

Our progress against the TCFD recommendations

The Company firmly believes that high-quality climate disclosure is essential for all Shareholders making long-term investment decisions. The following table outlines the Company's summary of the TCFD disclosures made for financial year 2021/22.

WHAT TCFD IS AND WHAT IT STANDS FOR

The Financial Reporting Council says that "Users expect companies to provide full information about the future impact of climate change on the business and how the company's activities affect the environment". In accordance with the net zero target by 2050, the UK Government also now expects listed companies to report in line with the TCFD framework.

This means that greater disclosure will be required across the areas of governance, risk, performance and strategy. Although investment firms are currently exempt from the provision of TCFD, the Company expects increased pressure from investors to lead to more voluntary compliance across the industry.

We are pleased to confirm that we have included in our TCFD Report climate-related financial disclosures consistent with the four recommendations and the 11 recommended disclosures set out in the June 2017 report entitled Recommendations of the Task Force on Climate-related Financial Disclosures. In October 2021, the TCFD released additional guidance implementing the Recommendations of the Task Force on Climate-related Financial Disclosures (2021 TCFD Annex), which supersedes the 2017 Annex of the same name (2017 TCFD Annex).

In line with the current UK Listing Rules (Listing Rules) requirements, our TCFD-aligned disclosures take into account the implementation recommendations in the 2017 TCFD Annex. In addition, we have considered the 2021 TCFD Annex and applied it where possible. Some recommendations in the 2021 TCFD Annex will require more time for us to fully consider. We will be working to implement the rest of the 2021 TCFD Annex recommendations over the course of 2022 and intend to apply these more fully in our next Annual Report. Further details on the TCFD Recommendations and Recommended Disclosures are available at: <https://www.fsb-tcfid.org>.

GOVERNANCE

Disclose the organisation's governance around climate-related risks and opportunities.

TCFD RECOMMENDED DISCLOSURES

A. The Board's oversight of climate-related risks and opportunities.

The whole Board is responsible for setting the strategy for the Company, including in relation to climate-related risks and opportunities. The Board meets at least quarterly, during which they, together with their independent consultants and the Investment Adviser, review the risks and opportunities facing the Company, including in relation to climate change. As part of this, the Investment Adviser prepares an ESG report each quarter for the Board.

The Company has a number of Committees which are tasked with focusing on various specific elements of climate-related risk and opportunity.

- The Management Engagement Committee is responsible for encouraging the Company's service providers to minimise their avoidable greenhouse gas emissions and offset unavoidable emissions, thereby helping to minimise the Company's Scope 2 emissions.
- The Audit Committee has responsibility for climate-related disclosures including SFDR and TCFD.
- The ESG and Stakeholder Engagement Committee reviews and approves the Company's ESG policy.

GOVERNANCE CONTINUED

Disclose the organisation's governance around climate-related risks and opportunities.

TCFD RECOMMENDED DISCLOSURES CONTINUED

B. Describe management's role in assessing and managing climate-related risks and opportunities.

ESG, including climate-related risks and opportunities, has become central to the Investment Adviser's approach to infrastructure debt.

Climate risks are considered at each stage of the investment process, including the initial screening of opportunities (where positive and negative screening are applied, as outlined in the ESG policy) and in meetings of the Investment Adviser's Investment Committee. Risk assessment takes the form of both qualitative analysis (such as scenario testing) and qualitative assessments (such as approach of the management of investee companies).

After an investment has been made, the Investment Adviser continues to monitor it for changes to its climate-related risk profile. Primarily this is undertaken through regular discussion with, and information gathering from, the borrowers that the Company has lent to. This is further enhanced in some cases by bespoke climate-related covenants and undertakings included within loan agreements.

The Investment Adviser considers climate-related risks not only in relation to individual investments, but also aggregated at the portfolio level. For example, it is necessary to assess correlations of climate-related risks.

KEY DEVELOPMENTS

- For the 2020/21 financial year, the Company engaged KPMG to provide an independent limited assurance process under ISAE (UK) 3000 on our ESG scores for the SEQI portfolio. We understand that we were the first FTSE 250 investment fund to undertake such a process. This mandate has been renewed for the 2021/22 financial year, providing an independent oversight of our analysis.
- In March 2022, the Board formed an ESG and Stakeholder Engagement Committee as discussed above.

STRATEGY

Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information is material.

TCFD RECOMMENDED DISCLOSURES

A. Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term.

The Company is well positioned to take advantage of the climate-related opportunities, since the transition to a low carbon economy is likely to require very significant capital, and governments around the world will look to the private sector to finance this, at least in part. These opportunities include: renewable energy, grid enhancement, energy storage, electric vehicle charging, energy efficiency projects and improved mass transit systems. Moreover, traditional lenders such as banks are not always well positioned to adapt quickly to new technologies and that will increase the need for private debt. The Company is already seeing significant lending opportunities in many of these areas and expects this demand for capital to increase over time.

STRATEGY CONTINUED

Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information is material.

TCFD RECOMMENDED DISCLOSURES CONTINUED

A. Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long term continued.

At the same time, the Company is exposed to climate-related risks, primarily through its investment portfolio. The key risks are:

- transitional risks, namely that some assets may become less profitable, or even worthless, as a result of legislation, regulation or market changes. For example, a carbon tax might mean that it is no longer economic to operate a gas-fired power plant;
- technology risk, namely that some parts of the infrastructure sector are developing rapidly, such as energy storage and hydrogen fuel systems, which may result in changes to markets that are difficult to predict. For example, the development of better batteries may make some "peaker plants" (power plants that operate when electricity prices spike) redundant;
- physical risk, namely that one consequence of climate change is the increased frequency of droughts, flooding, fires, storms or other natural phenomena. For example, businesses located in coastal areas may need to invest substantially in sea defences or otherwise harden their assets; and
- social and economic risks, namely that climate changes may make some areas much more difficult to live in, resulting in economic hardship, mass migration and potential political instability.

It is not possible to put precise time scales on these risks, but it is reasonable to assume that they are all currently present to a certain extent, and that they are likely to grow over time.

B. Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning.

The impact of the climate-related opportunities is that the Company will be able to deploy capital on attractive terms to a wider range of sectors than currently. This will increase the diversification of the Company's portfolio and help it to deliver an attractive risk-adjusted return to Shareholders.

Conversely, avoiding sectors where there is an unduly high level of climate-related risk, or even limiting the Company's exposure to sectors where there is some climate-related risk, will decrease the portfolio's diversification.

The Investment Adviser's view is that, between these two factors, there will be a net benefit for the Company's strategy. This is because the Company is already avoiding the most at-risk sectors, and is only beginning to see the full range of opportunities that are likely to arise. Moreover, avoiding borrowers with a high degree of climate-related risk is simply prudent lending and should be done regardless of any ESG strategy.

One purpose of the Company's ESG score is to help track resilience to climate change, amongst other things. Part of the investment strategy is to improve the portfolio's weighted average ESG score over time, which can be achieved by improving the portfolio's resilience to climate change risks.

STRATEGY CONTINUED

Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information is material.

TCFD RECOMMENDED DISCLOSURES CONTINUED

C. Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.

Overall, the Company believes that its strategy is resilient to climate change.

In order to assess resilience, it is necessary to consider a range of scenarios. Broadly speaking, in 2°C or lower scenarios, transitional risks will be high but physical and social-economic risks will be low. In higher temperature scenarios, the converse will be the case.

There are two potential impacts of climate-related risk on the Company.

Firstly, some sectors within the infrastructure market may become uninvestible in the future, for example assets in the hydrocarbon value chain such as gas-fired power stations. This is especially likely to be the case in low temperature increase scenarios, where the economy has transitioned rapidly to a low carbon state. Currently, under its ESG policy, the Company is avoiding those sectors where there is a near-term or medium-term risk of them becoming uninvestible, such as coal-fired power stations or upstream oil and gas assets. Therefore, this potential impact can be considered long-term. Should it happen, the Company's portfolio might over time become less diversified; however, in the opinion of the Investment Adviser, this risk is more than outweighed by the opportunities described above.

Secondly, the credit quality of some of the borrowers that the Company lends to might deteriorate. For example, extreme weather events might materially increase the cost of insuring some assets, or they may not be insurable without investing in asset-hardening. This risk is mitigated in a number of ways:

- each of the borrowers has equity capital at risk ahead of the loan. This acts as a "shock absorber". The equity capital needs to be lost before the Company can lose money;
- the Company's loans are typically short-dated; they are mostly due to be repaid within five years. That is before many of the most serious climate risks are likely to manifest themselves;
- the Investment Adviser undertakes thorough due diligence on each company that the Company lends to, and assessing their exposure to climate risk is part of that. In other words, the Company is not likely to make a loan to a business that has poor resilience to climate change risk; and
- the investment portfolio is highly diversified, in terms of the location of its borrowers and the sectors and sub-sectors they operate in. This will reduce the effect of many risks, such as technological disruption or unexpected regulation or legislation.

KEY DEVELOPMENTS

- After adopting its ESG policy in the 2020/21 financial year, the Company began disposing of, or in some cases waiting for the natural repayment of, its loans to borrowers in sectors that were not permitted under the ESG policy (for example, a loan to a coal export terminal). This process was completed during the 2021/22 financial year. This means that the Company no longer has exposure to sectors with the highest levels of transition risk.
- We have replaced these with, inter alia, loans in new sectors such as energy efficiency projects that are positioned to take advantage the opportunities that arise from the transition to a low carbon economy.

RISK MANAGEMENT

Disclose how the organisation identifies, assesses and manages climate-related risks.

TCFD RECOMMENDED DISCLOSURES

A. Describe the organisation's processes for identifying and assessing climate-related risks.

Climate-related risks are primarily assessed at the level of each investment, and form part of the Investment Adviser's due diligence and underwriting process.

Typically, third-party expert reports will be commissioned to assess key risks. For example, engineers might review the physical condition of the borrower's assets, including their exposure and resilience to extreme weather risk. This will then be analysed in tandem with a review of the borrower's insurance policy, and its other resources to cover uninsured risks. Each investment should also be analysed, where possible, in different climate scenarios, with the goal of identifying (a) credit rating changes arising from climate change and (b) elevated climate event risk. These items should be assessed separately as a standard credit rating framework struggles to incorporate event risk.

Climate-related risks are thus identified, and where possible quantified, in the due diligence phase of an investment, and discussed in the Investment Committee. Risks that are unacceptably high will result in an investment not being made.

B. Describe the organisation's processes for managing climate-related risks.

The Investment Adviser monitors each loan at least twice a year (and more frequently if required). This includes a review not just of credit quality, but also of the borrower's ESG profile, including climate-related factors. To assist in this, each borrower is sent annually a detailed questionnaire including qualitative and quantitative topics which will assist the Investment Adviser in updating its analysis.

A range of steps can be taken as a result of this ongoing monitoring of investments. For example, the internal credit rating may be adjusted, the loan may be considered for disposal, or the decision may be made not to participate in a refinancing of the loan, when it comes to its maturity date. In other words, if it becomes clear that a borrower's resilience to climate change is deteriorating, the Company can choose to dispose of the loan.

Similarly, if a sector is beginning to experience higher levels of climate-related risks, the Investment Adviser will avoid making new loans in it. Given the relatively short maturity of many of the loans in the portfolio, this will rapidly have the effect of decreasing the Company's exposure to that sector.



RISK MANAGEMENT CONTINUED

Disclose how the organisation identifies, assesses and manages climate-related risks.

TCFD RECOMMENDED DISCLOSURES CONTINUED

C. Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management.

Climate risk is integrated into the entire investment and risk management process.

At a very early stage, in considering whether to dedicate resources to a potential new loan, the Investment Adviser will apply negative and positive screening, and estimate the borrower's ESG score. Some potential investments will be rejected at this stage if the climate-related risks are likely to be unacceptably high.

Following the due diligence process, the Investment Committee will consider ESG matters as a part of the deliberations. The investment's ESG score will be agreed upon by the committee.

Subsequently, the investment is considered by the Investment Manager and in some cases the Risk Committee of the Board, who take into account both credit quality and ESG profile, including, where appropriate, resilience to climate change.

Finally, each quarter, the Investment Adviser prepares for the Board an ESG report, which reviews the overall portfolio.

KEY DEVELOPMENTS

- The Company has a comprehensive framework to identify and assess climate change risk. This is fully integrated into its loan approval, monitoring and risk management processes.



METRICS AND TARGETS

Disclose the metrics and targets used to assess and manage the relevant climate-related risks and opportunities where such information is material.

TCFD RECOMMENDED DISCLOSURES

A. Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.

Currently, the Company uses the ESG score as its key metric for assessing the environmental profile of its investments. This ESG scoring framework helps the Company allocate capital between projects and to measure its progress over time in a quantitative way. The methodology blends the “E”, “S” and “G” components without allowing strength in one area to offset entirely weakness in another. For example, a polluting company will always get a poor score, even if it has excellent social and governance policies. Moreover, the Fund’s policy is not to lend to companies with a very low E score, of less than one, regardless of the overall ESG score.

Going forward, the Company is looking to widen its range of metrics including potentially greenhouse gas emissions. However, currently this is not possible as the data that is available, in the context of a private debt portfolio, is not comprehensive enough to accurately calculate this type of metric. The ESG score serves as an analogous metric.

B. Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas emissions and the related risks.

The Company expects to be able to make Scope 1 and Scope 2 disclosures in the near future, and is working with the companies that it lends to in order to calculate or estimate its Scope 3 greenhouse gas emissions.

C. Describe the targets used by the organisation to manage climate-related risks and performance against targets.

Currently, the primary target used is to improve year-on-year the portfolio’s weighted average ESG score.

KEY DEVELOPMENTS

- The Company has improved the average portfolio ESG score from 60.59 to 61.88 over the course of the current financial year, largely as a result of making loans with a strong environmental profile, such as renewable energy and energy efficiency projects.