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Description of policies on the integration of sustainability risk

Owner APG AM Investment Risk Management
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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.

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**). 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.[1] In this context ‘sustainability risk’ 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 is enshrined in APG AM clients’ strategic investment plans and part of the asset liability management process. The integration of governance and 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.

APG AM approaches Responsible Investing based on the double materiality approach. 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 Environmental and Social factors (inside-out). The outside-in perspective is addressed by the APG AM Sustainability Risk Management Policy, while the inside-out contribution to sustainability factors is reflected in our Responsible Investment policies.

APG AM Sustainability Risk Management Policy

The APG AM Sustainability Risk Management Policy describes how APG AM identifies, assesses, mitigates, monitors and evaluates sustainability risk.

[1] Article 3 SFDR.

Risk identification aims to determine risks that could likely have a negative impact on the value of investment. For the purpose of the sustainability risk identification, the widely accepted SASB (Sustainability Accounting Standards Board) materiality map forms a basis for 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 and hence has been applied as the basis for sustainability risk identification. For products in the portfolio with direct sovereign exposures or exposures guaranteed by governments, the identification of material sustainability risk factors 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.

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 managing (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. Investment teams use the determined risk metrics/indicators, to assess the short-listed sustainability risk factors on strategy/product level taking into account mitigation indicators based on forward looking scenarios and anticipated trends. 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.

Risk mitigation aims to lower the risk level by taking into account any 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.

Risk monitoring 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 currently performed by investment teams on product/portfolio level.

Some of the investment teams have set up a periodic dashboards and reports to monitor the development of short-listed sustainability risks.

Risk evaluation 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.

<u>Examples of Sustainability Risk Integration for selected asset classes</u>

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 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 risk appetite in EME Fundamental's investment process is shaped by their clients' responsible investing goals and a set of policies that prioritize sustainable development investments (SDIs) and low carbon footprint opportunities. Investment decisions are influenced by these policies, leading to a preference for ESG leaders, although investments in ESG laggards are considered if there is a clear engagement plan aimed at driving positive change. 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 investing.

EME Fundamental employs a multifaceted assessment strategy that includes a Quality Scorecard and ESG Quick-dive and Deep-dive 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 Responsible Investment (RI) Guidelines. In investment proposals, appropriate mitigants for potential risks are defined, with detailed examples provided in the "ESG Integration Expectations" section of the RI Guidelines for Alternative Credits. 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

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 for in this portfolio are identified, assessed, and monitored according to APG AM Sustainability Risk Management Policy. The following list outlines APG AM's sustainability and governance measures 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 model to evaluate climate hazard exposure, impacting financial underwriting based on assessed risk.
4. GRESB: Participation in the Global Real Estate Sustainability Benchmark is compulsory for private investments, aiming for above-average ratings within three years.
5. Anti-bribery & Anti-corruption Policy and Whistleblower Program: Essential implementation of these policies, necessitating engagement if not in place.
6. ISS: Instrumental in issuing proxy votes and revealing governance and sustainability information.
7. Fee Principles (Private Real Estate): Establishes principles to guarantee fee alignment and limitation in private investments.
8. Corporate Governance Framework & Voting Policy (Listed): Specifies corporate governance expectations for listed entities, using proxy voting for enforcement and feedback.
9. Real Estate Remuneration Guidelines (Listed Only): Targets board remuneration expectations, communicated via proxy voting and engagement.
10. RepRisk: Tracks severe incidents and violations of UN Global Compact principles, ensuring follow-up engagement.
11. Sustainalytics: Differentiates ESG leaders and laggards in the real estate sector, necessitating an engagement plan for investing in laggards.

Additional sustainability risks at the individual investment level may exist beyond this list. To identify such risks, 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.

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 based on environmental impact, social impact, and good governance. These criteria are just 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 (*)[2]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 AGP'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.

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 Ambition (*) we assess how the products and services of our investments contribute to adverse impacts on Sustainable Development Goals 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.

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[2] Please note that all documents marked with (*) can be found on our website under section "Sustainability-related disclosures".
For English: https://apg.nl/en/about-apg/asset-management/responsible-investment/.
For Dutch: https://apg.nl/nl/over-apg/asset-management/verantwoord-beleggen/.

Climate risk

In addition to the policies and approaches described above, APG AM belongs to a select group of asset managers that are world leaders in identifying climate risks and the potential impact on investments by means of the Carbon Reduction Target & Climate Risk Policy (*). The Principles for Responsible Investment (PRI) has also recognized APG AM as one of the leaders in responsible investing. By including APG AM in its 2020 Leaders' Group, PRI specifically acknowledges APG AM's excellent disclosure and advanced efforts in climate reporting. Furthermore, the Asset Owner Disclosure Project (AODP) which maps out how institutional investors and their asset managers take climate risks and opportunities into account in their policies, awarded APG AM with the highest rating (A) awarded in 2019.

To identify climate risks and the potential impact on investments, APG AM has developed a proprietary internal Climate Dashboard which provides insight into climate change related aspects which may impact our investments. APG AM currently applies the dashboard to approximately 70% of all our investments and expects to reach 100% coverage in the coming years. In the investment decision making process, the Climate Dashboard provides insight in:

- Transition speed towards a below 2-degree scenario (world view);
- Overview of portfolio exposure regarding transition risks and opportunities per sector (22 sectors in scope) for the short (2022), medium (2030), and long term (2040);
- Overview of physical vulnerability per sector (22 sectors covered);
- Sector views with insights in the type of risks and opportunities as well as mitigation measures that are in place to mitigate risks or seize opportunities.

In addition to the Climate Dashboard, part of its policy framework and investment decision process, APG AM undertakes 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, e.g. through active participation in the Task Force on Climate related Financial Disclosures (TCFD) and Climate Action 100+;
- 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, 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 Responsible Investment team.