SHENKMAN

DISCIPLINE DRIVES PERFORMANCE®

2021 ESG YEAR IN REVIEW

SHENKMAN ESG | CREDIT INSIGHTS®

We believe ESG and SRI factors need to be a critical part of the investment process, and we endeavor to incorporate these considerations into our research analysis as well as in managing our business. The ESG umbrella can involve a variety of approaches and a diverse view on priorities. We strive to consider all the relevant factors in this field while also meeting our clients customized needs, whether by incorporating certain negative screens in separately managed accounts or through specific reporting.

In this year-end review we:

- Discuss our innovative Minority/Women-Owned Business Enterprises (MWBE) trading program.
- Highlight the evolution in green, sustainable and social bond issuance in the past year.
- Include a brief interview with our Energy analyst to give insight into how he considers ESG and SRI factors in one of the more controversial industries.
- Provide an example of deeper ESG engagement with management.
- Give samples, drawn from our database, on how ESG factors have impacted investment decisions.
- Outline some of the key data we track and factor into our investment decisions and the portfolios we manage.
- Give an update on developments we have undertaken in the last 12 months 1) in our ESG policies and processes such as adding ESG screens to our UCITS Funds and 2) on diversity and inclusion.

ESG and SRI investing is an evolving field that can be highly dependent on personal defined terms. We believe that the best way to progress in this dynamic area is to be a partner for innovation with our clients and to continue to evolve ourselves. With our deep focus and commitment to credit research, we believe we can be a valuable ESG partner for our clients, and we look forward to hearing from you throughout the year on how we can best work together.

MWBE (Minority/Women-Owned Business Enterprises) Trading Platform

In 2021, through our partnership with MarketAxess, the Firm launched a new diversity dealer initiative, to help clients interact more effectively with minority owned broker-dealers. This is a new opportunity to incorporate our ESG philosophy and principles into our trading execution.

- Shenkman has an opportunity to allocate approximately $500 – 800MM* of trading volume to diversity dealers through this program.
- In 2021, since the launch of the program on 8/24, the Firm has executed $715mm in volumes.

*Opportunity range is extrapolated using current electronic trading volumes 1/1/21 through July 31, 2021.

Growth in US ESG bond issuance

While the issuance of ESG bonds has been prevalent in the Global and Investment Grade markets, we have seen a pick-up this year in the US High Yield market. In anticipation of an expansion in this area, our Director of Capital Markets has built a tool to monitor and gather data on this segment of new issuance.

It is important to note that several different types of issuance are developing. One defining feature is if the ESG related issuance is being self-certified by the issuer or it is being certified by a third party. There are also differences in whether the debt issuance has a "response" feature to achieving or not achieving certain goals, such as a coupon declining or increasing if certain carbon footprint goals are achieved by a certain date (known as sustainability linked bonds). There is also "use of proceeds" issuance which states how the company will spend the funds on an ESG friendly project. Then there are differences around what topics the issuance is focused on such as environmental issues (e.g. carbon footprint, water usage etc.), or social issues (e.g. minority hiring, offering services in underserved communities, etc.).

New issuance in Green and Social bonds has its fair share of controversies, on topics such as how these features impact pricing and trading and whether a "green" bond from a "high carbon footprint" industry is an ESG friendly investment or not. Like many aspects of ESG investing, there are diverse efforts impacting issuance and a variety of methods being developed. It is clearly another important aspect to follow in ESG as it evolves. We believe our capital markets work will keep us on the front edge of developments.

Some US high yield bond highlights are below:

- 24 ESG tranches from 20 issuers came in 2021.
- $17.9bn of ESG issuance in 2021 represented 3.9% of total high yield issuance.
- 67% were green/social/sustainable "use of proceeds" bonds versus 33% that were sustainably linked. Overwhelmingly, the issuance was environmental/green related.
- The vast majority of the issuance was from higher quality (BB rated) public companies, although there were several sponsor-controlled issuers and single B credits.
- The TEVA financing in November 2021 was notable for the following reasons: 1) the 7.5 year tranche had coupon steps (12.5bp each) for three separate targets (one environmental and two social related) and 2) the 5.5 year tranche didn't have the coupon steps (because the maturity is too close to the testing date), so there is a 0.15% amount of principal payment for each of the 3 targets that is paid at maturity or when refinanced (as long as it occurs after the testing date).
- We continue to encourage standardization of these types of securities and look to the ICMA (International Capital Markets Association) and ELFA (European Leveraged Finance Associate) that have created the guidelines.

Q&A with our Energy Analyst, Chris Gault

Given the heightened attention on climate particularly around the COP26 conference last year, we sat down with our energy analyst to glean insights from his conversations with management teams.

Q: How have you seen oil & gas management teams discussions on ESG issues evolve over the last couple of years?

A: Particularly in the last two years, we have seen energy companies, even private ones, taking ESG seriously. They know investors will expect information, and managements know they need to be prepared. Although what investors want is not uniform, improved disclosure is a common theme. Company managements indicate that it is now common to hear from investors' ESG teams.

Q: What is a topic that has gained traction?

A: With the increased attention on methane, we have seen a trend of some labelling their gas as low methane. Producers are starting to report more data around flaring and methane leakage in their results and highlighting efforts in this area to investors.

Q: How do you think about recent shareholder activism focused on the larger investment grade names in the sector?

A: Equity returns in the sector have been weak since the 2014 oil crash, leading to increased sector pressure on reducing investment and improving returns. ESG concerns have had an additional dampening effect on investment, not only for the majors but across the industry, as longer-term demand trends come into question. Investors have made it clear they prefer cash returns, through buybacks or dividends, over uncertain growth investments. We do not see this phenomenon changing in the near term. Within high yield, there has been less pressure on companies to invest in renewable fuel production as the producers in high yield tend to have less business diversification than the fully integrated majors.

Q: How is the Shenkman's investments in the industry generally positioned?

A: Within high yield, the exploration and production subsector is highly concentrated in developed markets, particularly North America, which faces more regulatory scrutiny than most other supply regions. We have been selective in our positions and generally have an index underweight in the E&P, oilfield services, and refining subsectors. The loan and convertible bond markets have less concentration in energy issuers than the high yield bond market. We have generally avoided investments in Canadian oil sands due to the high cost structure in that region as well as ESG issues. We have also seen these oil sands companies show up often on our client's restricted list due to oil sands industry's impact on the environment as well as the higher carbon intensity than conventional oil.

Q: Do you think ESG is impacting valuations in the sector?

A: We believe that ESG factors are contributing to declining investment in the space. We also believe that longer term these companies will face a higher cost of capital, not only due to reduced investor interest, but also due to uncertainty around long term demand trends for carbon-based fuels. For private equity held companies, we see ESG factors influencing exit strategies as certain assets that draw higher levels of environmental scrutiny being unlikely to be sold to a strategic buyer.

Q: Do you think ESG is creating opportunities?

A: If investors exit an entire sector, and it creates selling pressure on their securities, we expect it creates opportunities in individual companies in cases where we are confident that there are differentiated strategies in improving company's ESG metrics and managing the transition to a lower carbon environment. This has to be uncovered through our conversations with management and monitoring industry-wide developments.

An Example of Engagement

A key element of Shenkman's investment process is engagement by the investment team with company management, underwriters, sponsors/owners, as well as clients. In all of the ESG examples below, it was critical to engage with management on these topics. Ongoing dialogue with management teams is a hallmark of Shenkman's investment process. There are times when it is critical to engage with management teams on specific ESG and SRI concerns. Over the years, we have found third party agencies that focus on ESG may rightfully uncover ESG concerns but, importantly do not then see how the company is addressing or looking to resolve these issues. Understanding how a company addresses, or does not address, these ESG concerns can change the risk profile of an investment in our opinion. We believe that digging deeper into these ESG risks could create opportunities for outperformance over time. One of our more notable ESG related engagements this year is highlighted below:

A pharmaceutical company was tagged by Sustainalytics as being non-compliant with the UN Global Compact Principle #10. Per Sustainalytics, they found the "company to be in violation of Principle 10 of the UN Global Compact and Chapters VII, VIII and X of the OECD Guidelines for Multinational Enterprises. The company and its subsidiaries face allegations of anti-competitive practices, including price-fixing of generic drugs in the US, and were involved in cases of corruption in several countries". We held a call with the company's IR and ESG team to address these concerns. We acknowledge that the company has paid material fines in the past decade related to foreign corrupt practices and is currently under investigation for price fixing of generic drugs in the United States. However, since the settlement related to the former issue over five years ago, the company has made substantial progress to improve governance throughout the organization to prevent a similar situation ever happening again. We discussed this in detail with management. Additionally, while the price fixing investigation in the US has not been settled, the company has also not been found guilty of anything yet, and at the very least, we have good reason to believe that any settlements/fines will be very manageable, from a financial perspective. After our conversation with management, SCM's ESG committee convened to discuss the Sustainalytics classification and decided to maintain our position.

Examples of ESG Integration in the Investment Process

Shenkman's long standing investment philosophy integrates ESG factors into its overall credit research process. Our research team regularly submits notable examples on ESG topics to a database that is shared and reviewed internally. Three examples of how we integrated ESG in our investment process in the last year are described below.

- **Environmental example**: We participated in a new issue for a leading provider of metering and network management solutions for utility and municipal customers. Their technology offerings allow customers to more efficiently monitor and manage the use of electricity, gas and water. We believe this "smart grid" technology will prove to be a critical part of improved energy conservation and this credit should benefit from an increased emphasis in this arena from policy makers and consumers.

- **Social example**: A for-profit college came to market to finance their planned acquisition of another for-profit college. The industry has benefited over the past few years from reduced regulation and removal of certain consumer protections. With the new Administration in place, there is elevated risk that those regulations could be put back into place or they may face increased legal actions from consumers. Most likely regulations to be enacted include reinstating Gainful Employment, or amending the 90-10 Federal Funding rule. Additionally, at the time of the transaction, the company was under investigation by the Federal government for misleading students about program costs, content, and availability of placements needed to graduate. All of these risks played a role in us electing not to lend to the company.

- **Governance example**: A company in which we owned an investment was seeking lender consent to conform the Restricted Payment covenants of the notes due in 2025 notes to that of those due in 2031. The '25s were issued during COVID with tighter terms while the '31s were issued recently and in line with looser competitors covenants. The amendment would change the Restricted Payment builder basket from 50% of Net Income to 100% of Net Income based on a Book Value of equity threshold (which they currently meet). We turned down the initial consent solicitation and 25bp consent fee, thinking it would set a bad example for the market. Ultimately the terms were revised to more fairly compensate bondholders.

ESG Checklist Data

Our proprietary ESG checklist highlights many ESG issues impacting a company and is included in our credit report that our Analysts prepare. A matrix is used to help guide the Analysts in filling out this checklist.

Based on the results of this checklist, each company is placed in one of four ESG tiers, with Tier 1 credits being the highest ESG quality. The ESG Tiers are stored in our internal database and are used to inform portfolio management decisions. We continue to enhance and update this database and seek ways to incorporate this information into the research and portfolio management process. Our ESG Tier report for a representative portfolio is shown on the next page.

The ESG checklist utilizes some of the elements in our proprietary C-Scope score. This score is one of the critical pieces of our credit approval process and our credit monitoring. Of the questions that make-up our C-Scope score 20%, of them are ESG related.

Shenkman's ESG Tiers for an indicative portfolio

	12/31/2021	12/31/2020
ESG Tier Weight		
Tier 1	59.7%	60.9%
Tier 2	35.2%	37.5%
Tier 3	0.5%	0.0%
Average OAS		
Tier 1	266	313
Tier 2	289	294
Tier 3	530	n/a

SRI data

We have a long history of applying screens on SRI factors at a client's request for their portfolio. In order to assist these efforts, we have developed proprietary screens on 17 common SRI factors. We track revenue exposure to these screens in three buckets: 1) 0% revenue exposure; 2) 0-50% revenue exposure and 3) Greater than 50% revenue exposure. Our custom SRI screens can also be used to monitor portfolio risks as internal reports show an individual portfolio's exposure to SRI factors. See below examples of information from our SRI report for a representative portfolio.

Shenkman's SRI data for a representative portfolio:

SRI FLAG REVENUE EXPOSURE	0%	>0% & <50%	>50%
SRI Flag Weighting	58.3%	24.4%	14.1%
Average OAS	286	306	339

SRI CATEGORY	>0% Revenue & <50% Revenue	>50% Revenue
Abortion/Abortion Related	4.57%	0.0%
Alcohol	5.18%	0.0%
Biological & Chemical Weapons	0.00%	0.0%
Civilian Firearms	0.00%	0.0%
Coal & Consumable Fuels	0.00%	0.0%
Defense	4.49%	0.0%
Gambling	0.76%	2.7%
Human Cloning	0.29%	0.0%
Landmines & Cluster Munitions	0.00%	0.0%
Nuclear Weapons	0.00%	0.0%
Oil & Gas	0.20%	11.4%
Pornography/Adult Entertainment	8.74%	0.0%
Private Prisons & Detention Centers	0.53%	0.0%
Prostitution	0.00%	0.0%
Predatory Lending	0.00%	0.0%
Sudanese Government	0.25%	0.0%
Tobacco	3.23%	0.0%
TOTAL	24.39%	14.1%

Diversity and Inclusion Committee Highlights

In 2020, the Firm established a Diversity and Inclusion Committee. The committee provides a meaningful forum to consider the Firm's culture, existing policies, recruitment, retention, promotion, and external relationships. The Committee presents ways in which the Firm may better address these initiatives across the organization. Recent accomplishments include:

- Adopted a Donation Matching Program – identifying non-profit organizations that provide support to historically underrepresented demographics, in our local communities and throughout the world

- Retained a diversity and inclusion consultant, Beyond Barriers, to help us expand and realize our D&I goals.

- Expanded the Firm's sensitivity training repertoire to include a specific course on "Unconscious Bias."

Updates to Shenkman's ESG Procedures and Policies

- **ESG and Structured Credit:** To continue to enhance our ESG integration in our investment process in 2021, we incorporated an ESG investment tool for our structured credit strategy. Informed by the LSTA's ESG diligence Questionnaire for CLO Managers, we created a document of 10 ESG questions to be completed as part of our manager due diligence. Answers to these questions are incorporated into our proprietary M.Scope score for each manager. The M.Scope score is part of the Firm's comprehensive research process and combines quantitative and qualitative analysis of a manager's platform, investment process, investment performance, and risk tolerance.

- **UCITS Funds Products Introduce ESG Screens:** Several of our UCITs funds, which are not Article 8 funds, have recently incorporated a screening process in their review of any companies involved in controversial weapons exposure or are non-compliant with UN Global Compact principles.

- **Signing TCFD:** In February 2021, the Firm became a public supporter of the efforts of the Task Force on Climate-Related Financial Disclosures ("TCFD"). In order to improve the ability to incorporate data into the research process, we believe the standardization of information is critical. Through our support of the TCFD, we hope that these standards continue to gain adoption from corporate borrowers and broadly increase transparency in the industry.

- **Updated ESG policy:** Along with our signing of the UN PRI, the Firm adopted a formal ESG Policy in April 2017. As we continue to review and enhance our ESG practices, our ESG Policy was updated in April 2021 to reflect the evolution of our work and processes in this arena. Please visit our website at https://www.shenkmancapital.com/responsible_investing to view the most recent policy.

- **Formation of the ESG Committee:** The Firm's RISK Committee has focused on implementing our ESG Policies and has provided explicit support of our ESG practices by the most senior members of the Firm. In 2021, in order to enhance our ESG focus, the Firm formed an ESG Committee as a sub-committee of the Risk Committee that also includes representatives from compliance and investor relations. The ESG Committee's mission is to support the Firm's ongoing commitment to ESG matters and to assist the Firm in fulfilling its responsibilities by providing oversight and support of the Firm's sustainability and ESG programs, goals and initiatives.

Conclusion

We look forward to enhancing our ESG work in 2022 as ESG and SRI investing continues to evolve. We believe in ESG principles and will continue to work in this area. As always, we encourage our clients to discuss their concerns and ideas with us.

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