SFDR Article 3 Disclosure: Integrating Sustainability Risk into Investment Decisions

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Muzinich & Co

Integrating Sustainability Risk into Investment Decisions

What are "Sustainability Risk"?
The Regulation (EU) 2019/2088 ("SFDR") defines a Sustainability Risk 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 the investment"[1]. Muzinich considers this definition to be synonymous with our understanding of ESG risks and we use these terms interchangeably. We believe such risks can have a material impact on the reputation, financial profile, liquidity, and profitability of companies we might invest in, and ultimately on the risk and return of a financial product or portfolio.

How Muzinich considers Sustainability Risk
As an investor in corporate credit, one of our primary concerns is to identify and, where possible, seek to manage and mitigate the negative impacts of Sustainability Risk on the returns of our financial products and services through investment due diligence or research, asset allocation, portfolio management, restrictions or exclusions, and/or ongoing monitoring of, and engagement with entities in which we invest. We seek to assess sustainability issues and potential materiality on a case-by-case basis based on available ESG data. Outside of investment products which have specific ESG scoring thresholds as part of their ESG policy, we do not typically follow a mechanistic or rules-based approach whereby ESG metrics directly impact buy, sell, or weighting decisions on investments.

Sustainability metrics may be sourced by our research teams from company publications and live interactions, from public news, from NGOs, from our ESG data providers, and from other sources, and are integrated into our research notes (for public debt), and investment memorandums (for private debt).

Where our analysts deem Sustainability Risk to be substantial and not adequately reflected in the pricing of an investment, they may recommend avoiding, reducing or selling relevant holdings. Pre- or Post-investment, we may engage with a company to seek its provision of better Sustainability Risk disclosures or to encourage the company to improve their management of those risks as outlined in our "Policy on Engaging Issuers on ESG Matters". Please also see our ESG policy for our "Policy on Integrating ESG and Sustainability Risk into Investment Research".

[1] See Article 2(22) of the SFDR. Available online:
https://eur-lex.europa.eu/eli/reg/2019/2088/oj

Risk warnings: Exclusion Risk: ESG screening can limit the investment opportunities available to a portfolio, such as the exclusion of certain investments for non-financial reasons. As such, a portfolio may underperform other similar portfolios that do not apply ESG screening. ESG Risk: Consideration of Sustainability Risks in the investment process can result in the exclusion of certain investments in a portfolio. Therefore, results may differ, and a portfolio that considers sustainability risks might underperform other similar portfolios that do not consider such risks.

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SFDR - Refers to Regulation (EU) 2019/2088 or the Sustainable Finance Disclosures Regulation (SFDR) a piece of European financial sector regulation which sets out obligations for financial market participants to disclose specific details on their approach to sustainability risks in their investment process and other details on the provenance of ESG claims that are used to market their financial products. Further details on Muzinich's SFDR disclosures are available in relevant product documentation such as fund prospectuses and supplements on our website www.muzinich.com.

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