainability information on the pre-contractual disclosures, such as prospectuses, and on the periodic reporting

What Articles 6, 8 and 9 really entail

The articles are often referred to in terms of categorization or labeling of individual financial products. But it actually comes from the regulation itself, and technically refers to disclosure requirements in the pre-contractuals. In summary, each of the articles require the following:

Article 6: Transparency of the integration of sustainability risks (in case of funds that do not promote nor have sustainability as an objective)

Article 8: Transparency of the promotion of environmental or social characteristics in pre-contractual disclosures (in case of funds that promote environmental or social characteristics - sometimes referred to as "light green")

Article 9: Transparency of sustainable investments in pre-contractual disclosures (in case of funds that have sustainable investment as their objective - sometimes referred to as "dark green")

How reporting requirements differ between the articles

The actual title of each article on the regulation already hints what the differences between the articles are. But, below, we will make further clarifications and summarize the reporting requirements:

Website disclosures: Financial Market Participants (FMPs) and financial advisors should maintain relevant and up-to-date information about their sustainability practices on their website. This information should convey how sustainability risks are integrated into the investment or advisory process, for example, through a policy document disclosed on the website. In addition, they should publish information on whether the remuneration policies are consistent with the integration of sustainability risks in the investment process. Products pursuing article 8 or 9 also need to disclose on the environmental or social characteristics (if article 8), or the sustainable objective (if article 9) of the product in line with article 10 in the regulation.

Pre-contractual information: Article 8 and 9 financial products need to include in the pre-contractual information the sustainability profile the product is seeking; the investment strategy of the product; asset allocation (and minimum levels of taxonomy alignment and sustainable investment ratios); whether PAIs are taken into account; and, finally information regarding potential indices used for benchmark. Additional information is also required in respect of products that have the objective of a reduction in carbon emissions (Article 9). Last but not least, information provided in the templates of the SFDR RTS also need to be included.

Periodic reporting: funds under Article 8 and 9 need to include information on how the environmental or social characteristics (Article 8) or sustainable investment objectives (Article 9) were met in their periodic reporting. Similarly to the pre-contractual information, the periodic reporting also need to follow the templates of the SFDR RTS.

Tip: To get an overview of exactly how the pre-contractual and periodic reporting differ between article 8 and 9 products, refer to:

- **The templates provided in the SFDR RTS (annex 2-5)**
- **The updated Level 2 RTS** - latest version available when this guide was published

Statement on Principal Adverse Impacts: All FMPs need to provide information on their website about how they integrate Principal Adverse Impacts (PAI) on their investment decisions. As part of this requirement, FMPs will have to report metrics related to the Principal Adverse Impacts, but also need to publicly state actions taken or planned to improve these metrics. The PAI statement is to be done annually, and the first disclosures should be have been published by June 30th 2023. FMPs with fewer than 500 employees can be exempt from publishing a PAI statement, but they still need to provide a public explanation for this decision.

Examples of PAI statement requirements

FMP with more than 500 employees, ony managing financial products under Article 6

Even if your company does not manage or hold funds under Article 8 or 9, you will still need to publish a PAI statement, including calculations of the PAI indicators on the entity-level, as well as comparison of data points across periods, starting from the PAI statement in reference to 2023.

FMP with fewer than 500 employees, managing financial products under Article 8 and 9

SFDR does not require the entities with fewer than 500 employees to publish a PAI statement. But, given that the entity already put substantial work on the periodic reporting of the Article 8 and 9 financial products, it could be a good idea to also publish a PAI statement on the entity level aggregating the data from all the financial products. It can help your entity position itself as a sustainability-driven actor.

Summary of requirements per entity or financial product

	Entity with **fewer** than 500 Employees	Entity with **more** than 500 Employees	Article 6 Financial Products	Article 8 Financial Products	Article 9 Financial Products
Website disclosure (article 10)	Not applicable	Not applicable	✗	✓	✓
Pre-contractual information	Not applicable	Not applicable	✓	✓	✓
Periodic reporting	Not applicable	Not applicable	✗	✓	✓
PAI statement	✓ with the option to opt-out by providing explanation	✓	Not applicable	Not applicable but is beneficial for marketing purposes	Not applicable but is beneficial for marketing purposes

Steps for “upgrading” your fund from Article 6 to 8 or 9

STEP 1

Adjust your current investment strategy

- Whether the aim is for Article 8 or 9, the investment strategy needs to be adjusted accordingly. This could entail how sustainability risks and impacts are taken into account in the decision making process, putting in place criteria for “do no significant harm”, for example, into place, etc.

STEP 2

Assess the reporting requirements

- SFDR is a disclosure regulation and funds with sustainability claims are expected to provide additional information. As outlined above, the disclosure requirements differ between articles 6, 8 and 9, hence the importance of staying aware and on top of what is expected.

STEP 3

Start working (and re-assess)

- SFDR is still a fairly new regulation, and there are still uncertainties regarding definitions made by the regulation and interpretations by the industry. The group of the three European Supervisory Authorities (EBA, EIOPA and ESMA), simply called ESAs, is providing guidance at a somewhat high frequency, so make sure to always keep an open eye on new developments.

Tip: **follow ESMA’s LinkedIn page to see ESAs updates closely.**

Benefits of upgrading from Article 6 to Article 8 or 9

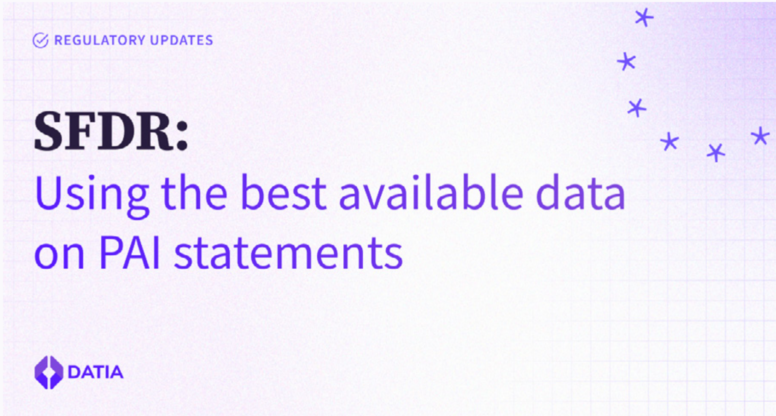
Some of the few good news in these turbulent times highlight the growing investments made on ESG-related financial products. If you are looking for motivation to take the leap and “upgrade” a fund to Article 8 or 9 or start a brand new ESG product, we are listing just a few of the latest reports or news articles highlighting ESG products’ success through 2021 and 2022:

- Article 9 funds were the only ones with a positive net flow of capital in Q2 and Q3 2022, according to a Morningstar
- According to the Financial Times, “ESG products” received 65% of the capital flows into European exchange-traded funds (ETFs), versus 51% in 2021
- ESG UCITs, on average, outperformed non-ESG equivalents in net terms (22.8% vs. 16.8%) in 2021, according to ESMA’s “Costs and Performance of EU Retail Investment Products 2023” report

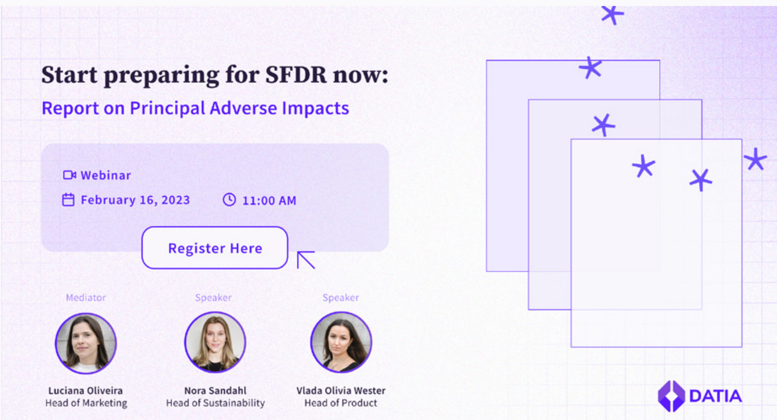
More resources to prepare for SFDR

Read the article:

Read the article:



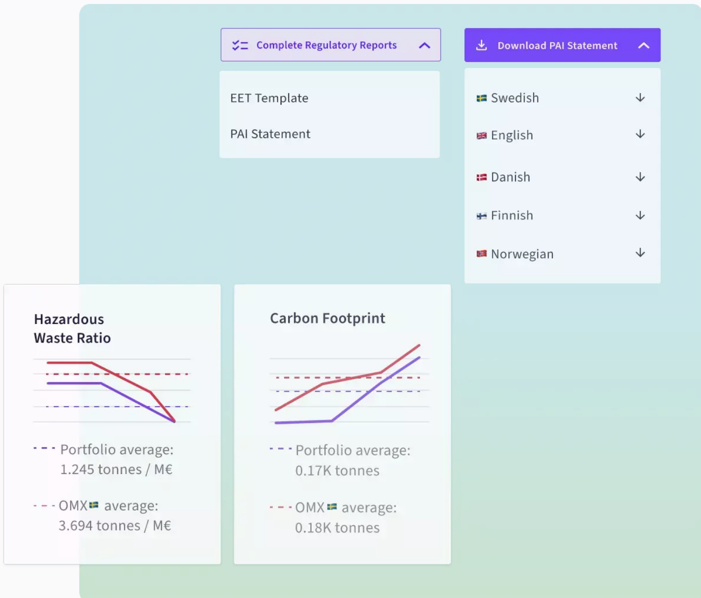
Watch the recorded webinar:



How Datia can help you with SFDR

Datia enables FMPs of any size with data sourcing, analysis, automatic calculations, and reporting.

- PAI indicators from 36,000+ companies, 210,000+ funds, and 210+ sovereign nations (or use your own data)
- Transparent and traceable data (origin, reporting periods, and links)
- Automatic calculations based on portfolio snapshots
- PAI statement ready to download in pdf or editable format, and in multiple languages
- PAI indicators automatically inserted into funds' EET files



About us

Datia is a climate fintech company on a mission to empower investors' transition to sustainable finance, serving asset managers, asset owners, management companies, wealth advisors and tech platforms.

Headquartered in Stockholm, Sweden, Datia has a customer network with over €200+ Billion Asset Under Management (AUM) and works with some of the most reputable investors in the Nordics.

We are trusted by some of the most reputable institutions in Europe

HSBC Life | Söderberg & Partners | SEC | Atlant Fonder

aifm group | FCG | BOREA ASSET MANAGEMENT | WS GRUPPEN

STRAND KAPITALFÖRVALTNING | Placerum KAPITALFÖRVALTNING | PriorNilsson | FONDER | GP.Bullhound

ANTILOOP | Health Invest | DIDNER & GERGE | ALCUR FONDER

atle | humle | GreenGrowth Make your money make change | SPILTAN FONDER

Get started