

Definition of a sustainable investment

Private Debt Expertise

The European Commission proposes, in Article 2 (17) of the EU Regulation 2019/2088, a definition of a sustainable investment within the meaning of the SFDR regulation.

"sustainable investment: an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance."

It is up to asset managers to apply this definition to determine the proportion of their investments that are sustainable.

The definition is broad and leaves room for interpretation. It does, however, specify that sustainable investments must:

- Contribute to an environmental or social objective, as measured by indicators
- Do not significantly harm ("DNSH") other sustainable objectives
- Follow good governance practices

Sienna's Private Debt Expertise approach to evaluating each of the three areas is detailed in the three sections below.

1. Contribution to a sustainable goal

Sienna IM – Private Credit structures the assessment of its contribution to a sustainable goal based on the Sustainable Development Goals (SDGs) and corresponding targets: each "sustainable investment" as defined by Sienna Private Credit pursues one of the 17 SDGs, further divided into 169 targets.

Sienna IM – Private Credit considers, as recommended by the European Commission, that a company's contribution to a Sustainable Development Goal (SDG) can be achieved in three ways:

- The company is active in a sector that directly contributes to an SDG (for example, a renewable energy producer or an organization promoting professional integration)
- The company has better practices than its peers regarding an SDG (best-in-class approach, such as achieving gender pay parity when the average gender pay gap in the sector is 15%)
- The company has made commitments and has an improvement plan (for example, it has signed a GHG reduction plan validated by SBTi)

For each asset, the contribution to an SDG is analyzed at the time of the investment and on an annual basis.

2. Do Not Significantly Harm analysis procedure

Sienna IM - Private Credit considers PAIs (Principal Adverse Impacts) in its investment opportunity analysis. The "DNSH" approach takes into account 7 PAI indicators that it considers the most important. These indicators are detailed below. Companies that have provided the response indicated below to any of the PAIs 1, 4, 7, 8, 9, 11, 14 are considered to have a negative impact on sustainable objectives and are not eligible for "sustainable investment":

- **Greenhouse gas emissions (scope 1 and 2, PAI #3):** the organization has a scope 1 + 2 carbon intensity (tons of CO2 equivalent per million euros of revenue) lower than the average carbon intensities of the 5 most emitting sectors of GHG (provided that the organization has revenue greater than €10m), and the organization has not implemented any measures to reduce emissions in line with a scenario that limits global warming to a maximum of 2° (subject to validation by a third-party organization)

The carbon intensity cap, corresponding to the average of the 80% median carbon intensities of companies in the 5 most polluting sectors, is updated annually (based on the scope covered by Sustainalytics). As of the writing of this note (May 3, 2023), it is 325 tons of CO2 equivalent per million euros of revenue.

Note: Sienna IM - Private Credit may use parametric models provided by third parties to measure borrowers' carbon intensity where borrowers are not equipped to do so (most of the borrowers involved in Sienna Private Credit's financing are not required to do so at this time)

- **Activity related to the fossil fuel sector (PAI #4):** Yes
- **Controversial Weapons Exposed Activity (PAI #14):** Yes
- **Pollutant waste emissions (PAI #9):** if manufacturing activity, and emissions > 1 ton/year, and the organization has not implemented a waste reduction policy, resulting in measurable and significant results
- **Emissions to water (PAI #8):** if manufacturing activity, and emissions > 1 ton/year, and the organization does not have a water emission reduction policy in place to reduce pollutant emissions to water to 0
- **Biodiversity impact (PAI #7):** activity of the organization affecting biodiversity-sensitive areas
- **Violations of the Global Compact and the OECD Guidelines for Multinational Enterprises (PAI #10):** Yes

The DNSH analysis is completed by an analysis of the controversies to which the beneficiary organization is or may have been exposed. The analysis of controversies is part of the systematic procedure for analyzing controversies.

3. Governance practices assessment policy

Our policy of assessing good governance practices focuses on the organizations that receive funding.

The policy of assessing good governance practices is systematic for all transactions carried out within the framework of funds that promote environmental and social characteristics, as long as the issuer of the debt securities is an organization with more than 50 employees, organized in corporate form (SAS, SA, SARL or European equivalent).

It covers, as recommended in Article 28 of the technical standards published in the Delegated Act (EU) 2022/1288, the following elements:

- **Sound management structures:** Sienna IM - Private Credit ensures that the issuer has governance bodies (board of directors, executive board, management committee, etc.) consistent with its size and jurisdiction, and includes independent members in its governance bodies - in case of non-compliance at the time of investment, the inclusion of an independent member may be subject to a commitment by the borrower;
- **Employee relations:** Sienna IM - Private Credit assesses the quality of employee relations by analyzing controversies to identify potential social tensions (such as strikes);
- **Employee compensation:** Sienna IM - Private Credit assesses the quality of the issuer's employee compensation practices, focusing in particular on the existence of a compensation policy, a profit-sharing agreement, the signing of at least one NAO agreement in the last three years (French issuers) and the existence of an employee share ownership mechanism. In the absence of all these elements, the issuer's practices in terms of employee compensation are considered weak;
- **Tax liabilities:** Sienna IM - Private Credit is aware of any pending tax disputes involving the beneficiary company. In the event that tax disputes are pending, an assessment of the materiality of the disputes is performed. Sienna Private Credit pays particular attention to the average tax rate on profits over the last 3 years: thorough due diligence is conducted when the average tax rate is below 15% (the minimum tax rate set by Europe for multinationals).