# TCFD Disclosure for SEDCO Capital

31-December 2022

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## Introduction

SEDCO Capital ("SC") has become the first Shariah-compliant signatory of the United Nations Principles for Responsible Investment (UNPRI). SC's responsible investment approach has gradually evolved by broadening the investment focus from Shariah-compliance to ESG integration, active ownership, thematic sustainability as well as positive societal and environmental impacts with investments. Over time, the importance of climate risk has grown, and it has been gradually developing into a secular theme from an investment perspective. Both climate related physical and transition risk levels are expected to increase in the near future. Those risks are expected to impact regions and sectors differently. Thus, climate-related risk are pertinent to all portfolios and products that SC manages.

SEDCO Capital is pleased to publish its first Taskforce on Climate-related Financial Disclosures ("TCFD") aligned report. Prior TCFD-related disclosures were made in the annual UNPRI assessment report. While SC is not required to provide any mandatory disclosures, SC would like to demonstrate, on a best-efforts basis, that we further aim to develop our disclosures in relation to climate related risks.

Transparency as to how companies and investors are addressing these risks and opportunities is important to shareholders, clients, employees, regulators and other stakeholders. SC's dedication to responsible investing and climate considerations is aligned with our objective of making investments that are well positioned to benefit from the transition to a more sustainable economy.

## 1. Governance

The nature of SEDCO Capital's business and its investment philosophy mean that the management of climate-related and broader sustainability-related risks and opportunities is a strategic focus. The Board of Directors ("Board") plays a crucial role in governing and overseeing SC's strategy and providing an oversight, control and monitoring role of its operations and risks. In this function, the Board also oversees climate-related risks and opportunities.

The Risk and Compliance Committee ("RCC") as a Board Committee, which includes independent non-executive members, is responsible for the oversight of risk management (including climate risk management). That means that the Board, with the support of the RCC oversees SC's Responsible Investment and Stewardship policies. This includes high-level guidelines on asset classes and exclusions. Accordingly, the Board and RCC are periodically updated on responsible investments, at least annually. The organization has KPIs related to responsible investments.

Management and monitoring of climate-related risks and opportunities, including implementing the TCFD recommendations, is delegated to senior management, specifically the Risk Management department led by the Chief Risk Officer. Senior management is represented on investment committees, which oversee SC's investment activities, investment performance, risk management, as well as climate-related issues.

The Chief Risk Officer is responsible for SC's responsible investment approach including climate-related considerations. Thus, the Chief Risk Officer leads the ongoing advancement of SC's sustainability efforts, the responsible investment process and the assessment of climate and sustainability related risks and opportunities.

Responsible investment considerations are fully integrated in SC's investment process so that all investment professionals assess exclusions, ESG, climate and active ownership considerations in line with the normal investment process.

***Board of Directors***

*SC is headed by an effective Board of Directors which meets regularly and directs and controls the Company. The Board is responsible for providing governance, guidance and oversight to senior management. Management is responsible for carrying out board directives, including implementing strategies and policies and establishing an effective system of internal controls. It is the joint responsibility of the Board and management to promote integrity and high ethical standards, and to establish a culture within the organization that emphasizes personals of all levels the importance of internal controls.*

*The Board is ultimately responsible for ensuring that an adequate and effective system of internal controls is established and maintained. The key elements in achieving this are:*

- *Approve strategies and policies, and periodically review their implementation.*
- *Understand and define limits for major risks.*
- *Ensure that management takes the steps necessary to identify measure, monitor and control risk.*
- *Approve appropriate risk management organizational structure.*
- *Ensure that management is monitoring the effectiveness of the internal control system.*
- *Ensure that all company operational policies and procedures are documented and up to date.*

***Committees***

*In fulfilling its responsibilities, the Board chose to delegate some of these responsibilities to committees. The focus of this document is on role to the Risk and Compliance Committee:*

*Risk and Compliance Committee ("RCC"): The purpose of the RCC is to assist the Board in exercising its oversight of the operational activities of SC and the timely identification, mitigation, and management of those risks that could have a material impact on SC. Also, the committee assists in fulfilling its risk management responsibilities as defined by applicable laws and regulations. The committee also oversee, monitor, direct and review the management of SC compliance and monitoring of its security business in line with the SC's established policies, procedures and program in accordance with regulatory requirements.*

***Management Role***

*Management, in supporting the Board and its committees, has a number of key responsibilities:*

- *Implement strategies and policies approved by the Board.*
- *Develop processes that identify, measure, monitor and control risks that may be incurred by the company.*
- *Maintain a risk management organizational structure that clearly assigns responsibility, authority and reporting relationships and avoids conflict of interest situations.*
- *Ensure that delegated responsibilities are effectively carried out.*
- *Set appropriate internal control policies.*
- *Monitor the adequacy and effectiveness of the internal control system.*

*Management, while ultimately responsible to the Board, executes its responsibilities by appointing competent and efficient personnel to the various types of risk functions and delegates appropriate responsibilities. Monitoring the performance of these nominated individuals is a key part of the success of risk management.*

*An essential element of an integrated Risk Management Framework is the recognition by all employees of the need to carry out their responsibilities effectively and to communicate where policy violations and other deviations are detected. Clearly written, distributed and readily available procedures are fundamental to the detection and communication of risk issues.*

## 2. Strategy

SEDCO Capital's pursues a strategy intended to seize the investment opportunities arising from the transition to a more sustainable economy. This includes the global transition to net-zero greenhouse gas emissions and adaptation to the unavoidable impacts of climate change. Through our research and/or with the help of external investment managers, advisors and service providers, SC seeks to invest in assets that may be well positioned to benefit from this transition. SC believes this approach to investment management can deliver compelling risk-adjusted financial returns to investors over the long term. This section outlines how SC aims to capitalize on climate-related opportunities and how climate-related risks are approached.

The importance of climate risk has grown, and it has been gradually evolving into a secular theme from an investment perspective. Both climate related physical and transition risk levels are expected to increase in the near future and those risks are expected to impact regions and sectors differently. For example, high carbon emitting investments and exposed locations are expected to have lower future returns. This means that investors must proactively consider these risks in their investment processes.

Based on pertinent academic research, climate considerations and risks are expected to become a stronger driver of economic activity and financial returns. The integration of climate considerations into the investment and risk processes is motivated by the fundamental investment proposition rather than solely as an ethical obligation for SC.

SC generally supports the objectives of the Paris Agreement and the Task Force on Climate-Related Financial Disclosures as a means for climate-related disclosure and transparency. Thus, SC aims to integrate climate considerations in its asset allocation subject to overriding constraints and the duty of protecting the interests of its clients. SC seeks transparency on climate risks and disclosure of carbon related data from its investments.

Geographic regions, countries down to micro locations will differ in their sensitivities to climate physical and transition risks. Industrial sectors and businesses differ in their sustainability profile and emissions. SC aims to evaluate future trends and technologies that could benefit from future climate engagement, which may represent strategic opportunities for investors.

Asset Allocation:

- Aim to reduce portfolio exposure to sustainability risks and negative sensitivities to physical climate risks.
- Evaluate climate transition risks for potential late and adverse policy responses.
- Aim to reduce portfolio exposure to high carbon emission sectors, particular if there are more carbon-efficient substitutes. Transition risk sensitivity has the greatest negativity for the energy sector, particularly coal. In contrast, certain sectors or industries may benefit from carbon reduction requirements such as renewable energy, battery technologies, etc.

Investment Selection:

- Aim to reduce the sustainability and carbon-related risks of portfolios in comparison to the benchmark (at minimal tracking error impact).
- Aim to improve portfolio ESG scores focusing on the most material ESG aspects (for example, relative to the Benchmark or relative to prior periods).

- Aim to increase the exposure to companies with lower sustainability risks (for example, relative to the Benchmark or relative to prior periods).
- Aim to increase the exposure to companies with lower carbon-related risks (for example, relative to the Benchmark or relative to prior periods).
- Aim to reduce the exposure to companies with less carbon efficient processes (for example, relative to the Benchmark or relative to prior periods).
- Certain commodities such as lithium, cobalt or copper are expected to benefit from the green transition. Thus, aim to invest in technologies and businesses that can benefit from the green transition (e.g., relatively overweight to benchmarks or prior periods).

However, investment decisions may differ in certain conditions, to preserve the overall financial characteristics of the portfolios, to respect other investment constraints, with regard to the overriding duty of protecting the interests of its clients. There can be no guarantee that any of the aims may be achieved, and SC shall in no way be bound by an objective or requirement to achieve these aims.

As an example, SC runs two public equity funds with climate-related investment themes: SC Global Sustainable Equities Fund invests in companies that derive underlying revenue from environmental products or services in the energy efficiency, renewable energy, water, waste and sustainable food and agriculture markets. SC LO Global ESG Equities Fund, investing in companies with stronger ESG-performance and low carbon footprint.

## 3. Risk Management

SC climate exposure is primarily through the investments it makes on behalf of clients. A failure to manage risks could negatively affect investment performance and SC's reputation as a sustainability-focused investment manager. Furthermore, SC also faces certain operational climate risks.

SC aims to assess climate and other material risks through ESG analysis that informs asset allocation and investment decisions as discussed above. Components of this analysis include particularly climate transition risks and physical climate risks.

Climate risks can be classified into transition and physical risks. Transition risk is the requirement to respond and adapt to a potentially rapidly changing regulatory, technological, market, and social backdrop. Physical risks entail the costs and damage resulting from climate change (such as extreme weather events). There is a trade-off between transition and physical risks driven by the speed of policy change.

Transition Risks result from moving to a lower-carbon economy, which may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organizations.

| Type | Climate-Related Risks | Potential Financial Impacts |
| --- | --- | --- |
| Policy and Legal | – Increased pricing of GHG emissions<br>– Enhanced emissions-reporting obligations<br>– Mandates on and regulation of existing products and services<br>– Exposure to litigation | – Increased operating costs (e.g., higher compliance costs, increased insurance premiums)<br>– Write-offs, asset impairment, and early retirement of existing assets due to policy changes<br>– Increased costs and/or reduced demand for products and services resulting from fines and judgments |

| Technology | – Substitution of existing products and services with lower emission options<br>– Unsuccessful investment in new technologies<br>– Costs to transition to lower emissions technology | – Write-offs and early retirement of existing assets<br>– Reduced demand for products and services<br>– Research and development (R&D) expenditures in new and alternative technologies<br>– Capital investments in technology development<br>– Costs to adopt/deploy new practices and processes |
|---|---|---|
| Market | – Changing customer behavior<br>– Uncertainty in market signals<br>– Increased cost of raw materials | – Reduced demand for goods and services due to shift in consumer preferences<br>– Increased production costs due to changing input prices (e.g., energy, water) and output requirements (e.g., waste treatment)<br>– Abrupt and unexpected shifts in energy costs<br>– Change in revenue mix and sources, resulting in decreased revenues<br>– Re-pricing of assets (e.g., fossil fuel reserves, land valuations, securities valuations) |
| Reputation | – Shifts in consumer preferences<br>– Stigmatization of sector<br>– Increased stakeholder concern or negative stakeholder feedback | – Reduced revenue from decreased demand for goods/services<br>– Reduced revenue from decreased production capacity (e.g., delayed planning approvals, supply chain interruptions)<br>– Reduced revenue from negative impacts on workforce management and planning (e.g., employee attraction and retention)<br>– Reduction in capital availability |

Physical risks resulting from climate change can be event driven (acute) or longer-term shifts (chronic) in climate patterns. Physical risks may have financial implications for organizations, such as direct damage to assets and indirect impacts from supply chain disruption. Organizations' financial performance may also be affected by changes in water availability, sourcing, and quality; food security; and extreme temperature changes affecting organizations' premises, operations, supply chain, transport needs, and employee safety.

| **Type** | **Climate-Related Risks** | **Potential Financial Impacts** |
|---|---|---|
| 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)<br>– Reduced revenue and higher costs from negative impacts on workforce (e.g., health, safety, absenteeism)<br>– Write-offs and early retirement of existing assets (e.g., damage to property and assets in "high-risk" locations)<br>– Increased operating costs (e.g., inadequate water supply for hydroelectric plants or to cool nuclear and fossil fuel plants)<br>– Increased capital costs (e.g., damage to facilities)<br>– Reduced revenues from lower sales/output<br>– Increased insurance premiums and potential for reduced availability of insurance on assets in "high-risk" locations |
| Chronic | – Changes in precipitation patterns and extreme variability in weather patterns<br>– Rising mean temperatures<br>– Rising sea levels | |

Transition and physical climate risks can be evaluated in SC's risk management framework similar to other types of risks. The framework of Risk Identification, Assessment, Addressing and Reporting is described below. Practically, SC uses a variety of different sources to identify climate-related risks such as screening of portfolios, stress testing, industry publication, news, internal and external stakeholders, service providers, etc.

| Risk Identification | Risk Assessment | Risk Addressing | Risk Reporting |
|---|---|---|---|
| • Risks and sources of risks to which SC is | • Measurement processes should be | • Proper risk management | • Reports provide relevant, accurate and |

| | | | |
|---|---|---|---|
| exposed are continually identified and defined.<br>• The company's "appetite" for risk is described based on SC business objectives. | comprehensive enough to cover all significant sources of risk exposure.<br>• Measurement processes are responsive to the needs of those who use the information.<br>• Identified risks are assessed in terms of their probability of occurrence and impact on SC should they occur. | strategies are defined to either reduce the probability of risk occurrence or reduce the impact should they occur.<br>• Risk limits are defined to be consistent with SC policies and authorized exposures.<br>• Risk management ensures that operational activities do not expose SC to losses that could threaten its viability. | timely information about risk exposures.<br>• Individuals monitoring risks are independent of those taking positions (incurring risks).<br>• Risks are reported and regularly reviewed across different organizational hierarchy and during each stage of the risk management cycle. |

Engagements on climate related issues can be a risk mitigation strategy for SC. SC mainly engages indirectly through its external investment managers, investment advisors and other service providers.

Scenario analysis has become a useful tool to evaluate sensitivities to certain factors for portfolios that SC manages. Risk Management uses the price-impact approach to integrate climate-related factors into existing scenario analysis. SC expects the scenario and portfolio stress testing to develop over time as more comprehensive models and data become available for portfolio modelling.

## 4. Metrix and Targets

The climate analytics tools SC deploys aim to provide a set of emissions-based and climate-related metrics at both a company and portfolio level to cater for different use cases in investment decision-making. SC manages diversified multi-asset class portfolios partially managed with the help of external investment managers and advisors. That means a high degree of complexity as well as lagged and/or limited data availability. Currently our efforts are focused on developing tools for our listed equities.

Beyond the Scope 1, 2 and 3 emissions, several other metrics can be used in a portfolio context. Below summary discusses metrics have SC has used for analyzing equity portfolios.

At this point, SC still experiences data gaps as public companies may not disclose their emissions data. There are larger data gaps for private investments. SC has started calculating carbon metrics for its listed equity funds and aims to enhance disclosure when more comprehensive data becomes publicly available.

For the short- to medium planning horizon, risks evolve from climate regulation resulting in decreasing value of investments, capital expenditure and similar. Consequently, there are opportunities resulting from capital expenditure for carbon emission reductions. As an example, SC Global Sustainable Equity Fund has exposure to technologies for the green transition such as emission reduction, resource preservation or alternative energy.

For the long-term planning horizon, physical climate risks could impact our investments directly. There could be opportunities from the growing impact of transition climate risks (regulation) in Middle Eastern real estate markets if anticipated early.

***Carbon Footprint*[1]**

- *Total carbon emissions for a portfolio normalized by the market value of the portfolio, expressed in tons CO2e/$M invested.*
- *+ Metric may be used to compare portfolios to one another and/or to a benchmark.*
- *+ Using the portfolio market value to normalize data is intuitive to investors.*
- *+ Metric allows for portfolio decomposition and attribution analysis.*
- *– Metric does not consider differences in the size of companies (e.g., does not consider the carbon efficiency of companies).*
- *TCFD Holdings Carbon Emissions per million USD invested (tonnes/millions USD) =*

$$\frac{\sum_{n}^{i}\left(\frac{\text{current value of investment}_i}{\text{issuer's market capitalization}_i} * \text{issuer's Scope 1 and Scope 2 GHG emissions}_i\right)}{\text{current portfolio value (\$M)}}$$

***Weighted Average Carbon Intensity of Investments***

- *Portfolio's exposure to carbon-intensive companies, expressed in tons CO2e/$M revenue.*
- *Scope 1 and Scope 2 GHG emissions are allocated based on portfolio weights (the current value of the investment relative to the current portfolio value), rather than the equity ownership approach (see Carbon Intensity).*
- *+ Metric can be more easily applied across asset classes since it does not rely on equity ownership approach.*
- *+ The calculation of this metric is fairly simple and easy to communicate to investors.*
- *+ Metric allows for portfolio decomposition and attribution analysis.*
- *– Metric is sensitive to outliers.*
- *– Using revenue (instead of physical or other metrics) to normalize the data tends to favor companies with higher pricing levels relative to their peers.*
- *TCFD Carbon Intensity (weighted average tonnes/millions USD) =*

$$\sum_{n}^{i}\left(\frac{\text{current value of investment}_i}{\text{current portfolio value}} * \frac{\text{issuer's Scope 1 and Scope 2 GHG emissions}_i}{\text{issuer's \$M revenue}_i}\right)$$

## Carbon Data

- The analysis comprises all public equity funds on SC's Luxembourg SIF and UCITS platforms as per 31st December 2022. The Assets under Management (AUM) was USD 1.43bn (SC's public equity funds on SC's SIF and UCITS platforms per 31-Dec-2022). About 71% of the AUM is in passively managed funds.

[1] See Task Force on Climate-related Financial Disclosures - Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures (October 2021).

- Portfolio and benchmark weights as per 31st December 2022 were used. However, the analysis is based on year 2021 scope 1 and 2 carbon data disclosures due to better data coverage at the time of conducting this analysis.
- Many stocks report carbon emissions data as part of their financial reporting. This report uses reported total greenhouse gas (GHG) emission data, which comprises GHG scope 1 and 2. GHG scope 3 is not directly controlled by the target company and is less frequently reported. Stocks without carbon data reporting have estimated data using listed peer groups.

**Carbon Footprint and Carbon Intensity**

- The Total Carbon Emissions (in thousand tons CO2e) of SC's public equity fund portfolio is 83. The average carbon footprint (tons CO2e/millions USD) is 74. The Weighted Average Carbon Intensity of Investments (tons CO2e/$M revenue) for the portfolio is 195, slightly above the Weighted Average Carbon Intensity of the benchmark of 192.
- SC Europe Equities Fund and SC Sustainable Equities Fund have the highest % of stocks with carbon data reporting.
- A portfolio's (benchmark's) industrial sector composition is an important driver of its carbon intensity. This is particularly evident for the carbon intensity for the SC Global Listed Infrastructure Equity Fund due to its high weight in utilities.
- In the portfolio, developed markets generally tend to have lower carbon intensity relative to emerging markets.
- SC LO Global ESG Equities, as an ESG data-driven fund, substantially lowers its carbon intensity relative to its benchmark despite being relatively neutral in its sector allocation. The fund has a negative carbon intensity attribution by allocating to lower carbon emitting stocks within each sector (relative to its benchmark).
- SC Global Listed Infrastructure Equities Fund has high carbon intensity. The fund has its exposure mainly in utilities and industrials sectors.
- For SC Global Sustainable Equities Fund, the higher carbon intensity relative to its benchmark is somewhat counterintuitive: The fund invests in companies with carbon-reduction technologies (such as renewable energy, clean transport, smart environment technologies, etc.). These products are expected to reduce carbon emissions during their lifecycle (i.e., scope 3) relative to conventional alternatives. In their own reporting, the manager adjusts company's actual emission data for emissions avoided due to sustainable products.

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