SFDR Article 4 Disclosure | Firm-level Principal Adverse Impacts Statement

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Muzinich & Co

Principal Adverse Impacts Statement

As part of their investment process, some of the Muzinich-branded funds listed in the "Product-specific ESG Policies of Muzinich-branded Funds" document consider principal adverse impacts of investment decisions on "sustainability factors" ("PAI") as defined in the SFDR. The SFDR explains that PAI factors should be understood as "those impacts of investment decisions and advice that result in negative effects on sustainability factors".

Principal Adverse Impacts are conceptually different from a "sustainability risk" as defined by the SFDR, as the former does not necessarily imply an immediate risk to investment value. However, in practice, we believe that many environmental, social or governance factors may be considered both financially material, and material sustainability factors.

Annex 1 of the Regulatory Technical Standards of the SFDR lists 14 PAI factors which are mandatory to report, plus a further two factors for investors in sovereign and supranational entities, and a further two for real estate investors. In addition, there are a further 46 PAI factors which are considered voluntary for investors to report on however all investors must report on at least one environmental, and one social PAI factor from this 'additional' list.[1]

As a result of clarifications made by the European Supervisory Agencies in 2021 and 2022, Muzinich has reviewed its position on the consideration of PAIs at entity level. While we consider PAIs in relation to certain financial products, most notably to all Muzinich UCITS products currently disclose under Article 8 SFDR, we do not consider PAI factors across the entirety of AuM for which we are responsible. This is primarily for one or more of the following reasons:

- we are a sub-advisor for certain strategies where the investment manager has set their own investment strategy and restrictions and for which the investor has not explicitly requested consideration of PAI factors;
- we manage certain strategies with significant holdings in cash, cash equivalents, credit derivatives, structured finance instruments or illiquid debt instruments for which we do not consider it to be practical to consider PAI factors because is it not possible to source relevant PAI data and/or because we do not perceive there to be a direct or representative link between the investment and the negative impacts of the underlying entity or entities linked to the security (e.g., a hedging instrument linked to a broad index of underlying securities);
- we anticipate that updates to the EU Non-financial Reporting Directive and other related transparency initiatives will drive more comprehensive corporate disclosures on PAI and ESG factors thus facilitating more consideration of PAI factors in a broader range of public and private investment strategies from 2023 onwards.

Prioritizing and Integrating Principal Adverse Impact Factors

At the date of this policy, there are 18 mandatory indicators and a further 46 additional voluntary indicators. While Muzinich believes all mandatory indicators of PAIs to be important, we have chosen to prioritize these indicators based on our ESG philosophy and practical considerations such as the availability of data, as shown below in Figure 1.

Muzinich considers indicators of PAIs in relevant investment strategies by integrating them alongside relevant ESG factors and more traditional financial

[1] Further details are available in the SFDR Regulatory Technical Standards Annex I which is available online: https://ec.europa.eu/finance/docs/level-2-measures/C_2022_1931_1_EN_annexe_acte_autonome_part1_v6.pdf

factors as part of its research and due diligence process. In practical terms, Muzinich's research analysts gather relevant information either directly from issuers, from public sources or indirectly from independent ESG data providers and other credible sources.

In order to avoid or reduce PAIs over time, where these are considered material, taking account of the importance of each investment across our overall investment activity, Muzinich may seek to engage with an issuer to manage their impacts better or may reduce an investment or ultimately exclude these companies from further consideration for investment. See "Policy on Engaging Issuers on ESG Matters" for further detail.

For certain Muzinich products, explicit ESG exclusion policies (e.g., for controversial weapons or tobacco), and conduct-based screening (e.g., for gross corruption) also aim to reduce PAIs of our investments. For further details on exclusions for specific Muzinich funds see our "Product-specific ESG Policies of Muzinich-branded Funds" document.

Figure 1: Prioritization of the indicators of PAIs

Mandatory PAI indicators[2]		Muzinich PAI prioritization
Corporate issuers		
Greenhouse gas emissions	**1. Greenhouse gas (GHG) emissions (scope 1, 2, 3 and absolute GHG emissions)**	**High**
	2. Carbon footprint	**High**
	3. GHG intensity of investee companies	**High**
	4. Exposure to activities in the fossil fuel sector	**High**
	5. Non-renewable energy consumption and production	Medium
	6. Energy consumption intensity per high impact climate sector	Medium
Biodiversity	**7. Activities negatively affecting biodiversity-sensitive areas**	**High**
Water	8. Emissions to water	Low
Waste	9. Hazardous waste ratio	Low
Social and employee matters	**10. Violations of UN Global Compact principles and Organization for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises**	**High**
	11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	**High**
	12. Unadjusted gender pay gap	Medium
	13. Board gender diversity	Medium
	14. Exposure to controversial weapons	**High**
Sovereign issuers		
Environmental	15. GHG intensity	Not applicable
Social	16. Investee countries subject to social violations	Not applicable
Real estate investments		
Fossil fuels	17. Exposure to fossil fuels through real estate assets	Not applicable
Energy efficiency	18. Exposure to energy-inefficient real estate assets	Not applicable

[2] The numbers listed in this table align with the number of the PAI indicators listed in Table 1 of Annex 1 of the RTS.

Voluntary PAI indicators		PAI prioritization
Additional climate and other environment-related indicators[3]		
Emissions	4. Investments in companies without carbon emission reduction initiatives	Medium
Energy performance	5. Breakdown of energy consumption by type of non-renewable sources of energy	Medium
Additional indicators for social and employee, respect for human rights, anti-corruption and anti-bribery matters[4]		
Social and employee matters	3. Number of days lost to injuries, accidents, fatalities or illness	Medium
Social and employee matters	6. Insufficient whistleblower protection	Medium
Human rights	**9. Lack of a human rights policy**	**High**
Anti-corruption and anti-bribery policies	**15. Lack of anti-corruption and anti-bribery policies**	**High**

[3] The numbers listed in the following rows align with the number of the PAI indicators listed in Table 2 of Annex 1 of the RTS.

[4] The numbers listed in the following rows align with the number of the PAI indicators listed in Table 3 of Annex 1 of the RTS.

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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