OUR PRIVATE ASSETS APPROACH TO FOSSIL FUELS

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Schroders capital

Contents

Schroders Capital is a leading private markets investor, focused on delivering sustainable investment performance for its institutional and private clients. Our institutional approach provides access to category-leading, specialised investment teams globally across four business segments; real estate, infrastructure, private equity and private debt & credit alternatives, with two transversal capabilities of 'Solutions' and 'Sustainability & Impact'.

With the resources, experience, and global institutional framework of one of the world's leading asset managers, we're dedicated to helping our clients achieve their investment goals.

Our philosophy

Sustainability and Impact is a defining characteristic of Schroders Capital and we believe that as a private markets investor we have responsibility to assess alignment of our portfolio to net zero. The investments we make are typically illiquid and made over long time horizons by this means as investors we are fully exposed, particularly within the short- and medium-term to both transition and physical risks relating to climate. Within fossil fuels, one of the greatest risks will be regulatory and market changes that create an increased risk of stranded assets.

Given opportunities for early exit may be limited, we seek to invest in assets that either already meet our climate-related expectations or ones that we believe demonstrate a willingness to improve or already on a pathway to do so; as active investors, we believe that engagement is a key investment tool. The distinct characteristics of private assets investment strategies, typically longer investment horizons combined with the provision of capital for tangible assets, provide a greater ability to operate and enhance our assets.

Our approach to fossil fuels involves assessing the management of climate-related risks and opportunities and alignment to net zero across the investment lifecycle and proactively engaging with key stakeholders through our active selection, management and monitoring of assets to capture the right investment opportunities.

We recognise, both, that these risks may not be evenly realised across the globe and that the transition will have social implications and so have formulated our approach with this in mind. The Just Transition[1] is an important consideration for Schroders Capital, particularly given our involvement and impact in developing markets. We consider the three dimensions of the Energy Trilemma[2] when defining our approach to fossil fuels: energy security, energy equity, or economics (accessibility and affordability) and environmental sustainability (the transition towards mitigating and avoiding potential environmental harm and climate change impacts). These are in addition to social considerations linked to the energy sector (e.g. impacts on the job market, transfer of skills). In places this has created a distinction between OECD[3] and non-OECD nations, largely to avoid transitional impacts on energy security and equity.

1 The Just Transition is the principle of mitigating the socio-economic impacts of a transition on all stakeholders and areas of society. For more detail, see https://www.schroders.com/en/insights/economics/what-isthe-just-transition-and-why-does-it-matter-for-investors/.
2 See World Energy Trilemma index, https://www.worldenergy.org/transition-toolkit/world-energy-trilemma-index.
3 OECD nations are largely defined as countries that have extensive economic infrastructure and participate directly in OECD, whereas non-OECD nations are those considered as developing or modernising economies.

Scope

Application of our fossil fuels approach is multifaceted:

1. The first is the Environmental, Social, Governance Policy at the Schroders Group level[4]

2. The second, detailed below, is the expectations of the fossil fuels industry that covers all Schroders Capital's directly managed investments*

3. The third and fourth levels apply to specific business areas of Schroders Capital and can be at both business or strategy level, depending on asset class specific, product classification and investment principles

New investments

The purpose of this document is to introduce a point of analysis that aligns the broader decarbonisation goals of Schroders Capital with the focused intent of the invested capital. It is in this capacity that we see the best opportunity to apply thoughtfulness, purpose, and influence during the investment selection and due diligence process. Given that Schroders Capital strives to be at the forefront of investment and improvement, it is contemplated that capital could be allocated explicitly for green initiatives and/or to help companies transition their fossil fuels policies.

Schroders Capital's expectations of the fossil fuels industry, in its entirety, covers all financial instruments issued by companies or specific assets. In principle this applies to all portfolios under Schroders Capital. The approach applies to Schroders Capital and all entities trading under Schroders Capital along with BlueOrchard with some limitations as indicated below.

* Examples of our investable universe where defining a fossil fuels approach is limited includes:

- Externally Managed Funds (e.g. private equity primary funds and third party real estate solutions)
- Tenants within debt and direct real estate portfolios
- Financial instruments where underlying recipient is unknown or decisions not within our control (CMBS, RMBS, ABS, CLOs, ILS, Private CRE lending[5])
- Listed Securities (through leverage loans)

Externally managed funds are not within our direct control in terms of the investments made. We attempt to align our externally managed funds with our own fossil fuels approach, largely through the use of side letters with our GPs to understand their fossil fuels approach and current exposure.

Within our direct and debt real estate portfolios we have control over tenants, unlike with private CRE lending, but we are unable to assess all tenants for fossil fuels exposure on the basis of data availability relating to fossil fuels exposure across all tenants. We attempt to align as much as possible our real estate tenants with our fossil fuels approach through tenant screening with the sources of data available to us.

Where we invest in developing markets financial institutions, the investee companies may have exposure to fossil fuels but we ensure that our use of proceeds are not contributing to these investments and/or lending. These financial institutions are significant in enabling developing markets to scale their decarbonisation efforts. Overall, we strive to align our investments to enable decarbonisation or societal improvements through our proceeds.

Whilst ILS has a limited ability to define an approach, given the nature of the business, i.e., predominantly providing protection against natural catastrophes to re/insurance companies on whose portfolio composition ILS managers don't have any influence and whose ultimate beneficiaries information is not always known. Nevertheless, ILS excludes transaction sponsors[6] if involved in fossil fuels extraction, production, and power generation, using the Carbon Underground 200 list to assess this exposure.

Existing investments

For investments we currently hold, we may look to methods of escalation where available and seek to apply them in cases deemed appropriate. Methods of escalation can include limiting future funding, voicing concerns, and exercise voting rights where possible. This is assessed on a case-by-case basis, and we may see investments out to their end term where deemed appropriate.

The above exclusions also apply to existing investments.*

Fossil fuels categories

Coal is a major contributor to atmospheric greenhouse gas emissions and companies directly exposed to that fuel face growing social and political pressures as a result. The IPCC Special 1.5C Report[7] (2018) stated that global coal emissions needed to peak in 2020 and OECD nations should end coal use entirely by 2030.

Since 2022, Schroders Capital has aligned to the Group's coal policy[8]. The policy is to exclude companies which generate more than 20% of revenue from thermal coal mining and is applied to all funds directly managed by Schroders. It includes all companies globally, aside from those with a corporate domicile or primary listing in Indonesia for which the same criteria will apply from 1 January 2026.

Alongside thermal coal mining, the IPCC Special 1.5C Report also stated that global coal use in electricity generation must fall by 80% below 2010 levels by 2030 and all coal-fired power stations must be shut by 2040 at the latest to keep in line with limiting 1.5C. Schroders Capital recognises the vital role and expanding demand for electricity through the electrification of industries and remaining role thermal coal power production has within many developing countries and even its current involvement within renewable energy supply chains: electricity supply for raw materials for example.

Unconventional oil and gas encompass oil sands, and activities within the Arctic Monitoring and Assessment Programme (excluding Norwegian operations) given the sensitivity of the region to environmental impacts[9]. Unconventional oil and gas are considered more environmentally damaging to produce and generally carry a higher emissions profile compared with conventional oil and gas at extraction and production stage; coupled with wider air pollution and environmental impacts.

4 Environmental, Social Governance Policy for Listed Assets, 2022, https://prod.schroders.com/en/sysglobalassets/global-assets/english/campaign/sustainability/integrity-documents/schroders-esg-policy.pdf.
5 CMBS – Commercial Mortgage-Backed Securities; RMBS – Residential Mortgage-Backed Securities; ABS – Asset-Backed Securities; CLOs – Collateralised Loan Obligations; ILS – Insurance-linked Securities; and CRE (Commercial Real Estate) Lending.
6 Insurance-linked securities ("ILS") are instruments that transfer insurance risks (typically related to natural perils such as earthquakes or hurricanes) in form of a security from a protection buyer (the transaction sponsor, such as re/insurance companies) to a protection seller (e.g., pension funds or other institutional investors). The security is typically issued by a fronting/transforming company, also called special purpose vehicle ("SPV"). The SPV sits between the protection buyer and the protection seller.
7 Special Report, Global Warming of 1.5C, 2018 – https://www.ipcc.ch/sr15/.
8 Environmental, Social Governance Policy for Listed Assets, 2022, https://prod.schroders.com/en/sysglobalassets/global-assets/english/campaign/sustainability/integrity-documents/schroders-esg-policy.pdf.
9 Arctic Monitoring and Assessment Programme: https://www.amap.no.

Categories

Thermal Coal Mining	In 2023, Schroders Capital has developed an approach relating to thermal coal mining for private assets, given our potential direct exposure to energy-related assets through long-term investments. Our specific view relating to thermal coal mining is as follows: – No direct investment in new thermal coal extraction and production infrastructure and no financing to companies that are developing new or expanding their thermal coal extraction or production. Expanding capacity is defined as the overall increase in metric tons extracted year-on-year – Other services linked to the thermal mining industry; processing, inventory and storage are engaged with to understand their long-term strategy towards net zero and the majority are not investable on the basis of the inability to diversify or transition – Services linked to mining safety remain investible on the basis they provide a key social service. Services include land remediation, tailings stabilisation and water ingress – Engagement with companies involved in the transportation of thermal coal mining (rail, port or ship) to understand their current level of exposure. We expect companies with above 10% revenue from thermal coal mining to have an exit strategy to diversify their revenue base across numerous industries – Our phase out expectations and strategy planning are 2030 for OECD nations and 2040 for non-OECD nations
Thermal Coal Power Generation	Our approach to thermal coal power generation focuses on commitments to transition power generation assets in efforts to achieve net zero. Our approach relating to thermal coal power generation is as follows: – No direct investment in new thermal coal power generation infrastructure and no financing to companies that are expanding their capacity of coal power generation – Engagement with companies with existing thermal coal power generation assets to understand and develop decarbonisation and exit strategies by 2030 for OECD nations and 2040 for non-OECD nations – We allow for <5% of annual power generated from thermal coal without an exit strategy where it is not used consistently throughout the year and is held strategically as a backup power source
Unconventional Oil and Gas	Our approach to fossil fuels at present only examines the unconventional oil and gas extraction and production industry* of the wider oil and gas value chain. Our approach relating to unconventional oil and gas is as follows: – No direct investment in unconventional oil and gas extraction and production infrastructure and no financing to companies developing new or expanding their unconventional oil and gas extraction and production – Engagement with companies involved in the extraction, production, refining, equipment and services of unconventional oil and gas to understand current exposure. The expectation is where revenue is above 10%, an exit strategy or decarbonisation strategy needs to be in place (by 2030 for OECD nations and 2040 for non-OECD nations) – Engagement with other value chain components including transportation, storage, distribution and retail is undertaken to understand exposure, given the difficulty in distinguishing the use of unconventional vs conventional oil and gas within these areas

*we define unconventional oil and gas as encompassing oil sands and activities within the Arctic Monitoring Assessment Programme (excluding Norwegian operations) for this document's purposes

Future revisions

Other areas of oil and gas remain out of scope within the document given the lack of market consensus on the current phase out dates required for conventional oil and gas and the country level nuances. Oil's significant usage within transportation and industry and natural gas's significance in the energy transition, particularly within certain regions are key considerations. At present, we commit to review our approach with regards to the wider oil and gas industry by 2025.

We set phase out dates for thermal coal and unconventional oil and gas according to current scenarios such as IPCC, IEA, to align to a 1.5C pathway. There is a general agreement across scenarios for the phase out dates required by developed and developing nations for thermal coal. Policymakers and Schroders Capital remain aspirational in achieving the global goal of keeping global temperatures below a 1.5C warming.

In 2025 and later dates we will re-examine the likelihood of achieving 1.5C, dimensions of the power generation market, and level of transition that has taken place to re-calculate the feasibility of the phase-out dates for thermal coal power generation considering all three aspects of the energy trilemma (energy equity, environmental and security). Our phase-out dates will only be re-adjusted where there is external and industry consensus that these should be extended due to market conditions.

Monitoring

The monitoring of these activities sits within each of the Schroders Capital's businesses and predominately forms part of their origination phase of the investment lifecycle; albeit some exposure can also be realised within the pre-investment due diligence phase. Each business will approach this exposure screening in a nature specific to their investment process and asset class, using third-party providers where suitable.

Pre-due diligence:
Preliminary screening occurs to ensure the avoidance of specific sectors and/or activities

Due diligence:
For most of our businesses, the assessment of fossil fuels exposure takes place specifically within the due diligence phase; integrated within the due diligence checklist and/or ESG scorecard. Each investment team carries out this analysis as part of the wider ESG due diligence process. Across a variety of financing types, information sourcing may come through different means: speaking directly with management, engaging with GPs, evaluating a lead sponsor, and analysing the specific business or asset itself

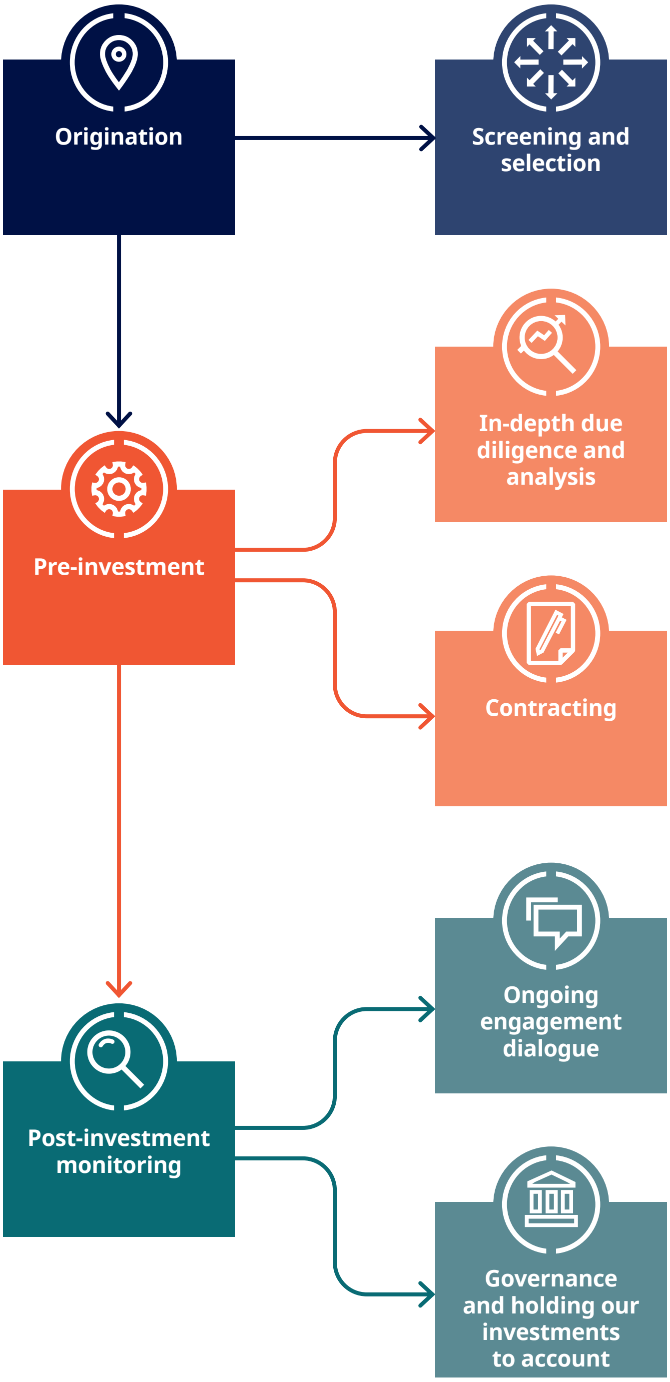
Investment decision:
Whereby an exposure is identified, the investment will be denied

Ownership phase:
Throughout the holding period, the investment team will monitor the ESG actions and evolution of the investment for example using ESG KPIs. During the annual ESG reporting cycle for each investment, the monitoring of continued adherence to the approach will take place

Extensive lists of companies exposures are harder to acquire for private companies, but where possible, third-party screening lists will also be applied. A quarterly review by the Schroders Capital Sustainability and Impact team will take place to monitor for exposure. Schroders Capital attempts to monitor and screen for fossil fuels to the best of its ability, largely relying on details and data from investees and managers; thereby always leaving an element of risk that this exposure may be unreported. We continue to look at how best to monitor and screen our investments for exposure and will continue to expand our process where improvements are realised.

Engagement

There are several different methods we utilise within Schroders Capital to practice active ownership throughout the investment lifecycle. Whilst it differs by asset class for when and how we may engage throughout the investment lifecycle, we broadly identify key points for engagement:



We consider sustainability and impact from the outset of our investment process. This can include negative, and positive selection criteria such as UN Sustainable Development Goals alignment or high impact or innovation potential and we may make data requests as part of this initial screening.

We often complete sustainability and impact assessment frameworks from the outset of an investment to identify future areas for engagement. They can then be regularly reviewed from thereon after and used to measure and monitor progress during the post-investment monitoring of our investments. Because of the long-term horizons of many of our investments, especially in indirect and buy and hold private debt strategies, it is during the pre-investment and due diligence stage that we often can have the most influence.

In certain private equity and debt strategies, we have the ability to incorporate certain sustainability and impact criteria into deal documentations. We can set out our intent, as well as agreed targets and action plans, including binding commitments which can impact our financial terms, and the renewal of our financing in the future. It is during this stage where in certain asset classes we may begin to engage with wider stakeholders such as service providers around their ESG credentials.

We seek to have regular dialogue with our holdings and stakeholders to understand challenges, communicate our expectations and to discuss progress. The nature of this dialogue differs by asset class and strategies and can be in addition to the regular reporting and monitoring activities. For example, there may be frequent interactions that are more consultative in nature, such as holding training sessions, and some where we are effectively responsible for delivering the Sustainability plan, such as in certain real estate transactions.

Our degree of involvement and influence in the governance in our investments depends on the nature of the investment. Where we have large direct equity investments we may sit on the board of our holding and have voting seats, in others we may have advisory seats.

At Schroders Capital, we commit time and resources to proactively influence behaviour and ensure that the assets we select and invest in are managed in a sustainable way. Active ownership in various guises enables us to understand the fossil fuels exposure and transition efforts of each investment we make, both prior to investment and the ongoing monitoring of this exposure over time.

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