Arcmont
ASSET MANAGEMENT

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 to 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, the firm is committed to adapting its business operations and investment practices to support the transition as well as promoting more responsible behaviour with regards to climate change through its engagement 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 change is considered at every step of the investment process 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 are widely considered to be industry best practices.

Climate Change as an Investment Risk

Climate change can affect the financial performance of companies over the near, medium and long term, thus can impact portfolio companies' risk and return profiles.

Note that the limited upside potential 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.

Material Climate Risks

Financially material climate risks are those that may significantly influence a company's financial performance. Please see below examples of climate-related risks and potentially material financial impacts as detailed in the Recommendations of the Task Force on Climate-related Financial Disclosures. Note that the materiality of climate risks (i.e., level of exposure and impact) differ by sector, industry, geography and organisation.

<table>
<tr><th colspan="2">Climate-Related Risks</th><th>Potential Financial Impacts</th></tr>
<tr><td rowspan="4">Physical Risks</td><td>Acute</td><td rowspan="4">– 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</td></tr>
<tr><td>– Increased severity of extreme weather events such as cyclones and floods</td></tr>
<tr><td>Chronic</td></tr>
<tr><td>– Changes in precipitation patterns and extreme variability in weather patterns
– Rising mean temperatures
– Rising sea levels</td></tr>
<tr><td rowspan="10">Transition Risks</td><td colspan="2">Policy and Legal</td></tr>
<tr><td>– Increased pricing of GHG emissions
– Enhanced GHG emissions reporting obligations
– Mandates on and regulation of existing products and services
– Exposure to litigation</td><td>– 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</td></tr>
<tr><td colspan="2">Technology</td></tr>
<tr><td>– Substitution of existing products and services with lower emissions options
– Unsuccessful investment in new technologies
– Costs to transition to lower emissions technology</td><td>– 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</td></tr>
<tr><td colspan="2">Market</td></tr>
<tr><td>– Changing customer behaviour
– Uncertainty in market signals
– Increased cost of raw materials</td><td>– 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)</td></tr>
<tr><td colspan="2">Reputation</td></tr>
<tr><td>– Shifts in consumer preferences
– Stigmatization of sector
– Increased stakeholder concern or negative stakeholder feedback</td><td>– 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</td></tr>
</table>

Integrating Climate Considerations into the Investment Process

Climate risk identification, assessment and management are core components of Arcmont's ESG-integrated investment process. Below we draw out and provide further details on how climate risks are considered at every stage of the investment process.

1. ESG Negative Screening

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.

Please see below a summary of the specific climate-related exclusions. Please refer to Arcmont's ESG Exclusions Policy for further details on each exclusion.

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%

2. ESG Due Diligence

Arcmont's Universe of ESG Issues

'Climate Risk', 'Greenhouse Gas Emissions' and 'Energy Management' are specific factors in Arcmont's Universe of ESG Issues, a bespoke resource that captures the most relevant and most material ESG factors for the companies in Arcmont's investable universe. All of the issues listed in the proprietary tool are systematically considered for every prospective investment at the due diligence stage of the investment process, as described below.

ESG Materiality Assessment and ESG Investment Impact Score

As part of the ESG materiality assessment, every prospective investment is assessed for financially material climate, greenhouse gas emissions and energy management risks. Where these risks are deemed to be financially material, they are factored into the investment's ESG Investment Impact Score.

(A) Climate Risk

A qualitative assessment of climate risk is performed using the Sustainability Accounting Standards Board's (SASB) Climate Risk Technical Bulletin as a guideline. The Bulletin breaks down climate risks into three categories that can ultimately impact corporate financial performance: (1) physical effects, (2) transition to a low-carbon, 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 exposed to a specific climate risk category based on its SASB industry, the investment team are required to assess the borrower's exposure to and management of the risk.

(B) Greenhouse Gas Emissions and Energy Management

The investment team are required to assess every borrower's exposure to and management of greenhouse gas emissions and energy management. When assessing a borrower's exposure, 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 borrower's management of these issues, the team will look at whether the borrower is currently measuring, reporting and ultimately taking steps to reduce their greenhouse gas emissions and energy consumption. Where quantitative data is available, the deal team will collect and document it.

The above analysis is embedded within Arcmont's due diligence process, and the results of this assessment are recorded in every investment memorandum. This ensures that the Investment Committee and Deal Approval Committee can consider climate-related risk exposure when making their respective decisions.

3. ESG Engagement

Climate change is a systemic risk affecting every business. It is therefore relevant, core and material to every company. With increasing climate-related regulations coming into force and increasing public awareness of a company's contribution to climate change, it is critical that every company assesses, measures, and mitigates its contribution to climate change.

Arcmont is committed to engaging with portfolio companies to encourage them to improve their ESG profiles, with a particular focus on encouraging borrowers to improve their climate change mitigation approach. Accordingly, Arcmont seeks to promote climate change mitigation through its engagement activities.

Arcmont engages with portfolio companies via two avenues as shown below. The avenue used will depend on the structure of an investment. Please refer to Arcmont's Responsible Investment Policy for further details of each engagement method.

Engagement Method	Details	Investment Structure
Sustainability-linked margin ratchet	Margin discounts offered to borrowers who meet sustainability performance targets centred around a climate change mitigation key performance indicator	– Debt only; and – Debt and a minority[1] equity positions.
Tailored ESG engagement plan	Performance gaps identified and sustainability performance targets are set for specific key performance indicators which will include at least one relating to climate change mitigation	– Debt and significant[2] equity position; and – Majority equity owner following a restructuring.

Metrics and Targets

Arcmont employs a materiality-first approach when selecting climate change mitigation key performance indicators for borrowers, focusing on the issues that will have the most significant impact

[1] Arcmont holds, in aggregate, less than 20% of the equity.
[2] Arcmont holds, in aggregate, 20% or more of the equity.

based on the results of the pre-investment ESG due diligence. Therefore, the key performance indicators selected for engagements will vary for each portfolio company depending on their individual characteristics. Below we provide examples of such key performance indicators:

- Absolute Scope 1 greenhouse gas emissions
- Absolute Scope 2 greenhouse gas emissions
- Absolute Scope 3 greenhouse gas emissions
- Total absolute greenhouse gas emissions
- Greenhouse gas emissions intensity
- Renewable energy ratio

Note that Arcmont prioritises key performance indicators that are aligned with the Sustainable Finance Disclosure Regulation's (SFDR) principal adverse impact indicators. Arcmont also leverages the guidance provided by the Sustainability-Linked Loan Principles to the extent possible when designing engagements.

4. ESG Monitoring

Climate risks are monitored as part of Arcmont's standard ESG monitoring process as described in the firm's Responsible Investment Policy. If climate-related data is available, the deal team will collect it and monitor the company's performance over time. If performance does not improve, the deal team will engage to determine the reason why. This is particularly relevant for greenhouse gas emissions performance data. Further, if a company has a greenhouse gas emissions reduction strategy or has set a net zero target, the deal team will monitor the company's progress towards meeting any targets set.

5. ESG Reporting

Product Level Reporting

The product level quarterly ESG reports contain details on every portfolio company's material risk exposure and risk management practices. This includes their exposure to and management of greenhouse gas emissions and energy management and may include climate risk if deemed material for the business. Further, where climate-related data is available, it will be disclosed in the reports.

For financial year 2022 and on an annual basis thereafter, Arcmont will provide investors with greenhouse gas emissions data for every portfolio company. In the absence of actual reported data, Arcmont will provide proxy estimates.

Public Disclosures

Arcmont intends to publish a Task Force on Climate-Related Financial Disclosures (TCFD) appendix within its 2022 Sustainability Report to provide readers with information on the anticipated impacts of climate change on Arcmont and the steps the firm is taking to address them.

Further, as a signatory of the UN Principles for Responsible Investment (PRI), Arcmont is required to submit an annual Transparency Report to the initiative which has a specific Climate Change module (ISP 26-33) that will also provide further insight into Arcmont's approach. The Transparency Reports will be publicly available on the PRI website.

Climate Change Governance

Climate change factors are considered under the 'E' pillar of Arcmont's ESG-integrated investment process. Arcmont's ESG Committee is therefore ultimately 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 policies, including this document. It is therefore the investment team who are responsible for implementing them on a day-to-day basis and are supported by the Portfolio Monitoring team, the ESG Committee as well as Arcmont's external ESG consultant.

Please refer to the *Responsible Investment 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 a number of initiatives as summarised below.

Initiative	Status
UN Principles for Responsible Investment	Firm is a signatory
Task Force on Climate-Related Financial Disclosures	Firm is a supporter
2021 Global Investor Statement to Governments on the Climate Crisis	Firm is a signatory
UN Global Compact Principles	Firm is exploring becoming a participant
Net Zero Asset Managers initiative	Firm is exploring becoming a participant

Fund Level Net Zero Targets

Net zero target setting is on the rise across the globe, largely driven by enabling regulatory environments. This is no different in the finance sector. While Arcmont fully supports the objectives of net zero targets, there is currently limited guidance available for Private Debt managers specifically. Without adequate guidance, there is uncertainty in the market over how lenders should define and commit to net zero targets. Nonetheless, Arcmont is determined to find an authentic pathway to set net zero targets at the fund level and is in discussions with a number of relevant industry bodies to understand the most practicable approach.

Contact Details

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

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