Climate Change Addendum to Arcmont's Responsible Investment Policy

Arcmont Asset Management Limited

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Introduction and Background

Climate change is a systemic risk that poses a threat to the planet, society and the global economy. As global temperatures continue to rise, the adverse impacts of climate change continue to increase in severity and frequency. In recognition of this, a variety of efforts have emerged around the world to limit global warming.

The landmark Paris Agreement was signed in 2015, formally committing developed and emerging economies to strengthen their response to the threat of climate change. The agreement's long-term goal is to substantially reduce the widespread adverse consequences of climate change by keeping the increase in global average temperature well below 2°C (3.6°F) above pre-industrial levels, with the ambition of staying under 1.5°C (2.7°F). The agreement has prompted governments around the world to take action to achieve Net Zero by 2050 or sooner, calling on businesses to mitigate and adapt to climate change to ensure an orderly transition to a Net Zero economy.

Arcmont supports the Paris Agreement and recognises the urgent need to transition to a Net Zero economy. Accordingly, Arcmont is committed to adapting the firm's business operations and investment practices to support the transition as well as promoting more responsible behaviour with regards to climate change through stewardship activities.

This document outlines the extent and process of how Arcmont identifies, assesses and manages climate change in the investment process. It is supplementary to Arcmont's Responsible Investment Policy, specifically highlighting how climate factors are considered at every stage of the deal lifecycle as well as how climate-related information is communicated to stakeholders. Note that assessing, managing and communicating climate risks are evolving practices, however, Arcmont is committed to staying well informed and to adopting what it believes to be industry best practices.

Climate Change as a Material Investment Risk

Material climate factors are those with a substantial impact on the current and future financial, economic, reputational and legal prospects of an issuer, security, investment or asset class. Note that the materiality of climate factors varies across companies, sectors, regions, asset classes and through time.

Note that the generally capped upside of Private Debt investments post-closing means Arcmont's focus is drawn to the potential downside risks that may lead to a default. This generally means that the firm prioritises climate factors that may be drivers of risk as opposed to sources of opportunity.

Please see overleaf definitions and examples of material climate-related risks as detailed in the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

Climate-Related Risks		Potential Financial Impacts
Physical Risks	**Acute** – Increased severity of extreme weather events such as cyclones and floods **Chronic** – Changes in precipitation patterns and extreme variability in weather patterns – Rising mean temperatures – Rising sea levels	– Reduced revenue from decreased production capacity (e.g., transport difficulties, supply chain interruptions) – Reduced revenue and higher costs from negative impacts on workforce (e.g., health, safety, absenteeism) – Write-offs and early retirement of existing assets (e.g., damage to property and assets in "high-risk" locations) – Increased operating costs (e.g., inadequate water supply for hydroelectric plants or to cool nuclear and fossil fuel plants) – Increased capital costs (e.g., damage to facilities) – Reduced revenues from lower sales/output – Increased insurance premiums and potential for reduced availability of insurance on assets in "high-risk" locations
Transition Risks	**Policy and Legal**	
	– Increased pricing of greenhouse gas (GHG) emissions – Enhanced GHG emissions reporting obligations – Mandates on and regulation of existing products and services – Exposure to litigation	– Increased operating costs (e.g., higher compliance costs, increased insurance premiums) – Write-offs, asset impairment, and early retirement of existing assets due to policy changes – Increased costs and/or reduced demand for products and services resulting from fines and judgments
	Technology	
	– Substitution of existing products and services with lower emissions options – Unsuccessful investment in new technologies – Costs to transition to lower emissions technology	– Write-offs and early retirement of existing asset – Reduced demand for products and services – Research and development (R&D) expenditures in new and alternative technologies – Capital investments in technology development – Costs to adopt/deploy new practices and processes
	Market	
	– Changing customer behaviour – Uncertainty in market signals – Increased cost of raw materials	– Reduced demand for goods and services due to shifts in consumer preferences – Increased production costs due to changing input prices (e.g., energy, water) and output requirements (e.g., waste treatment) – Abrupt and unexpected shifts in energy costs – Change in revenue mix and sources, resulting in decreased revenues – Re-pricing of assets (e.g., fossil fuel reserves, land valuations, securities valuations)
	Reputation	
	– Shifts in consumer preferences – Stigmatization of sector – Increased stakeholder concern or negative stakeholder feedback	– Reduced revenue from decreased demand for goods/services – Reduced revenue from decreased production capacity (e.g., delayed planning approvals, supply chain interruptions) – Reduced revenue from negative impacts on workforce management and planning (e.g., employee attraction and retention) – Reduction in capital availability

Integrating Climate Considerations into the Investment Process

Climate risk identification, assessment and management are core components of Arcmont's responsible investment process. Further details on how climate risks are considered at every stage of Arcmont's investment process are provided below.

1. Negative Screening

ESG Exclusions Policy

The first step in Arcmont's responsible investment process is to screen investments against an ESG exclusions policy. Arcmont seeks to avoid investments that contribute extensively to climate change, specifically prohibiting investment in companies engaged in certain heavy emitting activities as well as those that violate the UN Global Compact (UNGC) principles, three of which relate to environmental protection.

Climate Spotlight: Direct Lending ESG Exclusions Policy

Please see below a summary of the climate-related exclusions applicable to Arcmont's Direct Lending vehicles.

Climate-Related Excluded Activity	Exclusion Type
Violation of UNGC Principles: – #7: Businesses should support a precautionary approach to environmental challenges; and – #8: Undertake initiatives to promote greater environmental responsibility; and – #9: Encourage the development and diffusion of environmentally friendly technologies.	Absolute Exclusion
Thermal Coal	Revenue Threshold – Greater than 5%
Oil/Tar Sands	Revenue Threshold – Greater than 5%

RepRisk Screening

At this stage, Arcmont also utilises RepRisk to source additional information on ESG risk incidents and controversies. RepRisk specifically screens companies for 'climate change', 'GHG emissions' and 'global pollution'. This information is used to bolster Arcmont's pre-investment screening, ESG due diligence and ongoing climate risk monitoring efforts.

2. ESG Due Diligence

Arcmont's Universe of ESG Issues

'Climate Risk (Physical)', 'Climate Risk (Regulatory)', 'Climate Risk (Transitional)', and 'Energy Management', are specific climate-related factors in Arcmont's Universe of ESG Issues, a bespoke resource that captures the most relevant and material ESG factors for the companies in Arcmont's investable universe[1]. All of the issues listed in the proprietary tool are systematically considered when assessing and monitoring investments.

[1] Note that for the purpose of Arcmont's Universe of ESG Issues, Arcmont has adopted the Climate Risk categorisation as proposed in the Sustainability Accounting Standards Board's (SASB) Climate Risk Bulletin which in comparison to TCFD considers regulatory climate risks as separate (but related) from transitional climate risks.

ESG Materiality Assessment and ESG Risk Score

Arcmont has developed a bespoke ESG Appendix Generator together with sustainability experts to identify and assess material ESG risks. The Appendix includes all the risks in Arcmont's Universe of ESG Issues tool.

(a) Identifying Potential Material ESG Risks

By selecting an investment's industry classifications (i.e. MSCI's Global Industry Classification Standard (GICS)[2] and SASB's Sustainable Industry Classification System (SICS)[3]), the Generator will highlight potential material ESG risks leveraging MSCI and SASB materiality matrices, SASB's Climate Risk Technical Bulletin and Arcmont's bespoke GICS mapping tool as well as other sources.

Climate Spotlight: SASB Climate Risk Technical Bulletin

The SASB Climate Risk Technical Bulletin breaks down climate risks into three categories that can ultimately impact corporate financial performance: (1) physical effects, (2) transition to a low-carbon and resilient economy and (3) regulatory risk and provides the climate risk categories that each SASB industry is impacted by. Where the Bulletin indicates that a company is potentially exposed to a specific climate risk category based on its SASB industry, the deal team is required to assess the company's exposure to and management of the climate risk.

Climate Spotlight: Mandatory Assessment of Specific Climate Factors

As Arcmont is acutely sensitive to climate change, the Appendix considers 'Climate Risk (Regulatory)' and 'Energy Management' to be material for every company regardless of industry, thus mandating the deal team to assess each company's exposure to and management of each risk.

(b) Assessing Material ESG Risks

Where an ESG risk is deemed to be material by the ESG Appendix Generator, corresponding questions are shown for the deal team to answer. The questions consider a company's business activities, geographic location and other pertinent factors that were determined by Arcmont's ESG consultant, dss+. This helps the deal team determine whether the suggested risk is material for the business in question and ensures a systematic evaluation of ESG factors during due diligence.

Climate Spotlight: GHG Emissions Assessment

- When assessing a prospective investment's exposure to GHG emissions, factors such as scale and location of operations will be considered, as well as any existing or incoming climate-related regulations in the areas of operation.
- When assessing a prospective investment's management of GHG emissions, the deal team will look at whether the company is currently measuring, reporting and ultimately taking steps to reduce their GHG emissions and energy consumption. An assessment of whether the company has set a Net Zero target that is aligned with the latest climate science will also be considered.
- Where quantitative data is available, the deal team will collect and document it.

(c) ESG Risk Score

Next, prospective investments receive a rating along each pillar of 'E', 'S' and 'G', according to their potential negative financial impact on the investment. These are then aggregated to form an overall ESG Risk Score. The score ranges from +6 (Very Low Risk) to -6 (Very High Risk). Arcmont has a policy not to invest in a company with a score of less than -3 (High Risk). If a company is highly exposed to climate risks and the risks are not sufficiently managed, it will be reflected in the score.

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[2] MSCI GICS
[3] SASB SICS

(d) Independent Review

Once the deal team has completed and documented the ESG materiality assessment and score, the materials are sent to Arcmont's ESG consultant for an independent review before being finalised and documented in the Final Investment Memorandum (FIM).

3. Final Investment Decision

The relevant Investment Committee considers the information in the FIM, including material climate-related risks, when making an investment decision.

4. Deal Approval Committee

The Deal Approval Committee considers the information in the FIM, including material climate-related risks, when approving an investment.

5. Engagement (Stewardship)

As further explained in Arcmont's Responsible Investment Policy, Arcmont primary engages with borrowers via sustainability-linked margin ratchets[4].

Climate Spotlight: Promoting Climate Change Mitigation

At the time of implementation in April 2021, Arcmont endeavoured to create a bespoke plan for every participating borrower, targeting a specific material environmental and/or social issue a borrower faced, based on the results of the pre-investment ESG due diligence. However, in July 2022, in support of the transition to a Net Zero economy, the programme was revised to specifically target borrowers' climate change mitigation practices. Arcmont now endeavours to include a climate-related KPI in every ratchet and has a specific focus on encouraging borrowers to set and achieve science-based GHG emissions reduction targets.

Note that the Institutional Investors Group on Climate Change (IIGCC) recently endorsed sustainability-linked margin ratchets as a key tool for Private Debt managers to engage with portfolio companies on climate risk management and decarbonisation in its Net Zero Investment Framework for the Private Debt Industry.

6. Monitoring

As further explained in Arcmont's Responsible Investment Policy, a formal quarterly ESG review takes place where the deal teams and portfolio companies' management teams discuss the material ESG risks, including material climate-related risks.

Climate Spotlight: Climate Monitoring

If climate-related data is available, the deal team will collect it and monitor the company's performance over time. Further, if a company has a GHG emissions reduction strategy or has set a Net Zero target, the deal team will monitor the company's progress towards meeting any targets set. Based on these monitoring updates, the overall ESG Risk Score of every portfolio company is reviewed and updated when necessary. This is documented and then sent to Arcmont's ESG consultant to review before being finalised.

Portfolio companies with sustainability-linked margin ratchets are required to submit annual performance data. For the majority of ratchets, this includes verified GHG emissions data.

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[4] Arcmont has a policy to offer a sustainability-linked margin ratchet to every (i) new primary borrower since April 2021 and (ii) existing primary borrower who is provided additional financing after April 2021. Note that ratchets are voluntary, and borrowers elect to participate.

7. Reporting

Arcmont is committed to providing investors and stakeholders with climate-related information.

Climate Spotlight: Climate Reporting

(a) Product-Level Reporting

- **Quarterly ESG Reports:** detail every portfolio company's material risk exposure and risk management practices[5]. This includes their exposure to and management of material climate risks, including 'Climate Risk (Physical)', 'Climate Risk (Transitional)', 'Climate Risk (Regulatory)', and 'Energy Management', as well as climate-related data, if available.
- **Annual ESG data reports:** The reports cover a wide range of environmental and social metrics, including GHG emissions and energy consumption data.

(b) Public Disclosures

- **Annual corporate sustainability report**: climate change has been identified as a material issue for the Firm and therefore is reported on in detail each year.
- **UN PRI transparency report**: questions relating to climate change are required to be answered in the assessment.
- **Annual entity level TCFD report**: the report details how Arcmont takes climate-related matters into account in managing and administering investments on behalf of clients.

[5] Subject to obligations of confidentiality under the relevant legal documents.

Climate Change Governance

Climate factors are considered under the 'E' pillar of Arcmont's ESG-integrated investment process. Arcmont's ESG Committee is therefore responsible for ensuring climate risks are effectively managed in the investment process.

Further, Arcmont operates a four-tiered approach to the day-to-day implementation of its ESG-related policies, including this document. It is therefore the Investment team who is responsible for implementing them on a day-to-day basis. The Investment team is supported by the Responsible Investing team, the ESG Committee as well as Arcmont's ESG consultant, dss+.

Please refer to the Governance section in Arcmont's Responsible Investment Policy, for further details on the ESG Committee as well as Arcmont's four-tiered approach.

External Climate-Related Initiatives

Arcmont is committed to working with others to promote the transition to a low-carbon economy. Accordingly, the firm and members of the firm participate in initiatives as summarised below.

Initiative	Status
UN PRI	Firm is a signatory
IIGCC Private Debt Industry Focus Group	COO is a member

Fund-Level Net Zero Targets

Arcmont has not yet set fund-level Net Zero targets. Until the IIGCC published its Net Zero Investment Framework for the Private Debt Industry[6] in 2024, which Arcmont contributed to, there was limited Private Debt-specific Net Zero guidance available. The guidance establishes an industry-wide approach for measuring progress towards Net Zero targets and aims to ensure that Private Debt asset owners and asset managers align their portfolios with Net Zero emissions by 2050, if not before. Arcmont plans to use this guidance to set a Net Zero commitment once it has been finalised.

Contact Details

For further details on Arcmont's climate risk management approach, please contact ESG@arcmont.com.

[6] IIGCC: Net Zero Investment Framework for the Private Debt Industry