

# Understanding ESG Investing and SFDR Classifications



**BLACKTOWER**  
FINANCIAL MANAGEMENT GROUP

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## 1. Introduction to Sustainable Investing

Sustainable investing integrates Environmental, Social, and Governance (ESG) factors into the investment process. ESG investments aim to deliver financial returns while contributing to positive societal and environmental outcomes.

Environmental, Social, and Governance (ESG) factors are increasingly important in the investment landscape. This guide aims to provide clear explanations of ESG classifications under Articles 6, 8, and 9 of the Sustainable Finance Disclosure Regulation (SFDR), and their implications for investment products.

Additionally, it will incorporate Principal Adverse Impact (PAI) indicators to support clients in making informed investment decisions.

When fund managers (acting on behalf of the investors investing in their funds) are deciding which companies to invest in they may search out and include companies based on their ESG characteristics.

**Environmental factors** refer to how companies are performing in their stewardship of the environment, for example:

- Carbon footprint
- Energy consumption
- Greenhouse gas emissions

**Social factors** consider how companies manage relationships with employees, suppliers, customers, and the areas where they operate, for example:

- Human rights and social justice
- Working conditions and employee relations
- Health and safety standards

**Governance factors** focus on company leadership. For example:

- Board diversity, structure and pay
- Avoidance of bribery and corruption
- Management & culture

ESG investing offers the potential to invest in ways that reflect the values that are important to you through using investment solutions that aim to take related ESG characteristics into account.

ESG investing may be referred to by other terms such as socially responsible investing, sustainable investing, impact investing, or value-based investing.

**This guide has been created to empower you to make informed choices by:**

- Clarifying how investment products are classified under EU sustainable finance rules
- Explaining key ESG-related risks and Principal Adverse Impacts (PAIs)
- Helping you align your financial goals with your personal sustainability values

## 2. Overview of Regulatory Frameworks

- SFDR (Sustainable Finance Disclosure Regulation): Requires financial market participants to disclose how they integrate ESG risks and impacts in investment decisions.
- MiFID II (Markets in Financial Instruments Directive II): Mandates consideration of ESG preference in client suitability assessments.
- EU Taxonomy: A classification system for environmentally sustainable economic activities.

The SFDR classifies investment products into three categories based on their ESG characteristics			
Article	Classification	Definition	Implications
Article 6	Non-ESG Focused	Investment products that do not integrate ESG factors into their investment process.	These products are not required to disclose ESG-related information. Investors should be aware that these products may not consider sustainability risks.
Article 8	ESG – Integrated (“Light Green”)	Investment products that promote environmental or social characteristics, or a combination of both, provided that the companies in which the investments are made follow good governance practices.	These products must disclose how they integrate ESG factors into their investment process. Investors can expect these products to consider sustainability risks and opportunities.
Article 9	Sustainable Investments (“Dark Green”)	Investment products that have sustainable investment as their objective. These products aim to contribute to environmental or social objectives.	These products must disclose their sustainable investment objectives and how they achieve them. Investors can expect these products to have a strong focus on sustainability.

### 3. Principal Adverse Impact (PAI) Indicators

PAI indicators are metrics used to measure the negative impact of investment decisions on sustainability factors. These indicators help investors understand the potential adverse effects of their investments on the environment and society.

Example PAI Indicators

Category	Example Indicator	Why It Matters
Climate & Environment	Carbon footprint (total greenhouse gas emissions of the companies in the portfolio)	A lower carbon footprint aligns with efforts to combat climate change.
	Exposure to fossil fuels (e.g., oil, gas, coal)	Shows how much of your investment supports carbon-intensive industries.
Social & Human Rights	Gender diversity on boards	Reflects commitment to inclusive and equitable corporate governance.
	Violations of UN Global Compact principles (e.g., labour rights, anti-corruption)	Helps avoid supporting companies with unethical or illegal practices.
Biodiversity & Water	Impact on biodiversity-sensitive areas	Indicates whether companies may be harming endangered ecosystems.
Governance	Board member remuneration linked to sustainability performance	Encourages long-term thinking and alignment with ESG targets.

**Note:** Not all investment products consider PAIs equally. Some (especially Article 9 funds) may fully integrate them, while others (like Article 6) may not.

#### How Are PAIs Used in Your Investments?

While large asset managers must report on PAIs by law, your personal preference also plays a key role. You may choose to invest only in products that:

- Actively reduce adverse impacts (PAI-conscious), or
- Disclose and explain their PAI performance, even if they do not fully eliminate harm.

#### Making Informed Investment Decisions

To make informed investment decisions, clients should:

- Understand ESG Classifications: Know the differences between Articles 6, 8, and 9 products.
- Evaluate PAI Indicators: Assess the potential adverse impacts of investments. (review disclosures published by fund managers on how PAIs are considered).
- Consider Personal Values: Align investments with personal sustainability goals.

The Company does not manufacture financial products. Sustainability-related information is derived from disclosures provided by product manufacturers in accordance with applicable regulations and is used as part of our suitability assessment.

### 4. EU Taxonomy: What It Means for Your Investments

The EU Taxonomy is a classification system that defines which economic activities are considered environmentally sustainable.

It focuses on six key environmental objectives, including climate change mitigation and adaptation, water protection, and biodiversity.

Investments aligned with the EU Taxonomy contribute substantially to these goals and comply with strict technical screening criteria.

#### 5. How to Decide Your ESG Preferences – A Step-by-Step Guide

**Step 1:** Decide if you want ESG factors (Environmental, Social, and Governance) considered in your investments.

**Step 2:** Choose the level of sustainability focus by selecting SFDR product types:

- Article 6: No ESG focus
- Article 8: Promotes ESG characteristics
- Article 9: Has a sustainable investment objective

**Step 3:** Consider Principal Adverse Impacts (PAIs). Would you prefer to avoid investments with negative effects on climate, society, or governance?

**Step 4:** Identify industries or sectors you'd like to exclude (e.g., tobacco, fossil fuels).

**Step 5:** Share your sustainability preferences with your advisor to ensure your investments reflect your values.

**If you wish to invest in products that are aligned with the EU Taxonomy, please indicate this in your suitability questionnaire or consult your advisor.**

## The development of ESG investing

The United Nations (UN) agenda for sustainable development has been one of the driving forces behind the concept of ESG investing. The UN sustainable development goals (SDGs) are 17 high level goals to transform the world by 2030. They cover a broad range of issues such as quality education, decent work and economic growth, climate action, affordable and clean energy and good health and well-being.



These goals are inevitably feeding through to businesses and the investments landscape. Some fund managers refer directly to relevant SDGs as a way of explaining how the companies they invest in contribute to these goals. You can read more about the UN SDGs at: [www.un.org](http://www.un.org)