

# PACIFIC ASSET MANAGEMENT

## Integration of Sustainability Risk into Investment Decisions

Policy pursuant to Article 3 of EU Regulation 2019/2088, or Sustainable Finance  
Disclosure Regulation (SFDR)

## Introduction

The EU SFDR defines sustainability risks as an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of an investment. The sustainability risks set out below have been identified by the Pacific Asset Management<sup>1</sup> as being potentially relevant to the investments made by individual funds. The policy affects all investment funds of Pacific Asset Management. The description of the risks below is not exhaustive:

- failure to comply with environmental, social or governance standards resulting in reputational damage causing fall in demand for products and services or loss of business opportunities for a company or industry group,
- changes in laws, regulations or industry norms giving rise to possible fines, sanctions or change in consumer behaviour affecting a company or an entire industry's prospects for growth and development;
- changes in laws or regulations, may generate higher demand for, and thus undue increase in prices of securities of companies perceived as meeting higher ESG standards;
- changes in laws or regulations, may incentivize companies to provide misleading information about their environmental, social or governance standards or activities.
- increase in frequency and intensity of extreme weather events, adverse nature impacts or other physical risks, caused by human-based activities and which may impact financial performance, operational viability, and overall value of companies

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<sup>1</sup> Pacific Asset Management is a trade name of Pacific Capital Partners Limited (Registration Number: 02849777), which is authorised and regulated by the Financial Conduct Authority (FRN 171200).

## **Sustainability risk areas**

Commonly considered sustainability risk factors are split into "Environment, Social, and Governance" (ESG), and relate, among other things, to the following topics:

### *Environment*

- Climate mitigation;
- Adjustment to climate change;
- Protection of biodiversity;
- Sustainable use and protection of water and maritime resources;
- Transition to a circular economy, avoidance of waste, and recycling;
- The avoidance and reduction of environmental pollution;
- Protection of healthy ecosystems;
- Sustainable land use;

### *Social*

- Compliance with recognized labour law standards (no child and forced labour, no discrimination);
- Compliance with employment safety and health protection;
- Appropriate remuneration, fair working conditions, diversity, and training and development opportunities;
- Trade union rights and freedom of assembly;
- Guarantee of adequate product safety, including health protection;
- Application of the same requirements to entities in the supply chain;
- Inclusive projects or consideration of the interests of communities and social minorities;

### *Governance*

- Tax honesty;
- Anti-corruption measures;
- Sustainability management by the board;
- Board remuneration based on sustainability criteria;
- The facilitation of whistle-blowing;
- Employee rights guarantees; and
- Data protection and cyber security.

### *Potential impacts of sustainability risk across asset classes*

The impacts following the occurrence of a sustainability risk may be numerous and vary depending on the specific risk and asset class. In general, where a sustainability risk occurs in respect of an asset, there will be a negative impact on, or entire loss of, its value.

For a corporate, this may be because of damage to its reputation with a consequential fall in demand for its products or services, loss of key personnel, exclusion from potential business opportunities, increased costs of doing business and/or increased cost of capital. A corporate may also suffer the impact of fines and other regulatory sanctions. The time and resources of the corporate's management team may be diverted from furthering its business and be absorbed seeking to deal with the sustainability risk, including changes to business practices and dealing with investigations and litigation. Sustainability risks may also give rise to loss of assets and/or physical loss including damage to real estate and infrastructure. The utility and value of assets held by businesses to which a Fund is exposed may also be adversely impacted by a sustainability risk.

Equity and equity-like instruments such as corporate bonds that are bound to the performance of the company are deemed to be investments that inherently carry the highest level of sustainability risk. The market value of an equity instrument will often be affected by environmental, social or governance events or conditions such as natural disasters, global warming, income inequality, anti-consumerism or malicious governance. The Funds which invest or may invest primarily into equities are considered to have an inherently high level of sustainability risk.

The market value of fixed-rate corporate bonds or other bonds which are not bound to the performance of the investee company, will inherently carry similar sustainability risks. As such instruments are affected by the foreseen solvency of the company, the risks may be somewhat lower than in direct equity instruments and in some cases the longer-term conditions do not affect the solvency to the extent that sudden events do. The Funds which invest primarily into corporate bonds are considered to have an inherently moderate level of sustainability risk.

Government and other sovereign bonds are subject to similar sustainability risks as detailed for equities and corporate bonds. While nations and other sovereign issuers are subject to seemingly sudden events, the underlying conditions are often well-known, understood and already priced in to the market value of such assets. The Funds that invest mostly into government and other sovereign bonds are considered to have an inherently low level of sustainability risk.

Currencies, investments into currencies and the currency effect against the base currency of any Fund, regardless if such risk is hedged or not, shall not be subject to assessment of sustainability risk. The market value fluctuations of currencies are deemed not to be affected by actions of any specific entity where a materiality threshold could be exceeded by a single event or condition.

Investment decisions in bank deposits and ancillary liquid assets will be subject to an assessment of governance events: an inherent part of the analysis for instruments where the market value of the asset is largely bound to a counterparty risk were the

counterparty fails to fulfil its usually contractually or otherwise predetermined obligations.

Investment into diversified indices, other funds or diversified structured products are generally understood to be investments into instruments where any event or condition in one underlying asset is not likely to have a material impact on the investment due to the underlying diversification. The sustainability risks of such instruments are assessed in the manner set out in the relevant Supplement but may generally only be assessed on a high level; for example, where such an instrument primarily holds underlying assets that would be subject to the same conditions or events.

Sustainability risks derived from financial derivative instruments, including but not limited to futures, forwards, options and swaps, will be assessed on the basis of the assets underlying the derivative. Investors shall note that for the purposes of this section, sustainability risk is only assessed from the point of view of negative material impact; material positive impact will not be assessed. Consequently, this means that any derivative instruments (even where not used solely for hedging purposes) which have a negative correlation to their underlying asset e.g. short selling will not be subject to a risk assessment where due to negative correlation a negative impact on the value of the underlying asset would not create a negative impact on the market value of the asset.

### **Systemic consequences of sustainability risks**

Sustainability risks are relevant as both standalone risks, and as cross-cutting risks which manifest through many other risk types which are relevant to the assets of a Fund. For example, the occurrence of a sustainability risk can give rise to financial and business risk, including through a negative impact on the credit worthiness of other businesses. The increasing importance given to sustainability considerations by both businesses and consumers means that the occurrence of a sustainability risk may result in significant reputational damage to affected businesses. The occurrence of a sustainability risk may also give rise to enforcement risk by governments and regulators, and litigation risk.

A sustainability risk may arise and impact a specific investment or may have a broader impact on an economic sector, geographical regions and/or jurisdictions and political regions. Many economic sectors, regions and/or jurisdictions, including those in which a Fund may invest, are currently and/or in the future may be, subject to a general transition to a greener, lower carbon and less polluting economic model. Drivers of this transition include governmental and/or regulatory intervention, evolving consumer preferences and/or the influence of non-governmental organisations and special interest groups.

Laws, regulations and industry norms play a significant role in controlling the impact on sustainability factors of many industries, particularly in respect of environmental and social factors. Any changes in such measures, such as increasingly stringent environmental or health and safety laws, can have a material impact on the operations, costs and profitability of businesses. Further, businesses which are in compliance with current measures may suffer claims, penalties and other liabilities in respect of alleged prior failings. Any of the foregoing may result in a material loss in value of an investment linked to such businesses.

Further, certain industries face considerable scrutiny from regulatory authorities, non-governmental organisations and special interest groups in respect of their impact on sustainability factors, such as compliance with minimum wage or living wage requirements and working conditions for personnel in the supply chain. The influence of such authorities, organizations and groups along with the public attention they may bring can cause affected industries to make material changes to their business practices which can increase costs and result in a material negative impact on the profitability of businesses. Such external influence can also materially impact the consumer demand for a business's products and services which may result in a material loss in value of an investment linked to such businesses.

Sectors, regions, businesses and technologies which are carbon-intensive, higher polluting or otherwise cause a material adverse impact on sustainability factors may suffer from a significant fall in demand and/or obsolescence, resulting in stranded assets the value of which is significantly reduced or entirely lost ahead of their anticipated useful life. Attempts by sectors, regions, businesses and technologies to adapt to reduce their impact on sustainability factors may not be successful, may result in significant costs being incurred, and future ongoing profitability may be materially reduced.

In the event that a sustainability risk arises this may cause investors, including Pacific, in respect of a Fund to determine that a particular investment is no longer suitable and to divest of it (or not make an investment in it), further exacerbating the downward pressure on the value of the investment.

Sustainability risks can lead to a significant deterioration in the financial profile, profitability or reputation of an underlying investment and thus may materially impact its market price or liquidity.

## **Identifying sustainability risks**

Assessment of sustainability risks can be complex and require subjective judgement, which may be based on data, which is difficult to obtain, incomplete, estimated, out of date or otherwise materially inaccurate. Even when identified, there can be no guarantee that the methodology and models used to analyse the data/information will correctly assess the impact of sustainability risks on the Fund's investments.

There can be no assurance that Pacific Asset Management can successfully mitigate against all sustainability risks across a Fund. To the extent that a sustainability risk occurs or occurs in a manner that is not anticipated by Pacific Asset Management, there may be a sudden, material negative impact on the value of an investment, and hence on the Net Asset Value of the Fund. Such negative impact may result in an entire loss of value of the relevant investment(s) and may have an equivalent negative impact on the Net Asset Value of the Fund.

## **Integration of Sustainability Risk into Investment Decisions**

Pacific Asset Management holds the following beliefs relating to sustainable investing:

- Sustainability issues are sources of long-term risk and return, therefore considering sustainability risks as outlined above leads to better analyses and investment decisions;
- The execution of ownership rights may increase performance and lower risk over time; accordingly, in selecting investments for each Fund, the Investment Pacific Asset Management will seek to encourage good governance through its voting in respect of such ownership right with the belief that this should produce higher risk-adjusted returns over the long term;
- Sustainability risk and governance information and data may be sourced from in house analysis, from direct engagement and interaction with underlying funds, companies, governments and other issuers, and from third parties; and
- Integrating and assessing sustainability risk enhances the quality of investment processes as sustainability issues, when poorly managed, will create long-term material adverse impacts for society, the environment and undermine investment returns.

Further details in relation to the approach taken by each individual Fund regarding the integration of sustainability risk into investment decisions is set out on Pacific Asset Management's responsible investment webpage and their subsequent fund supplements.

## Integration of sustainability-risk by Sub-Investment Managers of Pacific Capital Partners

Investment Manager	Approach to the Integration of Sustainability Risks in investment decisions
<p><b>Guinness Asset Management Limited</b></p>	<p>The management of sustainability risk forms an important part of the due diligence process implemented by Guinness Asset Management Limited (“Guinness AM”).</p> <p>When assessing the sustainability risk associated with underlying investments, Guinness AM assesses the risk that the value of such underlying investments could be materially negatively impacted by environmental, social or governance factors.</p> <p>Using both quantitative and qualitative processes, sustainability risk is identified, monitored and managed by Guinness AM as follows.</p> <p>Prior to acquiring investments, Guinness AM uses ESG research from proprietary analysis and/or from third party data providers (“Data Providers”) in order to assess the relevant investment against sustainability risks. This process incorporates applying both an exclusion policy (further details of which are available from Guinness AM) whereby potential investments are removed from the investment universe on the basis that they pose too great a risk on sustainability, ethical or other grounds or based on the view of Guinness AM (for example, cluster munitions) and assessment of sustainability risks and opportunities.</p> <p>During the life of the investment, sustainability risk is monitored through review of ESG factors to determine whether the level of sustainability risk has changed materially since the initial assessment has been conducted. The sustainability risk associated with a particular investment is taken into consideration when Guinness AM considers changing the Fund’s exposure to the relevant investment, taking into account the best interests of the Shareholders.</p>
<p><b>Threadneedle Asset Management Limited</b></p>	<p>Threadneedle Asset Management Limited (“Threadneedle”) considers a range of sustainability related risks in the investment decision-making process, to the extent that it is possible to do so, by incorporating an issuer’s responsible investment practices and risks in the research available for the portfolio management team. This research is systematically incorporated into Threadneedle’s ratings and tools, for use by the portfolio management team when considering investment</p>

	<p>objectives, risk, and the implications for ongoing monitoring of holdings.</p> <p>Responsible investment factors considered by Threadneedle’s research analysts and personnel include assessment of exposure to – as well as management of – ESG risks including those relating to climate change, and instances of involvement in operational controversies. For example, when evaluating an issuer’s overall exposure to climate risk, research personnel may consider the implications of an issuer’s transition away from carbon-intensive activities and its ability to adapt accordingly, as well as the issuer’s potential exposure to the physical risks of climate change, arising from its operations, supply chain or market risks. Issuer-level analysis focuses on material, industry relevant ESG factors, offering the Sub-Investment Manager insight into the quality of a business, as well as its leadership, focus and operating standards assessed through an ESG lens. The Sub-Investment Manager incorporates this and other external research into ESG ratings and reports via tools it has developed for that purpose and utilizes such information when making investment decisions.</p> <p>Further, as applicable, Threadneedle’s research considers any flags around issuers’ operations in accordance with international standards such as the UN Global Compact, the International Labour Organisation core labour standards and the UN Guiding Principles for Business and Human Rights. These factors may provide insight into the effectiveness of the risk management oversight of an issuer’s sustainability practices and external impacts.</p> <p>Threadneedle may also seek to manage sustainability risks and impacts of an issuer through its stewardship efforts, and where appropriate, through its exercise of proxy voting rights. In accordance with applicable law, portfolio management and responsible investment analysts may determine to engage an issuer in dialogue regarding its sustainability risk management practices.</p>
<p><b>Fulcrum Asset Management LLP</b></p>	<p>Fulcrum Asset Management LLP (“Fulcrum”) seeks to integrate responsible investment practices in its investment process when investing in companies and Underlying Funds by considering several environmental, social and governance indicators. This includes investing in companies that have good corporate sustainability practices in place, treat employees fairly and have good governance as well as considering the ESG policy and approach of Underlying Funds. The Fund’s exposure to companies generating significant revenues from certain sectors will be limited which, as at the date of the Prospectus includes but is not limited to tobacco, controversial weapons and predatory lending. When investing in Underlying Funds, Fulcrum will seek to</p>

	<p>achieve diversity across the Fund in terms of location, gender diversity, experience, decision making and resources. Fulcrum will also assess certain carbon metrics when investing in companies and Underlying Funds as part of the investment decision-making process.</p> <p>Fulcrum may in its sole discretion may periodically update the indicators used in the investment decision-making process of the Fund. The indicators applied by the sub-Investment Manager are assessed in reliance on one or a number of third party ESG vendors. The Sub-Investment Manager, in its sole discretion, retains the right to disapply data and/or ratings provided by third party vendors where it deems the data and/or ratings to be inaccurate or inappropriate.</p>
<p><b>Lockhart Asset Management</b></p>	<p>The Sub-Investment Manager holds the same beliefs relating to ESG investing in addition to those held by the company as outlined above:</p> <ul style="list-style-type: none"> <li>- Sustainability issues are sources of long-term risk and return, therefore considering sustainability risks as outlined above leads to better analyses and investment decisions;</li> <li>- The execution of ownership rights may increase performance and lower risk over time; accordingly, in selecting investments for each Fund, the Investment Manager will seek to encourage good governance through its voting in respect of such ownership right with the belief that this should produce higher risk-adjusted returns over the long term;</li> <li>- Sustainability risk and governance information and data may be sourced from in house analysis, from direct engagement and interaction with underlying funds, companies, governments and other issuers, and from third parties; and –</li> <li>- Integrating and assessing sustainability risk enhances the quality of investment processes as sustainability issues, when poorly managed, will create long-term material adverse impacts for society, the environment and undermine investment returns.</li> </ul>

## **Governance and senior management responsibility**

Pacific Asset Management's Board of Directors are ultimately responsible for the firm's policies and procedures in respect of sustainability.

## **Monitoring**

As part of its ongoing monitoring of delegates in accordance with its Business Plan, the Pacific Asset Management oversees the Investment Managers to ensure compliance with this Policy.

## **Disclosure of this policy**

SFDR requires that the Company must publish on their website information about this Policy. Pacific Asset Management satisfies this requirement by disclosing this Policy at [www.pacificam.co.uk/responsible-investing](http://www.pacificam.co.uk/responsible-investing) and [www.devere-am.com](http://www.devere-am.com).

## **Date:**

This policy applies with effect from 1 October 2023.