Fair Oaks Capital – ESG and Responsible Investing Policy

1. Introduction and Overview

Fair Oaks believes that investing responsibly is in the best interests of its clients, its employees and the society in which we operate. This policy is intended to record and formalise the approach and practices already in existence at the firm and to provide clarity to our employees, clients and other interested parties in our approach to responsible investing.

While there are many interpretations of ESG integration and responsible investing, at Fair Oaks we define them as follows:

ESG Integration is the inclusion of environmental, social and governance ("ESG") issues in our investment analysis in order to identify ESG risks and consider them accordingly in our investment decision making. ESG issues, which are also called sustainability factors, include the risks associated with climate change.

Responsible Investing is investing to maximise the risk-adjusted return for our clients without having a detrimental impact on the environment or society

While our membership of the UN PRI and forthcoming EU regulation require ESG integration rather than responsible investing, we believe that regulation or investors will ultimately require both.

We also believe that elevated ESG risk is a good forward indicator of potential financial underperformance. When analysis of an investment (including ESG integration) reveals ESG issues that have a significant detrimental impact on the environment or society, the likelihood that the issuer will face increased regulation or sanctions or decreased customer demand as a result of its practices means that the best investment decision from a purely financial perspective, is usually to exclude the investment from portfolios we manage. We thus believe that responsible investment is entirely consistent with our duty to clients.

In addition to integrating ESG issues in our investment process and investing responsibly, Fair Oaks will continue to encourage the broader adoption of ESG and responsible investing policies. We do this through our involvement in industry initiatives, due diligence on debt issuers, interactions with market participants, participation in conferences and comments to the press.

We expect our ESG policy to evolve over time and we encourage all employees to provide feedback and suggestions.

2. Approach

At Fair Oaks, we consider ESG factors as integral to investment analysis. We thus treat ESG risks in the same way as other sources of investment risk, such as financial risk or operational risk. Instead of having separate teams, reports or committees to consider ESG risks, they are included in all investment memos and discussed at investment committee in the same way as other risks to investment returns. Investment analysts are encouraged to think of ESG integration not as an independent process or a reporting or marketing consideration but as a core part of their role as investment analysts.

In the same way that we maintain flexibility in other parts of our investment analysis, we need to be flexible in how we assess ESG issues and avoid falling into a box-ticking mentality. The availability of information relevant to ESG issues is currently evolving and often feels insufficient. Furthermore, the assessment of ESG issues often requires more consideration and nuanced judgement than the more conventional aspects of investment analysis. And while the investment industry continues to develop ESG scoring methodologies, we must recognise that it is inherently more challenging to score, rank and compare companies across very different environmental, social and governance issues than it is on financial metrics, for example.

At Fair Oaks, we attempt to strike a balance between systematic inclusion and thoughtful consideration of ESG issues. We do this be ensuring that the output of ESG analysis is included in every investment proposal and discussed at every investment committee but leaving some flexibility as to the details of the analysis to the investment analyst.

As the provision of information relevant to ESG analysis improves and becomes more standardised, we expect to introduce more standardisation to our ESG analysis. Similarly, while we do not currently have rules for the prioritisation of ESG issues, we expect that we will develop this as the availability of information and ratings improves.

3. Implementation

While the nature of ESG issues may differ between different types of investment, e.g. a CLO tranche or a corporate loan, we integrate them in our investment analysis process the same way:

1. Inclusion of ESG issues in standard due diligence questionnaires to issuers
2. Discussion of ESG issues in due diligence meetings/ calls
3. Completion of a clearly identified ESG section in every investment committee paper
4. Reference to any relevant ESG issues in description of financial projections and investment recommendation
5. Discussion of ESG issues in every investment committee, even if no material ESG risks have been identified
6. Discussion at portfolio review meetings of ESG risks identified at issuer level
7. Discussion at portfolio review meeting of potential impact of thematic ESG risks (e.g. climate change) on portfolios
8. Review of ESG risks to the firm and the firm's investments at management's' quarterly risk committee
9. Annual review of ESG Policy
10. Disclosure of ESG and responsible investing policies on firm website and annual reporting of ESG integration to UN PRI

In addition to the general implementation rules above, there are some specific guidelines by asset class:

3(a). Corporate issuers:

The ESG criteria included in the indenture of CLOs managed by Fair Oaks are intended to signal to the market our consideration of ESG issues in our loan selection. As the data and ratings system necessary for comprehensive inclusion of ESG criteria in a CLO indenture are not yet available for the loan asset class, we have limited the ESG language in the indentures to eligibility criteria which simply prohibit investment in loans from issuers who are primarily active in industry sectors which inherently involve very significant ESG issues and investment risks (e.g. thermal coal extraction or tobacco manufacturing). These exclusionary criteria are legally binding and should be treated in the same way as other eligibility criteria in a CLO indenture. Adherence to them, while required, should not be mistaken for ESG integration, which requires the consideration of all ESG issues relevant to the credit quality of the corporate issuer, and is required as described above.

3(b). CLO issuers:

CLO issuers:

The consideration of ESG issues while investing in CLO tranches takes place at two levels, that of the CLO manager and that of the CLO collateral, the underlying corporate loans.

Consideration of ESG issues at CLO manager level includes analysis of the manager's ESG practices and their own ESG and responsible investing policies. Questions are included in our standard manager assessment template to cover these aspects of manager diligence.

Consideration of ESG issues at CLO portfolio level is inherently challenging due to the number and diversity of CLO assets, limitations on information available on them and the fact that CLO portfolios are not static. Fair Oaks' approach is to maintain a separate risk rating in our risk list database to flag corporate issuers for whom we have identified significant ESG issues. These issuers are then highlighted for discussion in investment committee papers for CLO investments, together with other corporate issuers which operate in certain industry sectors identified as having a higher risk of ESG issues. In order to broaden the identification of ESG issuers at corporate issuer level, Fair Oaks asks CLO managers what ESG issues they have identified as part of its investment diligence and these issuers are flagged on Fair Oaks' risk list database, provided we agree with the CLO manager's assessment.

While our analysis of CLO documentation could be considered a governance consideration, it is in addition to rather than instead of the analysis of governance at a CLO manager, including their ESG policy, and at the underlying corporate issuers.

We expect that as the provision and standardisation of ESG information and ratings for corporate borrowers improves, we will be able to integrate the consideration of ESG issues into our analysis of CLO investments in a more systematic and numeric way.

Finally, the implementation of ESG integration and responsible investing can impact investment decisions differently for corporate loans or bonds and for CLO investments. For corporate issuers, identification of an ESG issue that, in our view, means the issuer has a significant detrimental impact on the environment or society will likely result in a decision not to invest in the loan or bond in question. For CLO investments, such a negative finding on the manager will likely preclude investment in the CLO tranche but identification of such issues at a single corporate borrower in the CLO portfolio may not result in a decision not to invest. This is because a CLO may hold several hundred loans and there are currently few CLOs outstanding for which Fair Oaks would not identify some significant ESG issue at a portfolio company. This does not mean that the results of the ESG analysis of a CLO portfolio do not impact the investment decision but that the decision may be based on a relative as well as absolute analysis, considering the other investments available.

4. Responsibility

The implementation of Fair Oaks' ESG Policy will be overseen by Roger Coyle and reviewed by the risk management committee on a quarterly basis. However, all employees are responsible for its implementation and adherence to this policy will be considered as part of annual performance appraisals.