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Description of policies on the integration of sustainability risk

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Change log

Version	Date	Author	Change log
1.0	March 10, 2021	Project Group SFDR	Initial version
1.1	September 21, 2023	Project Group Investment Advice	Minor textual changes. Added references to ‘financial advisor’ and ‘investment advice’ in the introduction text “Description of sustainability risk policies” on p3 to indicate that the risk policies also apply to APG Asset Management’s investment advice services
2.0	May 22, 2024	CFRO Investment Risk Management Responsible Investments (“CFRO IRM RI”)	Outside-in perspective, alignment with updated APG AM Sustainability Risk Management Policy, asset class specific examples.
3.0	April 30th 2025	CFRO IRM RI	Alignment with the revised APG AM Sustainability Risk Management Standard, description of governance and tooling, general update of information disclosed

Description of policies on the integration of sustainability risk

APG Asset Management N.V. (**'APG AM'**, LEI: 549300XWC21UGFTCR876) is considered a financial market participant and financial advisor in accordance with the Sustainable Finance Disclosure Regulation (EU/2019/2088) (**SFDR**). Integrating sustainability risk in investment due diligence, risk management and governance processes are requirements under MiFID 2 and AIFMD rules; the Dutch Central Bank (DNB) also expects financial institutions to adequately manage sustainability risk. Under Article 3 of the SFDR, financial market participants and financial advisors are required to publish information on their website about their policies on the integration of sustainability risks in their investment decision making process and investment advice.

This Statement outlines how APG AM integrates sustainability risk in its investment decision-making process according to applicable regulations, also in the fulfillment of applicable disclosure requirements. Product-level disclosures in the pre-contractual documentation shared with our clients indicate the materiality of specific sustainability risks for the investments in that product. Given that sustainability risk management is a rapidly evolving field, as data, technology and tools, as well as expertise improve over time, APG AM's approach to sustainability risk management is regularly reviewed and adjusted where necessary. In the context of this Statement, 'sustainability risk' as defined under the SFDR refers to an environmental, social or governance event or condition that, if it occurs, could cause an actual or potential material negative impact on the value of the investment.

At APG AM, investing responsibly means using the assets managed on behalf of pension fund clients and their participants to make a difference and contribute to a sustainable future for current and future generations. This means taking into account human rights, the environment and good corporate governance in every investment decision, with the objective to contribute to an enjoyable, livable world for society as a whole while generating stable returns for those who entrust their pension assets to APG AM. Responsible Investing (**RI**) is enshrined in APG AM clients' strategic investment plans and part of the asset liability management process. The integration of sustainability factors in all asset classes is therefore an important feature of APG AM's responsible investment approach, which is designed to:

- contribute to risk-adjusted financial returns;
- demonstrate social responsibility; and
- contribute to the integrity of financial markets.

This entails that before making investment decisions, APG AM actively considers sustainability risks and the potential negative impact on the value of investments. Furthermore, APG AM remuneration policy, also disclosed on APG AM's website, is consistent with sustainability risk integration, insofar it does not incentivize excessive risk-taking in relation to sustainability risk, and Responsible Investment objectives.

APG AM approaches RI based on the double materiality principle. The companies in which APG AM invests on behalf of its clients not only face risks due to changing environmental and social landscapes, but also contribute to these risks through their operations. The concept of double materiality refers to the dual perspective of considering both the impact of environmental, social, and governance (ESG) issues on the value of the investments managed by APG AM (financial materiality or outside-in), and the impact of APG AM via its investments on ESG factors (inside-out). The outside-in perspective is addressed by the APG AM Sustainability Risk Management Standard, while the inside-out contribution to sustainability factors is reflected in our Responsible Investment policies. Under the APG AM Sustainability Risk Management Standard, however, reputational risk that may result from ESG factors at the investment level, for example from adverse ESG impacts, is also considered.

APG AM Sustainability Risk Management Standard

The APG AM Sustainability Risk Management Standard describes how APG AM identifies, assesses, mitigates, monitors and evaluates sustainability risk, including applicable governance mechanisms. As general principles, managing risk (including sustainability risk) is the responsibility of the first line. The risk management function in the second line provides risk controls and independently identifies and assesses potential risks. The third line, including Group Internal Audit, provides risk assurance on the operation of the risk management framework.

All decisions related to risk management aspects of APG AM, including on sustainability risk, are assigned to the APG AM Risk Committee, consisting of the full APG AM Board of Directors, the Chief Compliance Officer, the Managing Directors of Risk Management and Legal, Tax and Regulation, as well as representatives from APG Group Risk and Compliance, and Group Internal Audit. All investment decisions are adopted by the Investment Committee (IC) and its asset-class specific sub-committees. These are responsible for ensuring that all transactions meet the solvency, liquidity, return, risk diversification requirements and the prudent person principle, while guaranteeing quality and transparency of the investment process. Sustainability risk is also part of the risks discussed by these committees with specific sections included in both investment proposal templates and charters. Policies and methodologies for sustainability risk management fall under the responsibility of the Responsible Investment Board (RIB), a sub-committee of the IC responsible for change activities in the domain of Responsible Investment.

At APG AM, the process for managing sustainability risk does not differ from other risk management processes consisting of six steps: risk framework development and maintenance; risk identification; risk assessment; risk mitigation; risk monitoring & reporting; evaluation of the risk management cycle.

Risk framework development and maintenance aims at ensuring compliance with the investment guidelines of clients and adequately managing risks. The sustainability risk framework of APG AM encompasses all policies, procedures and technical tools, including APG AM Sustainability Risk Taxonomy, related to sustainability risk management for client investment risk. The various elements of the framework are then reflected in the Responsible Investment Implementation Guidelines, which implement RI and sustainability risk policies at the level of each asset class, including asset class-specific requirements. The sustainability risk management framework for client investment risk is developed and maintained by Investment Risk Management – Responsible Investment Team (IRM/RI).

Risk identification aims to determine risks that could likely have a negative impact on the value of investments, as well as reputational risk that may result from ESG factors. Risk identification is performed for invested portfolios which already take into account several conditions as defined in (clients') Responsible Investment policies, described further below and leading to improved sustainability risk profiles of the portfolios. For the purpose of sustainability risk identification, the widely accepted SASB (Sustainability Accounting Standards Board) materiality map forms the basis of

APG AM Sustainability Risk Taxonomy for corporate exposures. SASB materiality map identifies the financially material issues that are reasonably likely to impact the financial condition or operating performance of a corporate entity. These issues are grouped under five broader dimensions such as environment, social capital, human capital, business model and innovation, and leadership and governance. For products in the portfolio with direct sovereign exposures or exposures guaranteed by governments, the identification of material sustainability risk factors within the five sustainability risk dimensions is based on a sub-set of country level sustainability risk rating provided by Sustainalytics.

Investment teams link their sustainability risk identification to the APG AM Sustainability Risk Taxonomy which functions as a long list of possible risks. Based on portfolio characteristics and investment strategy, the investment teams identify material risks to form a short list of sustainability risks to be managed in a specific portfolio. Once the risk factors are identified, a 'short list' is documented at product (strategy) level. At least on an annual basis, these are reassessed due to rapidly evolving underlying risks and interactions between risks. Climate and biodiversity risk identification is performed for all asset classes and in particular for private market investments during underwriting; portfolio exposure is then continually monitored. The specific characteristics of each asset class determine whether transition risk, physical risk, or both, are identified as material and the type of risk assessment performed.

Risk assessment aims to determine how, to what extent and through which channels the risk will impact the value of the investment. Assessing potential risks that could (negatively) impact the investment portfolios and its constituents helps manage (reduce, accept, transfer, avoid) those risks. The assessment can be both qualitative and quantitative.

Investment teams perform the sustainability risk assessment on the short-listed risks. The assessment is performed at the underwriting stage and during periodic portfolio monitoring and can be either a qualitative or quantitative assessment. In the event risk metrics/indicators are not available, impact analyses, qualitative assessments, dialogue with investees/managers or expert judgement can be used to assess the risks. Sustainability risks, including physical and transitional climate risk under scenario analysis as well as reputational risk, are independently assessed by IRM/RI. Climate risk assessment is described with additional detail below.

The assessment of sustainability risk is made against thresholds determined by the risk appetite of APG AM's clients. Clients have determined signal values based on specific qualitative and quantitative key risk indicators (KRIs) covering different sustainability risk factors. APG AM has linked the clients' sustainability risk appetite, KRIs, and signal values to the APG AM sustainability risk taxonomy in order to monitor adherence to the clients' risk appetite. For the time being, signal values have been only set up for listed corporate exposures, with their extension to other asset classes currently under development. Given the relative novelty and continuous improvement of sustainability risk management tools and methodologies, a risk level above the level indicated in signal values will not automatically result a breach, but it will instead trigger an in-depth assessment of the situation and the identification of suitable mitigants if necessary.

Risk mitigation aims to lower the risk to the level expressed under risk limits and signal values, by taking into account any existing mitigating actions and measures. Sustainability risk mitigation is primarily performed by the investment teams who determine the set of feasible and effective actions to mitigate short listed sustainability risks. Investment teams are responsible for executing risk mitigating actions. Inherent part of risk mitigation is the periodic assessment of the effectiveness of the measures taken to reduce risk, which should as far as possible be made measurable and subsequently monitored. When mitigation takes place through engagement with portfolio companies, the evaluation of its effectiveness is more complex, not least because the effectiveness of engagement may take time to fully materialize.

Risk monitoring and reporting aims to regularly assess the development of risk at the portfolio level on the basis of reports containing relevant sustainability risk indicators. Risk reports aim to regularly provide representative, accurate and timely information for the relevant stakeholders such as clients, regulators and internal stakeholders. Risk monitoring is performed by investment teams on product/mandate and total portfolio level, with independent monitoring performed by IRM/RI. Investment teams have set up periodic dashboards and reports to monitor the development of short-listed sustainability risks.

Evaluation of the risk management cycle aims to provide further insight into specific investments, risk dimensions, risk factors and the validity of risk mitigating actions. Risk evaluation is performed frequently both on a regular and ad-hoc basis to accommodate the respective needs for insight into the risk. The relevance of the sustainability risk level assessment and the effectiveness of the applied mitigation approaches is evaluated based on an annual sustainability risk evaluation. In the event of an inaccurate assessment or insufficient mitigation approach, the chosen assessment approach/method and mitigating actions are to be revised.

Examples of Sustainability Risk Integration for selected asset classes

Emerging Markets Equity (EME) Fundamental

EME Fundamental's investment approach integrates sustainability by emphasizing long-term value creation, active risk management, and a focus on the environmental and societal impacts of their investments. The investment team's process, designed to assess both risks and opportunities, relies on a comprehensive analysis that includes environmental, social, and governance (ESG) factors, facilitated by the involvement of Responsible Investment experts at crucial stages. This collaborative effort generally begins with a detailed bottom-up investment process that incorporates a wide range of information sources to evaluate the sustainability characteristics of potential investments, thereby ensuring that ESG considerations are central to investment decisions.

The sustainability risk appetite in EME Fundamental's investment process is shaped by their clients' responsible investing goals. Investment decisions are influenced by these policies, leading to a preference for companies with good governance and sustainability practices. This approach is complemented by careful attention to reputational risks that could affect the value of investments or the reputation of both EME Fundamental and their clients, underscoring a deep commitment to responsible investment.

EME Fundamental employs a multifaceted assessment strategy that includes a Quality Scorecard, sourcing external data and SASB factors, and ESG assessments to evaluate potential investments. These tools help in identifying and understanding the Sustainability risks and opportunities associated with each investment, guiding the decision-making process. The integration of these assessments into investment case meetings ensures that ESG issues are thoroughly debated and engagement priorities are set, highlighting the firm's proactive stance on sustainability. This rigorous pre-investment screening, coupled with ongoing monitoring and engagement, exemplifies EME Fundamental's dedication to mitigating risks and promoting sustainable and responsible corporate behavior throughout their investment portfolio.

Alternative Credits

In the Alternative Credits portfolio, sustainability risks relevant to investments are identified using the APG AM Sustainability Risk Taxonomy, expert judgment, and qualitative assessment. During the manager selection phase, a three-part assessment is conducted: examining past incidents in managers' portfolios related to sustainability risks, evaluating the manager's process for managing sustainability risks, and assessing sector-specific sustainability risks for significant portions of a manager's portfolio. An ESG due diligence questionnaire is sent to external managers to understand their policies and attitudes towards managing material sustainability risks. This assessment, along with identified risks and mitigants, is part of the investment proposal.

Mitigation of sustainability risks involves collaboration with external managers who commit to implementing ESG processes as per the APG AM RI Implementation Guidelines. In investment proposals, appropriate mitigants for potential risks are defined. The portfolio's sustainable risks are monitored quarterly using the APG AM Sustainability Risk Taxonomy, providing insight into any changes. Data from RepRisk is employed for continuous monitoring of severe ESG incidents. External managers are also required to report material ESG incidents to APG AM, and these are discussed in quarterly monitoring calls.

Annually, an external manager review is conducted, expanding to monitor sustainability risks per mandate and including a scorecard evaluation. The APG product is governed by the Life Cycle Management process, which updates the Management Team every six months.

Real Estate

As in the other asset classes, the Real Estate investment team addresses both inside-out sustainability factors and outside-in sustainability risks, translating them into financial underwritings using quantitative (Capex, Opex, discount rate) and qualitative metrics. Sustainability risks in this portfolio are identified, assessed, and monitored according to APG AM Sustainability Risk Management Standard.

To identify sustainability risks, the Real Estate team mandates its investee companies to regularly conduct materiality assessments, a requirement also embedded in standard global legal provisions. Due to the illiquid nature of real estate investments, sustainability risks are primarily mitigated at the individual asset level. To monitor the development of sustainability risks in the real estate portfolio, Key Risk Indicators (KRIs) are utilized, with regular checks to ensure they remain within predetermined norms/bandwidths.

The following list outlines APG AM's sustainability risk mitigants, assessment tools and frameworks for Real Estate investments:

1. Green Building Certification: Required for new and existing private investments, recommended for listed investments, encompassing a wide range of sustainability issues.
2. CRREM Alignment: Mandates alignment with Paris Agreement targets for energy and carbon intensity in private investments, incorporating these factors into financial valuations.
3. Physical Risk Dashboard: Employs a third-party tool to model and evaluate climate hazard exposure, impacting financial underwriting based on assessed risk.
4. Anti-bribery & Anti-corruption Policy and Whistleblower Program: Essential implementation of these policies, necessitating engagement if not in place.
5. ISS: Instrumental in issuing proxy votes and revealing governance and sustainability information.
6. Fee Principles (Private Real Estate): Establishes principles to guarantee fee alignment and limitation in private investments.
7. Corporate Governance Framework & Voting Policy (Listed): Specifies corporate governance expectations for listed entities, using proxy voting for enforcement and feedback.
8. Real Estate Remuneration Guidelines (Listed only): Targets board remuneration expectations, communicated via proxy voting and engagement.
9. RepRisk: Tracks severe incidents and violations of UN Global Compact principles, ensuring follow-up engagement.
10. Sustainalytics: Differentiates ESG leaders and laggards in the real estate sector, necessitating an engagement plan for investing in laggards.

Climate risk

APG AM quantifies the possible financial effects of climate risk via dedicated climate risk tools (CRG/ CCA by S&P) and scenario analysis in order to determine whether these effects are within the risk attitude of the clients expressed via their KRIs. For Equities and Credits, IRM/RI models the possible financial impacts of transition and physical climate risks and their effects such as, respectively, the change in value of the securities and expected physical risk-related costs. The tool employs the widely accepted climate scenarios developed by the Network for Greening the Financial System (NGFS) and the International Energy Agency (including Net Zero by 2050). These scenarios model the effects of both transition risk, i.e. the changes in policy, regulation, consumer preferences and technologies as a response to climate change, and physical risk, i.e. the damages and costs resulting from changed weather patterns, extreme events caused by climate change such as floods, droughts and wildfires.

APG AM also uses an additional tool, Climanomics by S&P, to determine in particular the climate change physical risk to which real assets may be exposed. Both at the asset level and at the portfolio level, the tool estimates a modelled annual average loss (MAAL) associated with various types of physical risks and transition risk under different scenarios. The tool uses geocoordinates in combination with the type of asset, different impact functions for each physical risk type and four representative climate scenarios (RCP 2.6, RCP 4.5, RCP 7.0 and RCP 8.5). It then determines MAAL over a ten-year period (i.e. 2020-30, 2030-49) until 2090.

In addition to these tools, asset-class specific scenarios of a qualitative nature are resorted to in several asset classes. Despite the more limited conclusions that can be drawn on the financial impact of climate risk, these assessments are helpful in identifying high risk exposures. For example, for governmental bonds, a country’s exposure to transition and physical risk is determined by a combination of indicators provided by a third party and ND-GAIN indicators. The latter also indicate a country's vulnerability to climate change impacts as well as it capacity to respond to them.

APG AM undertakes several general measures to mitigate climate risks and seize climate related opportunities for APG AM's financial products. Examples of such measures are:

- Monitoring developments in national and global policy, markets and technology developments;
- Analysis of energy companies' transition strategies, capex plans and sector trends;
- Engagement with carbon-intensive companies on carbon emission reductions and climate risk management;
- Usage of sustainability standards for the assessment of sustainability performance by our investments, such as the Global Real Estate Sustainability Benchmark (GRESB) in Real Estate and Infrastructure, and Forest Stewardship Council (FSC) in timberland investments;
- Commitment not to make any new coal-related investments in the Infrastructure portfolio;
- Commitment to include coal-fired power capacity expansion as a factor in the Inclusion policy methodology. This means that we can only invest in companies which expand their coal-fired power capacity if there is a positive engagement outlook;
- Continuous monitoring of the energy mix of the portfolio of energy investments;
- Investment targets on Sustainable Development Investments in particular on investments contributing to Climate and Biodiversity Solutions, renewable energy investments, and carbon footprint reduction;
- Accounting for carbon pricing, reduced volumes of fossil fuels and other financial impacts in investment cases and the memos submitted to the APG AM Committee of Investment Proposals;
- In illiquid asset classes, an investment rationale focused on next-generation assets. Long-term risks are included in the due diligence and monitoring, and investments are subject to conditions and sign-off by the IRM/RI team.

Responsible Investment policies

The Responsible Investment policies that APG AM implements on behalf of its clients are based on eight principles, one of which is that *responsible investment is an integral part of the investment process at APG AM*. As a result, for every single investment, regardless of the investment category, APG AM weighs ESG criteria, meaning that APG AM decides whether to go ahead with an investment also based on environmental impact, social impact, and good governance. These criteria are as important to APG AM as returns, costs, and risk. This empowers APG AM to make better investment decisions, especially since APG AM invests for the long term.

One way in which we do this is by implementation of the Inclusion Policy, which is based on the UN Global Compact themes (human rights, labor, environment, and anti-corruption) and the expectations of investors and companies under the OECD Guidelines. The Inclusion Policy enables us to meaningfully identify companies in our portfolio that are considered to be leading on ESG and affect genuine change at companies through using our influence. Using APG's proprietary methodology, capital market investments are assessed and categorized into leaders and laggards. Investments in laggards require engagement in order to improve their sustainability performance. Engagement is therefore one of the cornerstones of the inclusion policy. We aim to invest only in companies that either perform adequately on our chosen sustainability indicators or those that we expect can make progress in these areas. In addition, specific clients have additional ESG criteria for including investments in their portfolios.

Our Corporate Governance Framework and Voting Policy explains our policy framework for corporate governance including our underlying principles and expectations and sets out our voting standards on main agenda items at companies' annual general shareholders' meetings. Climate change and sustainability related considerations, such as adherence to the standards as set by the Task Force on Climate related Financial Disclosures (TCFD), are taken into account in our voting decisions to address sustainability risks.

By means of the Sustainable Development Investments (SDI) Ambition we assess how the products and services of our investments contribute to adverse impacts on Sustainable Development Goals (SDGs) such as no poverty, zero hunger, good health and wellbeing, quality education, clean water and sanitation, affordable and clean energy, sustainable cities and communities, life on land, industry, innovation and infrastructure, responsible consumption and production, climate action, life below water, and life on land. Based on specific SDGs, one of our clients has set targets for investments contributing to climate transition and nature and biodiversity. Contributing to the SDGs is also the first step for an investment to be considered as Sustainable Investment and impact investments under that client's frameworks.

On behalf of two of our clients, APG AM has finalized an impact investing framework and has started executing impact investments in several asset classes. Impact investments are made with the intention to generate, next to financial returns, a positive and measurable social and environmental impact, in line with the best practices of the Global Impact Investing Network (GIIN).