



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 significant threats to the planet, society, and the global economy. In support of the Paris Agreement and the global ambition to achieve Net Zero by 2050 or sooner, Arcmont Asset Management (“Arcmont”) is committed to integrating climate considerations into its investment practices and stewardship activities. This Climate Change Addendum (the “Addendum”) supplements Arcmont’s Responsible Investment Policy, outlining how climate factors are identified, assessed, and managed throughout the Direct Lending investment process¹. The Addendum is reviewed annually by the ESG Committee.

Climate Governance

Climate factors are considered under the ‘E’ pillar of Arcmont’s ESG-integrated investment process. The ESG Committee is responsible for the oversight of climate matters, with operational support from the Responsible Investing team. The Investment team is responsible for day-to-day integration of climate factors into the investment process, with ongoing support and independent review provided by the Responsible Investing team and the ESG Consultant. For further details, refer to the ‘Governance’ section of the Responsible Investment Policy².

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, or asset class. The materiality of climate factors varies across companies, sectors, regions, asset classes, and over time. Given the generally capped upside of Private Debt investments, Arcmont prioritises climate factors that may be drivers of downside risks, particularly those that could lead to default. Please refer to Appendix 1 for definitions and examples of material climate-related risks as detailed in the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)³.

¹ Direct Lending transactions involve the provision of lending solutions through the origination and underwriting of senior secured and subordinated loans, including equity components associated with such loans, to European medium-sized businesses.

² Available on the Arcmont website.

³ [Recommendations of the Task Force on Climate-Related Financial Disclosures](#).

Integrating Climate Considerations into the Direct Lending Investment Process

Climate risk identification, assessment and management are embedded at each stage of Arcmont's Direct Lending investment process, as outlined below.

1. Negative Screening

(a) ESG Exclusions Policy

The first step in Arcmont's Direct Lending responsible investment process is to screen prospective companies 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 and those that violate the UN Global Compact (UNGC) principles, three of which relate to environmental protection, as shown below.

Excluded Activity	Exclusion Type
Violation of UNGC Principles: - #7: Businesses should support a precautionary approach to environmental challenges. - #8: Undertake initiatives to promote greater environmental responsibility. - #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%

(b) RepRisk/Controversy Screening

Prospective investments are also be screened for risk incidents/controversies prior to the initial investment decision and any follow-on investment. As part of this, all investments are screened for climate-related controversies, including 'climate change', 'GHG emissions', and 'global pollution', using RepRisk, which compliments desk-based research.

2. Due Diligence

Every prospective investment undergoes an ESG materiality assessment and is assigned an ESG Risk Score. Further details on each element of this process can be found in the Responsible Investment Policy⁴.

(a) 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 list. All of the issues listed are systematically considered when assessing and monitoring investments.

⁴ Available on the Arcmont website.

(b) ESG Appendix Generator

The ESG Appendix Generator, developed with the ESG Consultant, systematically identifies and assess material ESG risks, including climate risks. Based on a company's industry classifications, specifically MSCI's Global Industry Classification Standard (GICS)⁵ and SASB's Sustainable Industry Classification System (SICS)⁶, the ESG Appendix will highlight potential material ESG risks leveraging a range of sources, including SASB materiality matrices and the SASB Climate Risk Technical Bulletin⁷.

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 SICS industry is impacted by. Where the Bulletin indicates that a company is potentially exposed to a specific climate risk category, the deal team is required to assess the company's exposure to and management of the risk.

Climate Spotlight: Mandatory Assessment of Specific Climate Factors

Recognising the potential financial impact of regulatory climate risks, particularly in Europe, the Appendix considers 'Climate Risk (Regulatory)' 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.

(c) ESG Risk Score

Climate factors are considered under the 'E' pillar of the ESG Risk Score, which quantifies the likelihood of a negative financial impact on the investment due to ESG risks. If a company is highly exposed to climate risks and the risks are not sufficiently managed, it will be reflected in the score. Arcmont does not invest in companies with a score below -3 (High Risk).

(d) UN Sustainable Development Goal (SDG) Alignment Assessment

Each company's products and services are screened for potential contributions to the UN SDGs, including UN SDG 13 (Climate Action).

⁵ [MSCI GICS](#)

⁶ [SASB SICS](#)

⁷ [SASB Climate Risk Technical Bulletin](#)

(e) Independent Review

The ESG Consultant independently reviews the ESG materiality assessment, which includes an assessment of material ESG risks, and ESG Risk Score before being finalised.

3. Final Investment Decision

The relevant investment committee reviews the Final Investment Memorandum (FIM) prior to making an investment decision. This memorandum includes the results of the ESG materiality assessment, specifically covering material climate-related risks where relevant, and the ESG Risk Score. This ensures that material climate factors are systematically considered as part of the overall investment decision-making process.

4. Deal Approval Committee

All Direct Lending transactions must also be approved by the Deal Approval Committee. The Committee reviews the FIM as well as a checklist covering legal, tax, compliance, and ESG matters, including climate-related issues. A member of the Responsible Investing team must sign off on each transaction from an ESG perspective.

5. Engagement (Stewardship)

Arcmont primarily engages with portfolio companies through sustainability-linked margin ratchets, which financially incentivise improved management of material ESG risks⁸.

At the time of implementation in April 2021, Arcmont developed bespoke plans for each participating borrower, targeting specific material environmental and/or social issues identified during pre-investment ESG due diligence. In July 2022, to further support the transition to a Net Zero economy, the programme was revised to specifically target borrowers' climate change mitigation practices. Arcmont now seeks to include a climate-related KPI in every ratchet, with a particular focus on encouraging borrowers to set and achieve science-based greenhouse gas (GHG) emissions reduction targets.

Note that the Institutional Investors Group on Climate Change (IIGCC) has endorsed sustainability-linked margin ratchets as a key tool for Private Debt managers to engage with portfolio companies on climate risk management and decarbonisation, as outlined in its Net Zero Investment Framework for the Private Debt Industry⁹.

⁸ 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 the take up of the offer of a ratchet is voluntary, and borrowers elect to participate

⁹ [Net Zero Investment Framework for the Private Debt Industry](#)

6. Monitoring

A formal quarterly ESG review is conducted for each investment, with updates made to the ESG materiality assessment and ESG Risk Score as necessary. The ESG Consultant independently reviews these updates before being finalised.

Climate Spotlight: Climate Monitoring

Arcmont seeks to collect and monitor GHG emissions data for every portfolio company. Arcmont also tracks whether portfolio companies report GHG emissions in line with the GHG protocol¹⁰ and have set net term or Net Zero science-based targets. This approach ensures comprehensive oversight of climate-related performance and supports ongoing engagement with portfolio companies on their climate transition.

7. Reporting

Arcmont provides comprehensive ESG information to stakeholders, including climate-related disclosures. In addition to the reports highlighted below, Arcmont seeks to provide investors with product-level climate-related data.

Climate Spotlight: Climate Reporting

- Product-Level Quarterly ESG Reports: These reports detail each portfolio company's material risk exposure and risk management practices, including their exposure to and management of material climate risks such as 'Climate Risk (Physical)', 'Climate Risk (Transitional)', 'Climate Risk (Regulatory)', and 'Energy Management'.
- Annual Entity Level TCFD report: details how Arcmont takes climate-related matters into account in managing and administering investments on behalf of clients.

Contact Details

For further information on Arcmont's responsible investment approach, please contact ESG@arcmont.com.

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¹⁰ [GHG Protocol](#)

Appendix 1: Definitions and Examples of Material Climate-Related Risks

Climate-Related Risks		Potential Financial Impacts
Physical Risks	Acute - Increased severity of extreme weather events such as cyclones and floods	- 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)
	Chronic - Increased severity of extreme weather events such as cyclones and floods	- 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 - Shifts in consumer preferences - Stigmatization of sector - Increased stakeholder concern or negative stakeholder feedback	- 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