

Novadvice alternative Investments

Transparency factors on sustainability

September 2022

Introduction

NovEta GP S.à r.l. (the “AIFM”) is a registered alternative investment manager pursuant to Article 3 of the Law dated 12 July 2013 relating to alternative investment fund managers, as amended from time to time (the “AIFM Law”).

The present document purports to fulfil the requirements (the “Requirements”) of Article 3 and 4 of Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (“SFDR”):

- *“Financial market participants shall publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process.”*
- *“Financial market participants shall publish and maintain on their websites: (i) where they consider principal adverse impacts of investment decisions on sustainability factors, a statement on due diligence policies with respect to those impacts, taking due account of their size, the nature and scale of their activities and the types of financial products they make available; or (ii) where they do not consider adverse impacts of investment decisions on sustainability factors, clear reasons for why they do not do so, including, where relevant, information as to whether and when they intend to consider such adverse impacts.”*

Integration of sustainability risks in the investment decision process

Definition

Sustainable finance covers investments taking into account Environmental, Social or Governance (“ESG”) considerations. Impact finance is subset of sustainable finance, investing with the intention to generate a measurable, beneficial social or environmental impact alongside a financial return.

A sustainability risk is an uncertain social, governance or environmental issue or condition that, if it occurs, may positively or negatively affect a company’s/issuer’s revenues, costs, cash flows, value of assets and or/liabilities:

- environmental issues relate to the quality, durability and functioning of the natural environment and natural system such as, but not limited to, climate, carbon emissions, deforestation, environmental regulations, water stress and waste;
- social issues relate to the rights, well-being and interests of people and communities such as labour management, employee’s relation and health and safety; and
- governance issues relate to the management and oversight of companies and other investee entities such as board, ownership and pay.

Impacts on investments

Even though sustainability is a critical component of investments, in particular in relation to real estate and private equity, integrated into the AIFM’s investment decision-making, applying ESG criteria to the investment process may exclude the consideration of certain assets (for non-financial investment reasons) and therefore of some market opportunities available to the funds under management.

Additionally, despite the strong development of sustainable finance observed in the recent years, the lack of reliable data and of a standardized approach to assess sustainability represent a strong challenge for ESG monitoring. The lack of harmonized definitions may also potentially result in certain investments not benefitting from preferential tax treatments or credits because sustainable criteria are assessed differently than initially thought. Investors should note that the subjective value that they may or may not assign to certain types of ESG criteria may differ substantially from the AIFM’s methodology.

Besides, several Member States are implementing national standards and financial product labels based on market-based classification systems, which may lead to market fragmentation and confuse investors with sustainability preferences. Furthermore, differences between national standards and labels may hinder cross-border sustainable investments. Lastly, the risk of greenwashing may challenge the confidence of investors and provide unfair competitive advantage to financial actors engaged in those practices.

However, there is increasing evidence that sustainable investment can both preserve and increase asset value. In addition, investments in ESG funds will create environmental and social value by, for example, preserving the environment (reducing gas emissions, recycling, reconditioning of electronic waste, creating new technologies with an ecological purpose, etc.), innovating in labor protection and sound governance, reducing cost (e.g. installing more energy-efficient equipment) and liabilities (as better

consideration of ESG risks reduces the chance of unforeseen litigation). Failure to actively deal with these risks will not only delay global efforts to address the climate challenge but will also damage long-term returns and threaten economic sustainability.

Implementation

Finally, further to the sustainability risk assessment at the level of the funds under management, the AIFM considers sustainability risks assessment as a mean of identifying investment opportunities, managing and monitoring investment risk, and therefore integrate this assessment in their investment decisions as early as in their due diligence processes in order to maximize the long-term risk-adjusted return.

Indeed, sustainability risks are ESG factors that pose a material risk to the value of the investment. When deciding whether ESG data are material for a particular investment, the AIFM shall evaluate the relevance of the information and the likely impact on the financial return of the investment in the context of the particular fund's investment strategy. Indeed, even if the fund concerned does not pursue or promote ESG objectives for the moment nor has sustainable investments' objectives, it remains exposed to sustainability risks.

Though it may occasionally and partially invest in assets that have an ESG objective or sustainable investment objective, the sustainability risks shall still be managed in accordance with the risks assessment methods and procedures of the asset class, without specifically being considered as sustainability risks.

Indeed, the AIFM further considers that as the legal and regulatory framework governing sustainable finance is still under development, sustainability risks assessment methods and procedures may be developed over time alongside the evolution of the investment objective, in light of the evolving legal and regulatory framework.

In cases where the AIFM is keeping internally the portfolio management function for a fund under management, a pre-due diligence will usually be performed by an investment advisor or investment committee which shall provide the AIFM with specific analysis which will be part of the investment decision making process. The final due diligence and investment decision will remain the prerogative of the AIFM. Investment proposals will be duly assessed against regulatory and legal requirements before their approval by the AIFM which shall request that sustainability risk assessment is part of the pre-due diligences provided by potential investment advisors or the funds' investment committees (for the funds for which sustainability risks are relevant).

In cases where the AIFM is delegating the portfolio management function for a fund under management, the external portfolio manager is responsible for the investment decision process and pre-trade analysis of the investments concerned. The AIFM will perform appropriate ongoing due diligence on the work performed by the portfolio manager with regards to the investment decision taken and will consider if the portfolio manager considered appropriately sustainability risks in his decision (for the funds for which sustainability risks are relevant).

Consideration of principal adverse impact

In conformity with SFDR, AIFMs are expected to comply with a series of sustainability-related disclosure requirements.

In this regard, considering:

- no funds under management have sustainable investments as investment objective and/or promotes ESG factors;
- that certain funds under management may try to incorporate sustainability factors to their investment strategy;

the AIFM states for the time being, not to consider principal adverse impacts ("PAI"). PAI are defined as adverse effects on sustainability of the investment decision and/or the investment advice.

The approach to ESG and sustainable investments of the funds under management may evolve and develop over time.