CAPITAL
FOUR

OCTOBER 2022

# Sustainability Report

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# Letter from Management

We are pleased to present our second Sustainability Report for Capital Four. At Capital Four, we remain firmly committed to the principles of PRI, the UN Global Compact and the Task Force on Climate-related Financial Disclosures (TCFD). We have spent significant efforts on developing our approach during the past year, including improving our access to sustainability data. We are very pleased to see an open and constructive collaboration on sustainability related issues with both the investors for whom we manage capital and the companies that we fund.

We publish this report at a time when there is war in Ukraine, with tragic human consequences every day. Climate change is accelerating, with a number of negative consequences for people and the planet. There is an energy crisis in Europe that threatens the ability of a number of European countries and companies to operate at full capacity. Inflation and interest rates have significantly upset financial markets. We believe this is a time when it is very important to show a continued commitment to sustainability.

We have significantly advanced our understanding of the $CO_2e$ emissions profile of the companies in our investment portfolios by collecting and mapping carbon emissions data for many of the issuers. This has been instrumental for offering investment products with environmental characteristics –Article 8 products under the European Sustainable Finance Disclosure Regulation (SFDR). These investment products are committed to having a weighted average carbon intensity significantly below the relevant benchmark.

We have also structured and improved our engagement efforts and are having constructive dialogue with a number of issuers on topics ranging from human rights to carbon footprint.

In our own operations, the most important initiative has been Capital Four's work on Diversity, Equity and Inclusion (DEI). We consider it essential that Capital Four becomes more diverse during the coming years. We are especially focused on improving the gender balance in the company and developing more female talents into management positions.

We would like to thank Capital Four's clients, employees and partners for your continued dedication, trust and support in driving the sustainability agenda forward.

## About Capital Four

- An **industry-leading** credit asset manager for some of the largest international pension funds and institutional investors.
- Manages **€16+ bn** on behalf of clients.
- **UN PRI**, **UN Global Compact** and **TCFD** signatory
- **100%** of assets under management scored using Capital Four's ESG scoring model.
- **126** employees representing **21** nationalities.
- Offices in **Copenhagen**, **New York**, **Frankfurt am Main** and **Stockholm**.

**Sandro Näf**
CEO, Portfolio Manager & Co-founder

**Torben Skødeberg**
Portfolio Manager & Co-founder

# Status on 2021/22 Focus Areas

During 2021 and throughout 2022, Capital Four has focused on the following key areas to strengthen our sustainability initiatives both in terms of investment activities and in our own operations.

## 1. Investments and stewardship

| Focus area | Progress |
|---|---|
| Calculate carbon footprint of portfolios and strategies | We have calculated carbon footprint and weighted average carbon intensity (WACI) on portfolios and strategies based on our current data coverage. We continuously work to increase our data coverage and improve our data analytics tools. |
| Integrate and increase ESG data availability and quality in ESG Scoring Model | We have worked to further integrate ESG data into our financial models. We have increased our efforts to collect data and engage with issuers to increase transparency. We are participating in working groups and initiatives to increase ESG data disclosure and understanding in the leveraged finance universe. |
| Pursue carbon-reduction initiatives regarding the investment portfolio | Several strategies now have investment guidelines where carbon intensity (CI) at portfolio level must be significantly lower than their benchmark. |

## 2. Capital Four's own corporate activities

| Focus area | Progress |
|---|---|
| Calculating carbon footprint of corporate activities incl. scope 1-3 | In 2021, we took the first steps to map and calculate our carbon footprint from our corporate activities. We strive to continuously increase the quality of our carbon footprint calculation and to further increase the transparency of our scope 3 carbon footprint. |
| Pursue carbon neutrality, incl. use of offsetting schemes and initiatives | In 2021, we purchased green certificates for our electricity consumption in our main office in Copenhagen to minimize our net carbon footprint. Additionally, we now offset all carbon emissions arising from business travel. |

# Focus Areas for 2022/23

1

**Commitment to a net zero target**
During the autumn of 2022, we will begin to map our current portfolio's net zero carbon trajectory, with the aim of committing to a net zero carbon target for a portion of our investments.

2

**Developing our climate risk assessment**
As part of our work with ESG scoring and TCFD, we will work to further develop our methodology for conducting more detailed climate risks assessments of our investments and portfolios.

3

**Strengthening our engagement efforts and tracking these**
Following our updated Engagement Policy, we will focus on strengthening our ongoing engagement efforts across our investment teams and portfolios, in addition to reporting on them.

4

**Continued work with ESG risk and data disclosure from investee companies**
During 2021 and 2022, we have worked to further integrate ESG data into our financial models and we will continue to work with investee companies to increase transparency and data quality.

5

**Continued work on Diversity, Equity and Inclusion**
We will continue the work we have initiated with DEI. This will be done by developing a DEI Policy, as well as implementing a range of initiatives aimed at strengthening DEI at Capital Four.

# Sustainability Highlights

At Capital Four we strive to advance on our incorporation of ESG into our investment practices, increased disclosure and strengthen our stewardship efforts. During the reporting period we have advanced on:

## Responsible Investment Policy

Revised Responsible Investment Policy, including further disclosure on governance structure and firm-wide exclusions. Read more.

## TCFD

Became a supporter to the TCFD and began work on TCFD reporting, which we will continue and expand in the coming years. Read more.

## Carbon Data

Extensive work collecting and mapping carbon data for issuers. Developed data analytics tool at issuer and portfolio level to better incorporate carbon data in investment decisions, understand changes over time and increase transparency. Read more.

## ESG Scoring

All investments in companies and CLOs are scored on an ongoing basis using Capital Four's ESG scoring framework. The scoring is updated at least annually. The scores and the scoring methodology have been disclosed to clients.

## Engagement

Formalized an Engagement Policy and process providing a structured plan, with clear definitions of objectives, scopes and goals. The approach allows Capital Four to formulate trigger point for actions and aims to increase our impact. Read more.

## Training

Ongoing training of investment staff in key sustainability areas. Training has included norm-based assessments based on UN Global Compact and OECD standards as well as training in new regulatory requirements, including the SFDR and greenhouse gas (GHG) accounting.

## Diversity, Equity and Inclusion

We want to define and shape initiatives that make Capital Four an even more diverse and inclusive place to work. We have initiated a working group, conducted a survey, worked with external consultants to write policy and set targets. Read more.

## ESG Data

Increased our access to ESG data through two additional providers, MSCI and S&P. Data waterfall applied in central systems and accessible throughout the organization. We continued building our ESG data analytics.

## Collaboration

Participated in several programs, initiatives and events managed by the UN Global Compact, PRI and European Leverage Finance Association (ELFA). These included the UN Global Compact facilitated “Climate Ambition Accelerator”, PRI workshops on enhanced ESG disclosure and ESG factors material to credit risk, and an ELFA workshop and roundtables on material ESG factors.

## Capital Four led Initiatives

Capital Four and Copenhagen Business School (CBS) hosted a Credit Day. The day included a breakout session on ESG and credit investing. Capital Four also hosted a roundtable on integrating ESG and illiquid assets at CBS together with DANSIF and others.

## Sustainability-Linked Loans

73% of all new commitments in our private debt strategies now have sustainability-linked loan (SLL) features in the loan documentation.

## New Product Offering

Aligned with the SFDR, we have launched new Article 8 products for respectively our bond, loan and multi-asset strategies, and our private debt strategy.

## Capital Four PRI scoring

PRI Principles for Responsible Investment

As a signatory of PRI, Capital Four strive to advance our incorporation of ESG into our investment practices, increase disclosure and improve our stewardship efforts. Based on our inputs from March 2021 our PRI Assessment Report and PRI Transparency Report reflect the following scores:

★★★★★

**Fixed Income – Corporates**
Capital Four score: 94 of 100
Median score: 62 of 100

★★★★☆

**Fixed Income – Private Debt**
Capital Four score: 90 of 100
Median score: 67 of 100

★★★★☆

**Fixed Income – Securitization**
Capital Four score: 87 of 100
Median score: 55 of 100

★★★☆☆

**Investment & Stewardship Policy**
Capital Four score: 60 of 100
Median score: 60 of 100

Since the 2021 PRI reporting cycle, we have continued our work driving forward on our sustainability efforts as disclosed in our Sustainability Reports.

# Responsible Investing

Capital Four's approach to responsible investing is outlined in our Responsible Investment Policy. The policy covers 100% of Capital Four's assets under management.

## Vision

Capital Four focuses on investments that contribute to long term financial value creation, while avoiding investments that we believe have a negative effect on society.

## Investment Universe

Capital Four applies minimum standards requirements for all investments. These standards are based on UN Guiding Principles on Business and Human Rights, OECD Guidelines for Multinational Enterprises and the Ten Principles of the UN Global Compact.

Capital Four will not invest in companies which are involved in the production of controversial weapons, are producers of tobacco or that generate more than a minimal part of their revenue from coal mining, coal-based energy production, Arctic drilling or involvement in oil sands extraction. Additional limitations to our investment universe stem from screening against the EU, UN and OFAC sanction list. Where an investor has explicit investment restrictions, Capital Four will comply with these restrictions.

Our internal ESG scoring further assigns a minimum threshold to our investable universe.

## Process and Guidelines

Our ESG process uses our ESG scoring model as a foundation and includes product and conduct screening, client guideline compliance, and the inclusion of Principal Adverse Impacts (PAIs).

## Commitment to Global Principles and Standards

Capital Four is a signatory to the UN Global Compact, PRI and TCFD. We intend to become a signatory to the Net Zero Asset Managers Initiative (NZAMI) in 2022.

## ESG Investment Decisions

The portfolio managers at Capital Four decide on and are responsible for the investments we make. The ESG scores and available information on PAI indicators are important inputs to the portfolio managers prior to making investment decisions.

## Training and Education

We continuously participate in multiple responsible investing-related courses, conferences and webinars. In addition, we conduct internal ESG training for all Capital Four analysts, and all new hires at Capital Four are given an introduction to responsible investing and sustainability.

## ESG Committee

Capital Four has an ESG Committee comprising professionals from across the organization. The purpose of the ESG Committee is to ensure Capital Four stays at the forefront of responsible investment practices and developments.

## Governance

The CEO, who reports to the Board of Directors of Capital Four, has to ensure Capital Four has a Responsible Investment Policy in place. The Investment Committee is responsible for implementing Capital Four's ESG policies, including the Responsible Investment Policy throughout the investment process. The COO ensures the implementation of all ESG restrictions on funds and mandates, and the Compliance Officer monitors compliance with the ESG governance framework. All employees at Capital Four are responsible for carrying out the firm's ESG objectives and upholding the firm's policies and procedures.

## Collaborations

Capital Four is a member of the ELFA, where we participate actively in the ESG Committee and various sub-committees with an ESG focus.

Capital Four is a member of Finansforeningen (CFA Society Denmark), where we participate actively in the ESG Integration Network.

## ESG Framework

Capital Four's ESG framework is built around the following elements, which we consider most central in our approach to ensuring responsible and sustainable investment practices. The objective is to take into account environmental, social, and governance factors in a data-driven, structured and repeatable manner.

# Carbon Data

Carbon footprint has become an important factor in credit analysis, since carbon-related costs and risks can significantly impact the financial performance of companies. Analyzing the carbon footprint of the companies in the investment portfolio therefore improves our understanding of how the portfolio is positioned regarding carbon-related financial risks. At the same time, the carbon footprint data provides insight into the individual companies' and the overall investment portfolio's contribution to decarbonizing the economy.

The GHG emissions for individual companies are used to calculate the carbon footprint of the investment portfolio. Companies' CI, measured as scope 1 and 2 GHG emissions per revenue unit, combined with portfolio weights, gives us the WACI, a measure of portfolio exposure to carbon intensive companies.

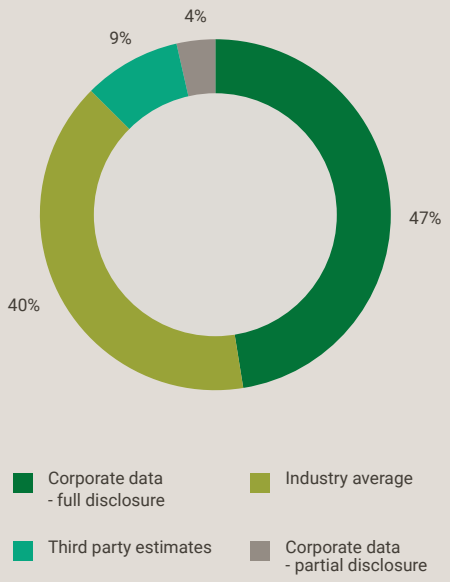
At Capital Four, we have integrated carbon data, such as CI and WACI, into our investment strategy. A key element of this work is to increase our data coverage of companies' emission data.

When working with carbon data, we use a tiered approach. First, we collect reported data on scope 1, 2 and 3 emissions for a company, in our proprietary research management systems, and then we use external data providers for further data points and estimations. Where no corporate data is available, we rely on industry averages on CI.

The Capital Four investment universe spans from smaller private company lenders in private debt to larger listed issuers of high yield debt. They are at very different stages of their sustainability journey, and their resources dedicated to sustainability and climate range from limited to large. During the year, we have experienced an increasing awareness and responsiveness from borrowers relating the issue, which is further supported by regulation on sustainability disclosure and several proposals on streamlining sustainability disclosure. As an investor in the leverage finance universe, we need the information and data on our investee companies' climate risk and opportunities to form a holistic view of the company and the quality of management.

At Capital Four, we acknowledge these challenges associated with integrating carbon data as an active part of asset management, especially for private companies with little data coverage. We are fully focused on increasing data coverage through collaborative work and our own efforts, and we also believe current developments in markets and regulation will significantly help increase data availability over the next few years. We can see that data is becoming more readily available as asset owners are starting to require data from portfolio companies and helping with resources and knowledge to obtain the data.

**Figure 1: Carbon intensity data coverage**



We find the best carbon data coverage for the loan, bond and multi-asset strategies, with average carbon footprint coverage of 47% across these strategies. In the coming years, we will focus on increasing the carbon data coverage for all our strategies, especially with a focus on increasing coverage for our private debt strategy.

Table 1 shows the coverage of financed emissions for our investment strategies. Financed emissions are defined as the total tonnes of scope 1 and 2 GHG emissions based on an investor's share of the total enterprise value of an investee company. The data coverage ratios include fully disclosed, partially disclosed, industry averages and third party estimated carbon data.

**Table 1: Carbon data coverage in our investment strategies**

| Strategy | Financed emissions scope 1 coverage | Financed emissions scope 2 coverage | Financed emissions scope 3 coverage |
|---|---|---|---|
| **High Yield Bonds** | 47.9% | 47.5% | 27.2% |
| **Senior Loans** | 34.7% | 33.7% | 17.8% |
| **Multi-Asset Credit** | 37.9% | 37.3% | 23.4% |
| **Private Debt** | 5.9% | 5.9% | 5.8% |

The figure below shows the WACI and carbon footprint of each of the investment strategies managed by Capital Four.

The WACI is measured as the total tonnes of scope 1 and 2 GHG emissions per million euro revenue of investee companies. The carbon footprint is measured as the total tonnes of scope 1 and 2 GHG emissions of investee companies per million euro of investment.

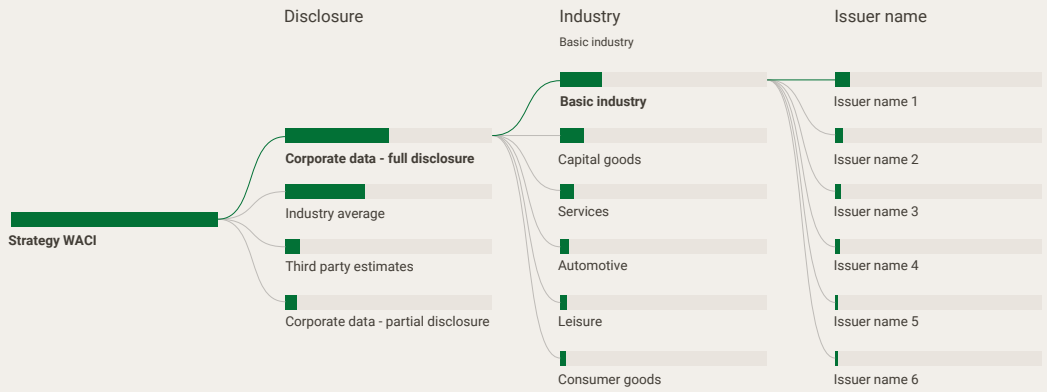
**Figure 2: WACI and carbon footprint of Capital Four investment strategies**


[4] See page 17

**Figure 3: Portfolio WACI**

Example of data analytics tools developed for working with carbon data. For a given strategy or portfolio, our analysts are able to get a detailed understanding of the carbon exposure

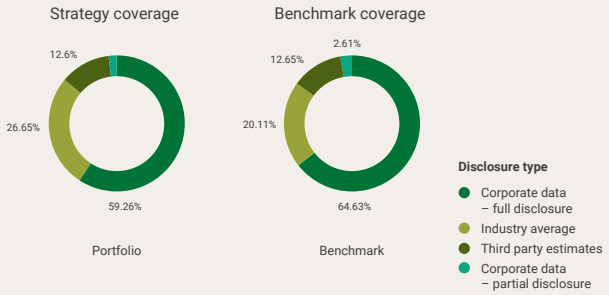
Portfolio WACI contribution



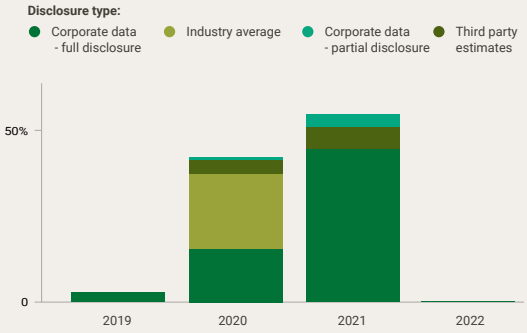

Carbon exposure and development of emissions of investments

| Issuer name | WACI contribution | WACI % Δ from last observation | Accumulated WACI contribution change |
|---|---|---|---|
| Issuer name 1 | 9.44 | -15.40% ↓ | |
| Issuer name 2 | 5.11 | -2.02% ↓ | |
| Issuer name 3 | 3.85 | 219.36% ↑ | |
| Issuer name 4 | 3.24 | 1.90% ↑ | |
| Issuer name 5 | 3.18 | -1.23% ↓ | |
| Issuer name 6 | 2.95 | 2.94% ↑ | |
| Issuer name 7 | 2.59 | -2.15% ↓ | |
| Issuer name 8 | 2.47 | 5.18% ↑ | |
| Issuer name 9 | 2.25 | 4.56% ↑ | |
| **Total** | **83.07** | **-2.79%** | |

GHG data coverage




Portfolio disclosure by reporting year

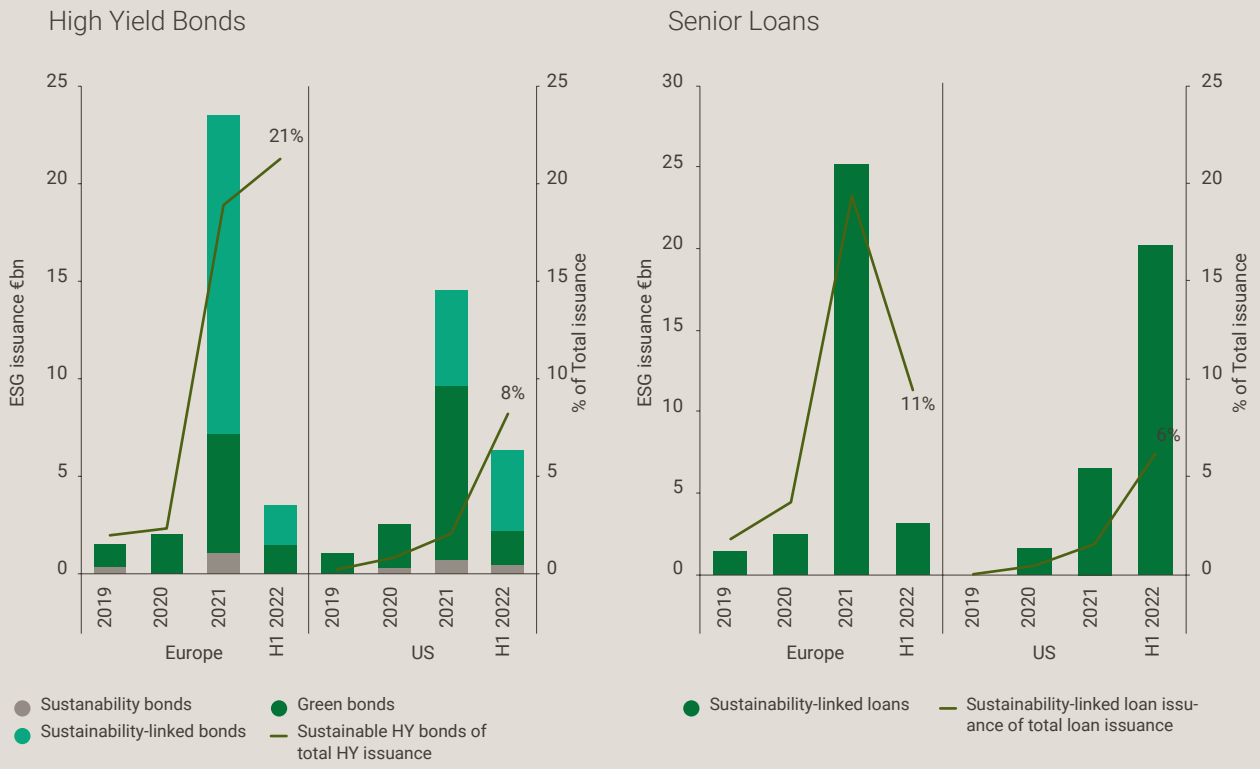


# Investment Strategies

## The sustainable debt market grew rapidly in 2021, with the total issuance of sustainable debt reaching around €1.5 trillion during the year globally.

The growth was driven by several factors, most importantly, dramatic growth in SLLs, reaching a total global level of issuance of €410 billion in 2021. European issuers particularly continue to dominate the market for SLLs. An estimated 21% of all European leveraged loans launched in 2021 carry sustainability-linked margin ratchets. In contrast, only 1.38% of US leveraged loans launched in 2021 carried these features in the margin ratchet. However, US has seen a strong increase in H1 2022. Almost all new-issue CLOs and reset deals in Europe in 2021 carried some form of ESG restrictions or exclusionary language.

**Figure 4: Sustainable debt issuance**



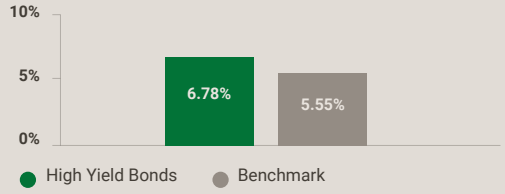

Following COP26, 2022 was set to see a further increase in the sustainable debt market, including expectations of large commitments to Net Zero Carbon strategies from investors and managers. However, the general disruption in the primary market due to the war in Ukraine, inflation and interest levels, and the uncertainty of the macroeconomic environment, consequently led to a slowdown of the market with a fall back in issuance in the first quarter of 2022. The issuance started to return in April 2022, but still on a low level compared to 2021.

Capital Four manages five strategies. Below is a description of the strategies, and the weighted ESG scores, WACI and carbon footprint for each strategy as of first half of 2022, where data is adequately available.

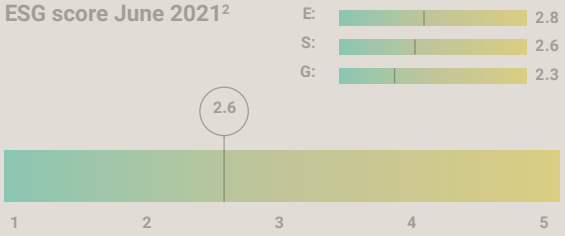
# High Yield Bonds

- Inception: 2001
- Assets Managed: €5.8bn
- Assets: Focus on high yield bonds issues by corporates and financials
- Geography: Global and European strategies

## Track record since inception, annualized return[1]

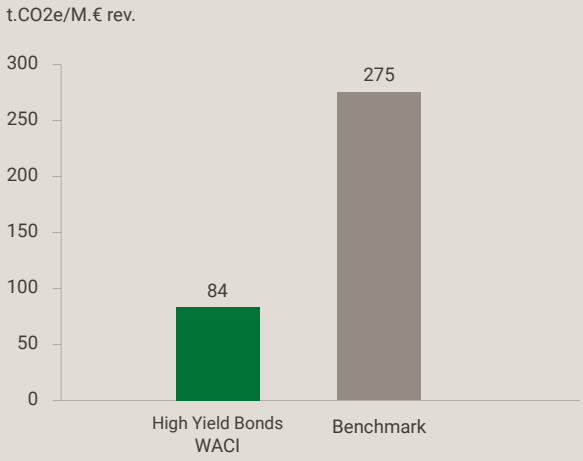



## ESG score June 2021[2]

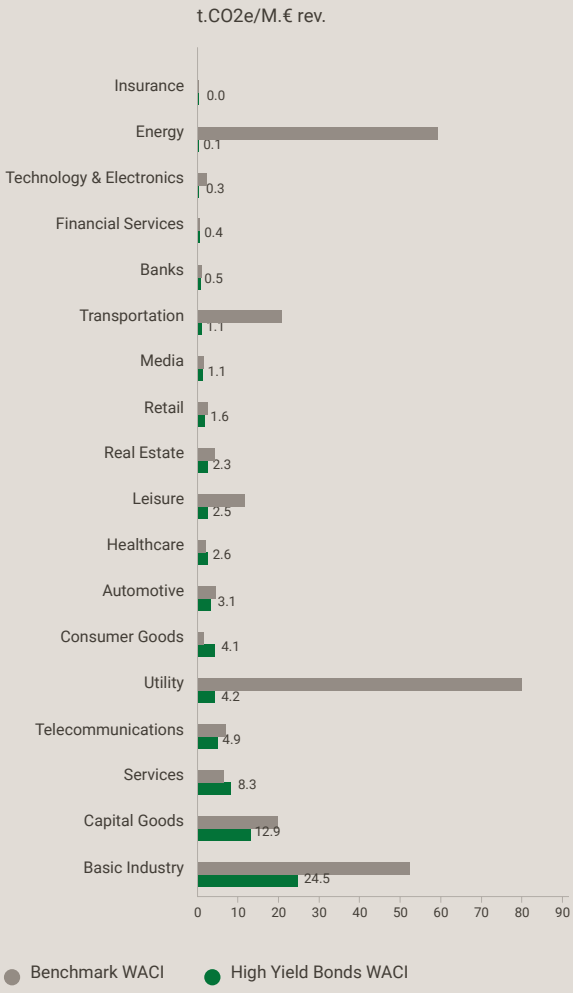



## ESG score June 2022

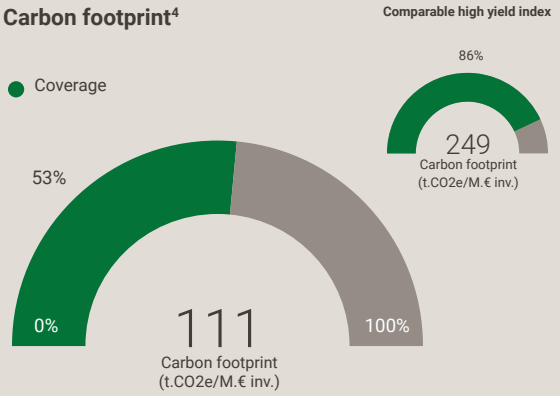

## WACI[3]




## WACI contribution on industries




## Carbon footprint[4]

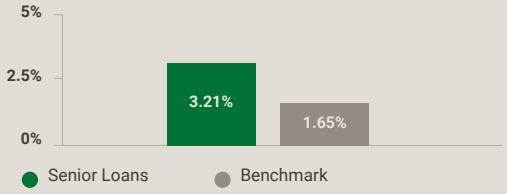



See notes on page 17

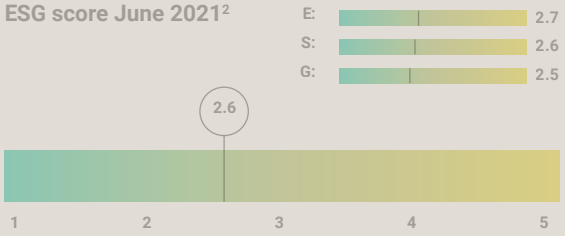
# Senior Loans

- Inception: 2013
- Assets Managed: €4.1bn
- Assets: Focus on senior secured loans, senior secured bonds and floating rate notes
- Geography: Global and European strategies

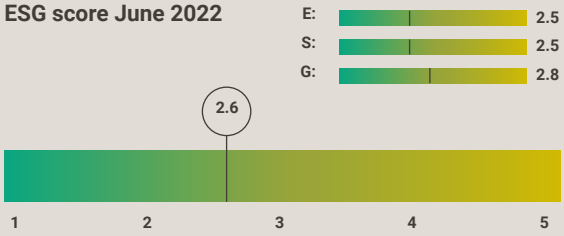
## Track record since inception, annualized return[1]



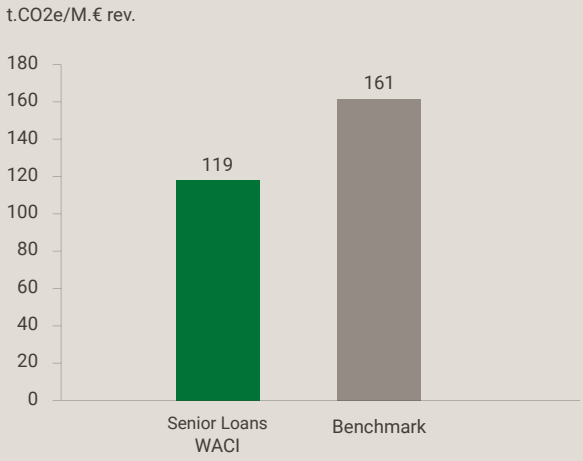

## ESG score June 2021[2]



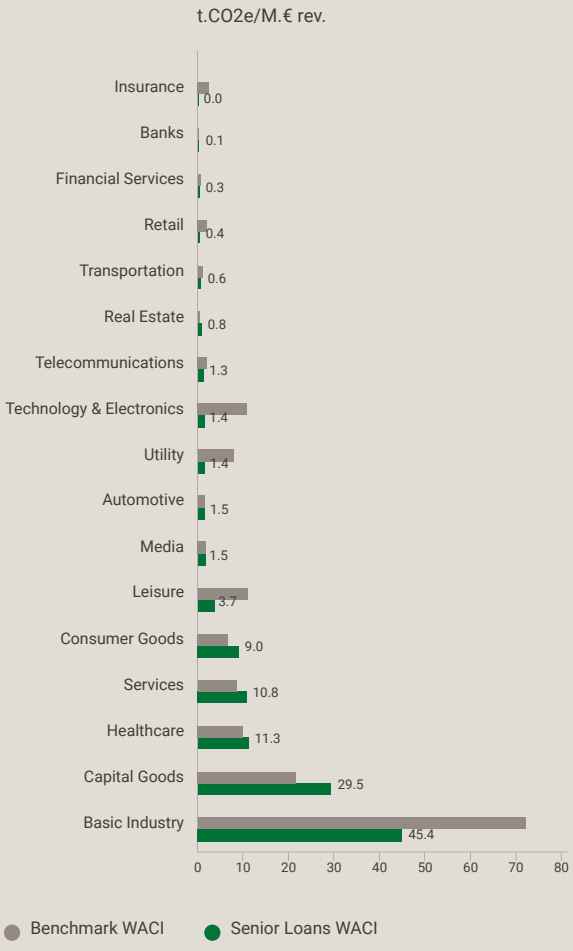

## ESG score June 2022



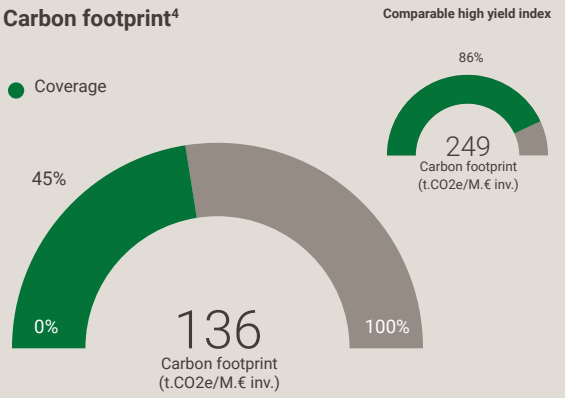

## WACI[3]




## WACI contribution on industries




## Carbon footprint[4]

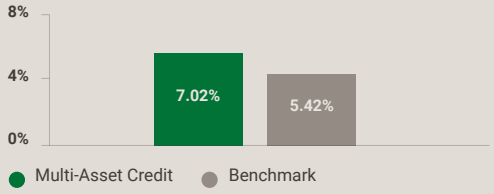



See notes on page 17

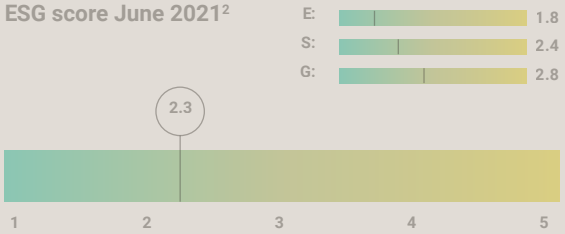
# Multi-Asset Credit

- Inception: 2010
- Assets Managed: €2.7bn
- Assets: Focus on relative value in addition to bottom-up security selection
- Geography: Global

## Track record since inception, annualized return[1]

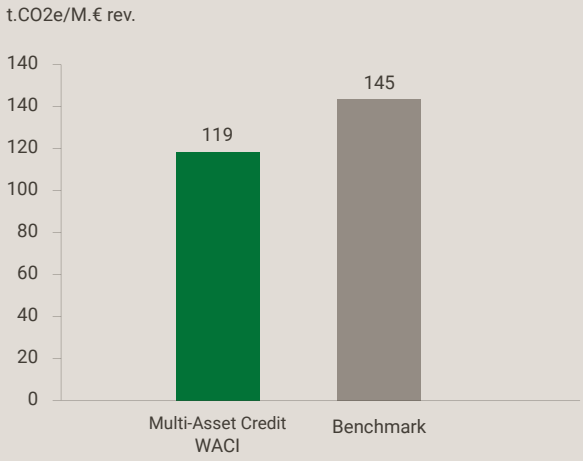



## ESG score June 2021[2]

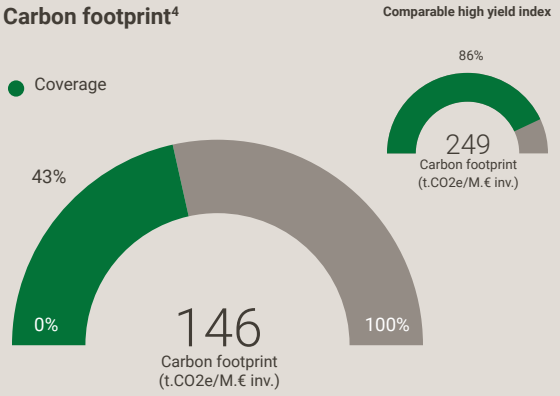



## ESG score June 2022

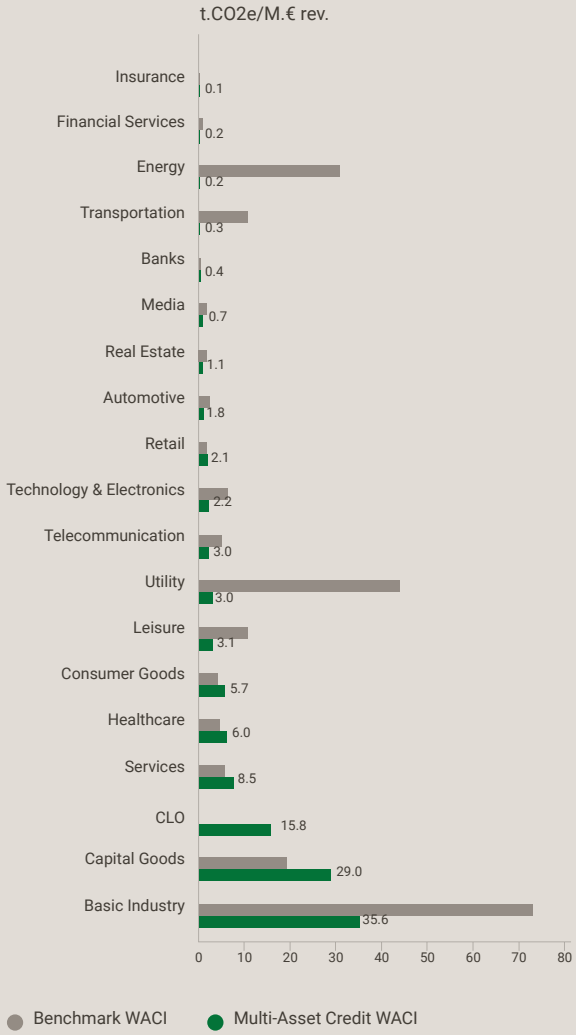

## WACI[3]




## Carbon footprint[4]




## WACI contribution on industries

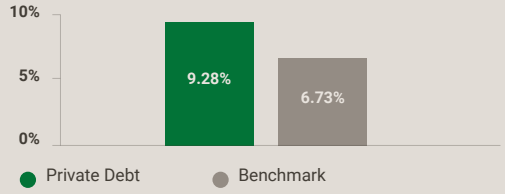



See notes on page 17

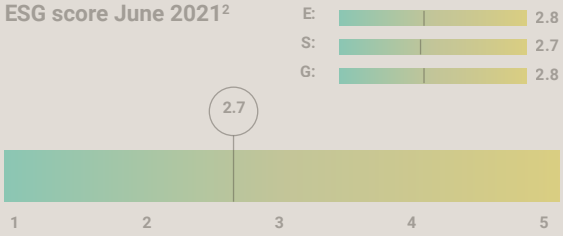
## Private Debt

- Inception: 2015
- Assets Managed: €2.8bn
- Assets: Focus on lower middle-market corporates (EBITDA around €10-20m)
- Geography: Nordics and Northern Europe

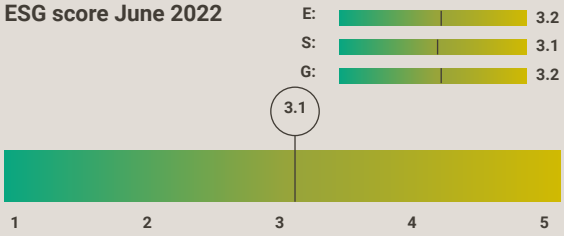
**Track record since inception, annualized return[1]**




**ESG score June 2021[2]**



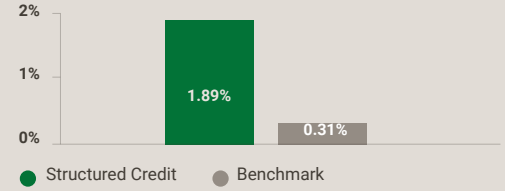

**ESG score June 2022**



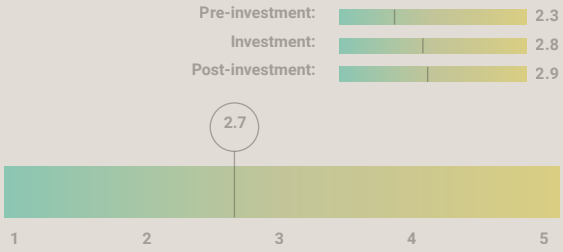

## Structured Credit

- Inception: 2020
- Assets Managed: €0.2bn
- Assets: Defensive (high-grade) and opportunistic (equity & mezzanine) strategies
- Geography: Europe

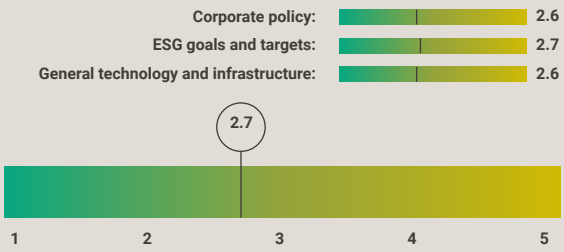
**Track record since inception, annualized return[3]**



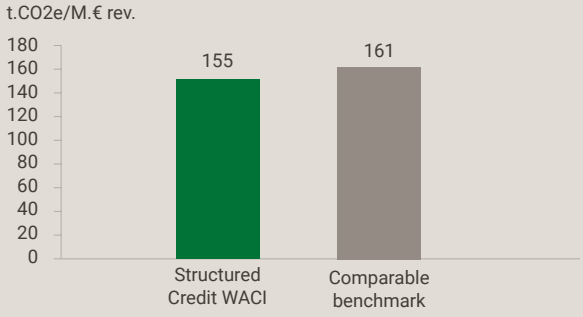

**ESG score June 2021[4]**




**ESG score June 2022**




**WACI[5]**




[1] Annualized return. Data as of June 30 2022
[2] See section ESG in the Investment Process for a description of our ESG scoring
[3] Annualized return. Data as of June 30 2022
[4] See section ESG in the Investment Process for a description of our ESG scoring. The data for the carbon footprint of the comparable high yield bond is taken from a European High Yield bond index using data as provided by index owner ICE BofA
[5] The WACI coverage includes Full Disclosures, Partial Disclosures, Modelled and Estimated figures for a full picture of strategy emissions (scope 1 and 2 included). The comparable benchmark for structured credit is a European High Yield bond index using data as provided by index owner ICE BofA

# Regulatory Sustainability Focus

The European Union has introduced a series of legal measures requiring firms that manage investment funds to disclose how they integrate sustainability in the investment process. Capital Four has in line with the requirement made several disclosures under the SFDR.

**Integration of sustainability risk**
Capital Four identifies and evaluates sustainability risks and other relevant ESG factors at multiple stages throughout the investment process. This is done by scoring the sustainability profile of a company in accordance with Capital Four's ESG scoring model and by using sector and norm-based exclusions. Sustainability risks are integrated into the investment decision-making process and risk-management to the extent that they represent potential or actual material risks and/or opportunities to optimize the long-term risk-adjusted return[6]. The sustainability risk assessment at strategy level is reflected in the ESG score presented in the investment strategy section of this report.

**New product offering**
Aligned with our regulatory sustainability focus we have launched two new types of SFDR Article 8 products.

For our bond, loan and multi-asset credit strategies our new product offering promotes environmental characteristics. Our approach focuses on GHG emissions, measured in terms of the CI of each investee company. Several of the products and mandates in these strategies have adopted this approach, where the portfolios are invested such that the WACI of the portfolio is, depending on the specific product, at least 10 to 20 per cent lower than the WACI of the relevant ESG benchmark.

For our private debt strategy our new offering promotes both environmental and social characteristics, through incorporating sustainability features in the underlying investment instruments. The private debt loans will include sustainability-linked key performance indicators (KPIs) which have an impact to the economics of the private debt loan invested in the strategy. When negotiating terms with an issuer, Capital Four aims to ensure that the KPIs address relevant and material sustainability issues of the borrower and are aligned with Capital Four's assessment of which issues are material for the company. For each KPI, Capital Four will in good faith set ambitious sustainability performance targets (SPTs) and the timeline for reaching these targets. Targets should be considered to be outside the normal course of business and represent a meaningful improvement. In our work with private debt issuers, it is sometimes not possible to align the SPTs with recognised international targets like the Science-Based Target initiative (SBTi). In these cases, Capital Four aims to use sustainability metrics, which can for example be baselined or benchmarked against past performance of the company or a relevant peer group[7].

**Principal Adverse Impacts**
Capital Four considers PAIs of investments on sustainability factors prior to making an investment decision and will in line with regulatory requirement report on this during 2023.

During the year we have worked intensively on collecting the PAI data of our investee companies. The availability of data in our investment universe is still very limited, but we see an increased awareness among borrowers of reporting on key sustainability related data. Many borrowers are still in an early stage of their sustainability reporting, and Capital Four engages with companies to discuss materiality and increased transparency. We collect data ourselves and through external providers (MSCI and S&P). We have decided to keep the data analytics on PAIs in-house and have created our own tools to assess and integrate PAIs into our investment decisions.

[6] See section ESG in the Investment Process for more

[7] Capital Four's approach to SLL is based on the framework set out in "Sustainability-Linked Loan Principles, supporting environmentally and socially sustainable economic activity" published in March 2022 by APLMA, LMA and LSTA, and the "Guidance on Sustainability-Linked Loan Principles" published in March 2022 by APLMA, LMA and LSTA)

# Case Study: VDK's Sustainability-Linked Loans

**About VDK**
VDK Groep B.V. ("VDK") is a leading group of technical installation and service solutions companies operating in the Netherlands. Through its multiple subsidiaries, VDK focuses on generic and niche electrical and mechanical installation, service technology and industrial maintenance services, offering end-to-end solutions, which cover most of the value chain from design to installation and maintenance.

**Private Equity owner**
EMK capital is a private equity firm with offices in Amsterdam, Frankfurt, London, Milan, Mumbai, Munich, Paris and Singapore focusing on growth buyout investments.

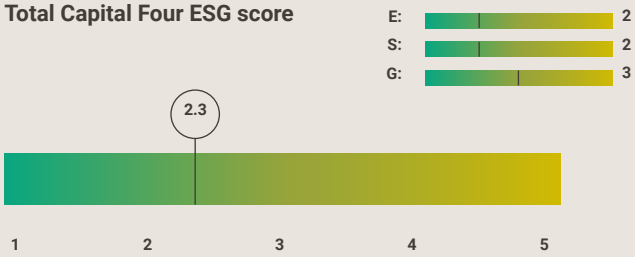
**Case**
EMK Capital ("EMK") acquired a majority stake in VDK in November 2020. The transaction was funded all equity, including a bridge loan facility provided by EMK. In June 2021, Capital Four provided a financing solution to (i) refinance EMK's and VDK's existing bridge loan facility and other financial indebtedness, (ii) support VDK's buy and build strategy, and (iii) finance working capital requirements.

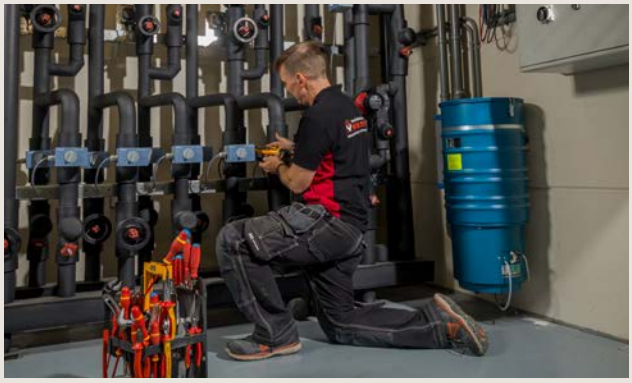
The financing solution is sustainability-linked with five KPIs linked to the margin payments. The objective is to provide additional incentive for EMK and VDK to facilitate and support environmental and social sustainable economic activity and in return VDK can potentially enjoy a reduced margin through the structure of the lending facility. However, if KPIs are not achieved the margins will increase.

VDK has worked extensively with external sustainability consultants to gain better understanding of the risks and opportunities the company faces and create a roadmap for its future sustainability transition. Capital Four has together with EMK used the sustainability assessment to design material KPIs and related SPTs. KPIs linked to the financing facility will focus on VDKs climate transition plan towards Net Zero with science-based targets, EU taxonomy alignment and its resource management improvement in the form of reduced waste and obtaining ISO 140001 accreditations for its handling of hazardous substances. For a human capital-intensive company like VDK, it was further important to bring in a social KPI, which will be linked to the work culture of the company both in terms of retention rates and employees' wellbeing.

The bespoke selection and calibration of KPIs and targets means that Capital Four can influence the borrower's sustainability priorities and work to align them with our assessment of the material ESG risk factors for VDK. Setting and achieving the targets is likely to lead to an improvement in our ESG score of VDK over time, which will be included in our overall risk return assessment of the company.

**Total Capital Four ESG score**



"Sustainability-linked loans create a significant opportunity to bake-in sustainability objectives and targets into the business strategy at a time where they are set to experience a significant period of growth. The existence of such loans provides short term financial benefit for what is often seen as a 'long play game'. Knowing the cost savings each year creates a potential budget that companies can essentially hypothecate to establishing and resourcing a focused sustainability strategy."

EMK Capital

# ESG in the Investment Process

Capital Four's investment process is driven by bottom-up fundamental research analysis that includes assessment of material environmental, social and governance factors for the specific industry and company in question.

Capital Four's proprietary ESG scoring framework is implemented across all investment portfolios, to identify and analyze sustainability risks and opportunities. The framework combines our own analytical models, research and knowledge, with inspiration from different sources, most notably SASB's Materiality Map, as well as input from different data and research providers. The framework is aligned with the disclosure and reporting requirements set out in the SFDR.

**Figure 5: Fully integrated ESG investment process**


Process:

| 01 Research and Company Screening | 02 Company Scoring | 03 Integration in Security Selection | 04 Monitoring and Company Engagement |
|---|---|---|---|
| – Sustainability research<br>– Company dialogue<br>– Data gathering and ESG questionnaire<br>– Proactive engagement | – Capital Four general company score<br>– Capital Four ESG Score<br>– External ESG rating | – Integration of general and ESG Score in credit write-up and discussed in Investment Committee | – Regular financial and non-financial reporting<br>– Continuous company dialogue<br>– Regular ESG scoring update |

Output:

| 01 | 02 | 03 | 04 |
|---|---|---|---|
| Structured ESG data analyses and information about the individual company* | Specific company score relative to other companies in the industry<br><br>Investable/not investable | Investment decision under consideration of ESG aspects<br><br>Definition of ambitious, quantifiable and measurable sustainability targets | Exert our influence to create better investment decisions and ongoing tracking on progress of sustainability targets |

The investment philosophy illustrated above is for illustrative purposes only. * Performed by all credit analysts, performed in every credit analysis.

## 1. Research and Company Screening

Capital Four has built an extensive knowledge of general industry themes and issuer-specific topics, as well as strong processes for knowledge-gathering and efficient information storage. We place great emphasis on continuing to develop our in-house analytical capabilities in terms of talent, data and information sources and processes. Improving our access to quality ESG data is a high priority, and we rely on internally gathered information, ESG due diligence questionnaires, external vendors and estimations to build our ESG data analytics. Capital Four's company screening includes:

- Product screening based on revenue from sensitive product lines which can lead to exclusion depending on fund/mandate exclusion criteria. Across all funds/mandates, Capital Four will not invest in companies which are involved in the production of controversial weapons, are producers of tobacco or generate more than a minimal part of their revenue from coal mining, coal-based energy production, artic drilling or involvement in oil sands extraction.
- Screening of all names against EU, UN and OFAC sanction lists. We also screen all names for violations of the UN Global Compact and related conventions. Capital Four will assess violators flagged by external screening and will exclude a company if we do not find they take reasonable action to address the issue.

## 2.a Company Scoring

For a company to be considered ESG investable by Capital Four, it must obtain an ESG score within the threshold of Capital Four's ESG scoring framework. A company is deemed non-investable if 1) the total score is ≥ 4.0; or 2) the total score is ≥ 3.75 and the company scores 5 in E, S or G. We have applied the framework to our investments and not to the full investable universe. However, we estimate that our minimum ESG score threshold in conjunction with our top-down screening would eliminate around 3-5% of the investable universe. This is in line with our general approach to responsible investment, where we do find value in transitional companies.

ESG scores are captured in a scoring template in a structured format that feeds into the general investments process at Capital Four. All information in the scoring framework is stored in our proprietary research management system. The scoring template is shown in figure 6 on the next page. We score the ESG profile of a company on a scale from 1 to 5, where 1 is the best ESG score. We start with a neutral rating of 3 and then upgrade or downgrade the specific sub-scores. The total ESG score of a company is the simple average of the general sub-score and the company-specific sub-score.

**The general score includes:**

- External ESG score from a service provider for reference (if such a score is available).
- Company ESG assessment/involvement evaluates the company's overall ESG awareness from a management or owner perspective. This assessment is based on how well the company identifies, discloses, and shows how they manage ESG risk in general. It also takes into account whether the company is a member of relevant collaborative initiatives, and if it publishes sustainability reports, answers ESG due diligence questionnaires, etc.
- Industry risk exposure reflects Capital Four's assessment of the relevant industry's general exposure to ESG issues compared to other industries.
- An assessment of country exposure to ESG depending on where the relevant company is based.

**Figure 6: Fully integrated ESG investment process**

Comprehensive ESG assessment through integrated top-down/bottom-up approach

01

Top-down assessment

(General score)

| General score | |
|---|---|
| External ESG rating | 2.5 |
| Company ESG awareness/involvement | 4.0 |
| Industry exposure to ESG | 3.0 |
| Country exposure to ESG | 3.0 |
| **Sub total** | 3.0 |

02

Bottom-up assessment

(Company specific score)

| Company Specific Risk | | |
|---|---|---|
| Environmental | GHG emission, resource management, opportunities in clean tech | 2.0 |
| Social | Human capital, data privacy & security, product/service governance, providing access to basic services | 4.0 |
| Governance | Corporate governance, business ethics | 4.0 |
| **Sub total** | | 3.3 |

| | |
|---|---|
| **Total score** | **3.17** |

The scoring example illustrated above is for illustrative purposes only, and no assurance can be given that it will be applied to any portfolio at any given time.

**Company specific risk:**
A company is scored on environment, social and governance relative to other companies within the industry. The subtotal is calculated as a simple average of the E, S and G scores.

When considering the materiality of ESG factors, Capital Four has been inspired by SASB's mapping of material industry specific ESG impacts and other sources.

In line with SASB, we see these impacts arising from the companies' production of goods and services, including management of the environmental and social capital, and the impacts that sustainability challenges have on innovation, business models, corporate governance and vice versa. We have also sourced inspiration from rating agencies and a number of ESG data providers in order to establish a list of industry-specific ESG factors. In conjunction with the industry investment analysts at Capital Four, we have assessed which of these factors we at Capital Four consider to be material for different industries. We have developed a description of each ESG factor in order to shape a common understanding of the risks and opportunities we associate with the individual ESG factors. The ESG factors we consider material for each industry are shown in table 2.

How the individual company manages the industry-specific ESG risk exposure is assessed relative to the industry it is operating in, and is an essential part of the core company analysis performed by the investment analysts.

**Table 2: Material ESG risk factors, industry level**

| Material sustainable risk factors | Auto | Banks | Basic industry | Capital goods | Chemicals | Consumer goods | Financial service | Health care | Insurance | Leisure | Media | Packaging goods | Pharma | Real estate | Retail | Services | Software & IT | Technology | Telco | Transportation | Utilities |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Environmental | High | Medium | High | Medium | High | Medium | Low | Low | Medium | Low | Low | High | Low | Medium | Medium | Low | Low | Medium | Low | High | High |
| GHG emission | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| Resource management | ● | | ● | ● | ● | ● | | ● | | ● | | ● | | ● | ● | ● | ● | ● | | ● | ● |
| Material sourcing | | | | | | | | | | | ● | | | | | | | | | | |
| Toxic emission and waste | ● | | ● | | ● | ● | | | | | | | ● | | | | | | | ● | |
| Waste management | | | | | | | | | | | | | | | ● | | | | | | ● |
| Emission & biodiversity | | | ● | | | | | | | | | | | | | | | | | ● | ● |
| Product lifecycle environmental impact | | | | ● | | ● | | | | | | ● | | | | | | | | | |
| Climate change vulnerability | | | | | | | | | ● | | | | | | | | | | | | |
| Responsible investment | | | | | | | | | ● | | | | | | | | | | | | |
| Financing environmental impact | | ● | | | | | ● | | | | | | | | | | | | | | |
| Opportunity in emission-reducing tech | ● | | | | | | | | | | | | | | | | | | | | |
| Opportunities in clean tech | | | | | | | | | | | | | | | | | | | | | |
| Opportunities/risk in efficiencies and renewables | | | | | | | | | | | | | | | | ● | ● | ● | | ● | |
| Social | | | | | | | | | | | | | | | | | | | | | ● |
| Social | High | Medium | Medium | Medium | High | High | High | High | Medium | High | High | Low | High | Medium | Medium | High | High | High | Medium | High | High |
| Human capital | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| Privacy and data security | | | | | | | ● | ● | ● | ● | ● | | | | ● | ● | ● | ● | ● | | |
| Product safety and quality | ● | ● | | ● | ● | ● | | ● | | ● | | ● | ● | | ● | | | | ● | ● | ● |
| Product governance/labeling and selling practices | | | | | | ● | | ● | ● | | ● | | ● | ● | ● | ● | | | | ● | |
| Selling / lender practises / financial product safety | | ● | | | | | ● | | | | | | | | | | | | | | |
| Affordability/availability | | | | | | | | | | | | | | | | | | | | | ● |
| Supply chain management | | | ● | ● | | ● | | | | ● | | ● | | | ● | | | ● | | ● | |
| Product impact on society | | | | | | | | | | | | | | ● | | | | | | | |
| Community relations | | | ● | | ● | | | | | | | | | | | | | | | ● | |
| Access to basic services | | | | | | | | ● | ● | | ● | | ● | | | ● | | | | ● | |
| Access to finance / responsible investment | | ● | | | | | | | | | | | | | | | | | | | |
| Responsible investment | | | | | | | ● | | | | | | | | | | | | | | |
| Opportunities in nutrition and health | | | | | | | | | | | | | | | ● | | | | | | |
| Governance | Medium | High | Medium | Low | Medium | Medium | High | Medium | High | Medium | Medium | Low | High | Medium | Medium | Medium | Medium | Medium | Medium | Medium | Low |
| Corporate governance | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● | ● |
| Corruption / instability / bribery | ● | | ● | | | | | ● | | | | | ● | | | | | | | ● | ● |
| Competitive behaviour | | | | | | | | ● | | ● | | | ● | | ● | | ● | ● | ● | | |
| Business ethics | ● | ● | ● | | | | ● | ● | ● | ● | ● | | ● | ● | | ● | ● | ● | ● | | |
| Political interference | ● | | | | | | | | | | | | | | | | | | | | |
| Systematic risk management / risk control systems | | ● | | | ● | | ● | | ● | | | | | | | | ● | ● | ● | | |

## 2.b CLO Manager Scoring

Sustainability risk in CLO Investments is assessed through a systematic bottom-up approach, considering both qualitative and quantitative aspects. The qualitative assessment consists of the manager scoring and a structural feature analysis. Whereas the qualitative assessment is reflected in our collateral analysis.

**Manager assessment**
The Capital Four ESG approach to CLO investments takes departure at the level of the individual manager. The manager assessment is the core of the qualitative ESG assessment. For this purpose, Capital Four has developed a proprietary scoring framework specific to the ESG evaluation of CLO managers to resolve and prevent material ESG risk. As shown in Figure 7, this qualitative assessment comprises three fundamental elements: I) governance and corporate strategy, II) ESG integration in the investment process, and III) technology and infrastructure used by the manager. Aligned with Capital Four's corporate process for ESG assessment and scoring, each element is assigned a score from 1 to 5. The point of departure is a neutral score of 3 which is notched up or down, depending on the quality of a manager's ESG efforts relative to peers. The manager assessment is summarized in an overall ESG score which is the equally weighted average of all sub-scores.

**Figure 7: Manager assessment**

Qualitative assessment of CLO managers' ESG efforts using proprietary scoring framework
The scoring framework evaluates ESG efforts at three different levels:

**I Governance and corporate strategy**
A) Corporate policy and philosophy
B) Corporate E & S efforts

- Formal policies and commitments (signatories)
- Organisational design and accountability structure
- Oversight responsibilities

**II Integration in investment process**
A) Pre-Investment: Screening and research
B) Investment decision
C) Post-Investment: Monitoring and reporting

- ESG risk factors as part of credit research
- Engagement with companies
- Impact on investment decision and portfolio construction

**III Technology and infrastructure**
A) ESG data and ratings
B) ESG scoring, tools etc.

- Use of third-party and proprietary ESG research/data
- Integration of ESG data into internal data management system
- ESG training for investment professionals

A score from 1 – 5 is assigned to each subcomponent (1 is best, 5 worst) – The total score is the equally weighted average of the sub-scores.
An investment opportunity becomes un-investable based on score, if it has either i) a total score ≥ 4.0 or ii) total score ≥ 3.75, combined with sub-score I-A ("G-score") > 4.0

**Structural feature assessment**
As part of the deal-level ESG assessment each CLO prospectus is screened for ESG-focused wording. Of particular interest are features such as negative exclusion, positive screening, or a manager's commitment to report on ESG risks in the portfolio. The inclusion and the phrasing of such elements offer additional insights on a manager's ESG commitment. The identified characteristics are captured in more depth in the above outlined qualitative manager assessment and in the following quantitative analysis.

**Collateral analysis**
The formation of a holistic and robust opinion on a manager's ESG-related efforts require quantitative collateral assessment. This procedure complements the preceding qualitative features of our ESG approach. Collateral assessment presents the integration of carbon data into the CLO investment analysis. Through examining the exposure to carbon intensive companies, our structured credit analysts assess climate-related risks. For each CLO we calculate the weighted average carbon intensity (WACI), based on our work with carbon data of the underlying obligors.

Capital Four's ESG approach to CLO investments is based on detailed and rigorous assessment of both qualitative and quantitative information on CLOs and CLO managers. The key outputs of our ESG approach – a concrete ESG score from the manager assessment and a CLO's WACI – summarize our analysts' opinion on sustainability and climate-related risks. These tools are used side-by-side, reflecting both qualitative and quantitative considerations.

## 3. Integration in Investment Committee

A key element in Capital Four's investment process is the company-specific credit write-up produced by investment analysts, which includes ESG analysis and scoring. The credit-analysis process is aggregated and presented in a quantitative framework in conjunction with the credit write-up.

**ESG integration in investment decisions**
The analysis is performed by investment analysts in Capital Four's research team, and is presented to Capital Four's portfolio managers in the Investment Committee for decision making. Any conclusions agreed upon by the Investment Committee, incl. material ESG factors and impacts, are documented in an updated version of the credit write-up.

In our multi-asset credit strategies, we select individual credits and allocate among different credit asset classes by combining high yield, senior loans and structured credit. Identifying sustainability factors on individual credits and aggregating ESG data across credit asset classes makes it possible for Capital Four's portfolio managers to integrate ESG in both the relative value allocation decisions as well as security selection decisions.

## 4. Monitoring

Capital Four's research team is responsible for the ongoing monitoring of existing investments. Monitoring of developments on material sustainability factors and engagement with the issuer is integrated in the ongoing due diligence for the investment, including monitoring of financial statements, news flow, industry trends, regulatory changes and dialogue with management or sponsor.

The individual ESG scores will be reviewed at least yearly, but can be reassessed at any given point when new information is received.

The ESG data gathering, analysis and scoring further helps provide the analyst with key information and focus areas for engagement with the underlying issuer.

# Case Study: Investment in IU Group

**About IU Group**
With over 85,000 students enrolled, IU Group, the holding company behind IU, the International University of Applied Sciences, is Germany's largest and fastest growing private university group. IU Group offers more than 200 accredited Bachelor's and Master's degree courses in German and English, providing students with a digitally supported learning environment with various study models, such as distance learning, dual study (private on-site education in cooperation with corporate partners), and my-Studies (a combination of online and on-campus studies).

**Case**
Given the rising appetite for online education, IU Group can remove geographical and social entry barriers by increasingly offering online courses. IU Group's mission is to make education accessible to everyone via online learning, independent of students' social background and nationality. This is evidenced by the fact that 70% of the students are from non-academic households, compared to 47% at traditional universities, and IU Group has accepted seven times more new students without A-levels than traditional universities.

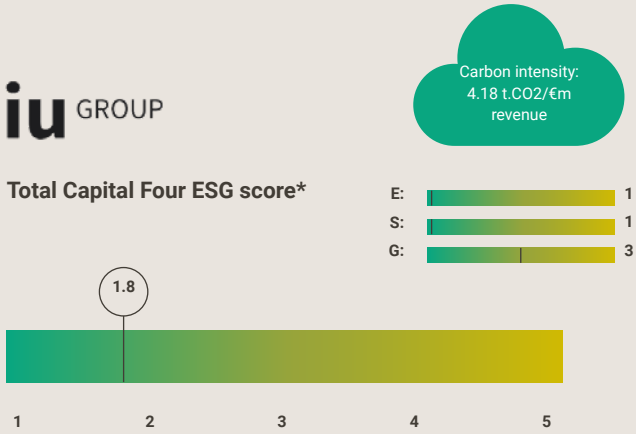
Recognizing the role of sustainable finance in supporting an inclusive and equitable quality education and promoting lifelong learning opportunities for all, IU Group issued a sustainability-linked loan in December 2021. Capital Four provided financing for this transaction, and noted the company's strong social impact, and that it was enforced through the financing framework.

The SLL framework contains a commitment to increasing the ratio of scholarships which cover at least 50% of the fees of students from low-income countries to the total student intake.

In 2022, IU Group has joined the Study Access Alliance initiative and committed funds to provide scholarship covering at least 90% of the fees for 100,000 students from African countries. The initiative is building up partnerships with other organizations to offer the remaining 10%.

In 2021, IU Group has given out more than €45m in scholarships to their students from low-income countries.

In addition to the positive social impact, IU Group has low environmental risk, as online education reduces carbon emissions by a factor of ten compared to in-person teaching. Furthermore, IU Group is the first carbon neutral distance university worldwide and has set a plan to further reduce their carbon footprint as part of the commitment to being carbon neutral.




"As an education business, we directly help our students to achieve personal fulfilment and to realize their professional goals. It is crucial for us to feel the support of our partners and investors, including Capital Four, as we enhance the social contribution and sustainability of our services."

Sven Schütt, CEO of IU Group

* See section ESG in the Investment Process for a description of our ESG scoring.

# Engagement

Capital Four believes that ESG engagement creates value for our investors, the companies we invest in and, indirectly, society at large. Capital Four is committed to actively engage with investee companies to improve their public non-financial disclosure and sustainability awareness. We wish to set explicit reward-linked SPTs directly linked to the funding costs of the companies, to increase incentives. Read more in our Engagement Policy.

**Figure 8: Capital Four's engagement approach**

### Objective of engagement

To exert our influence to allow us to make better responsible investment decisions and achieve better outcomes leading to enhanced value for our clients.

### Prioritization of engagement

- Proprietary ESG scoring
- Impact achievement
- Position

### Engagement Scope

- Issuer engagement
- Collaborative engagement
- Stakeholder engagement

### Engagement process

- Structured approach to conduct engagement
- Ensures planning by tracking
- Objectives up front
- Trigger points for actions

### Engagement goals

- Raise awareness of sustainability factors
- Transparency and disclosure
- E, S or G charcteristics and outcome
- ESG risk assessment
- Resolve controversies and issues

### Governance and responsibilities

- Credit analyst owner of engagement cases directly linked to issuers
- ESG team owns collaborative engagements

Capital Four is an active participant in a number of industry forums, such as the ELFA and the ESG Integration Network of the CFA Society Denmark, which focuses on various aspects of sustainability issues related to investments. Capital Four encourages an open dialogue with investors and typically holds quarterly or annual reviews specifically focused on ESG related issues in the portfolio, as well as internal developments and progress.

# Engagement Cases

We use our position as an investor to engage with issuers and stakeholders. Here we show same examples of the variance in our engagement efforts to reflect our approach:

## Engagement case 1: Collaborative Engagement

**Engagement type:**
Capital Four leading a collaborative engagement with regulators through ELFA.

**Issue:**
Standardization of borrower's sustainability and climate reporting.

**Objectives:**
Provide feedback to the International Sustainability Standards Board's proposed sustainability and climate-related disclosures, which aims to be a comprehensive global baseline of sustainability disclosures to meet the information needs of investors.

**Achievements:**
Collaboration with peers in the leverage finance industry to express our acknowledgement of the proposed reporting standards and highlight the complications and issues which issuers in our investment universe will face under the current draft proposal.

**Conclusion:**
ELFA's submission to the IFRS highlighted the need to focus on companies disclosing actual ESG strategies, not just the risks and opportunities, and the importance of incorporating a "double materiality concept" over time.

Read ELFA's letter here.

## Engagement case 2: Controversy

**Engagement type:**
Direct engagement with management (CFO & CMO) of the borrower and the private equity owner.

**Industry:**
Health care.

**Issue:**
Human rights concerns with alleged abuse at one of the borrower's facilities, which allegedly started two years before the current owner was in control of the company and terminated during the current ownership.

**Objectives:**
Ensure sufficient governance processes in place.

Assess if necessary initiatives were taken and if procedures were updated to significantly limit the risk of re-occurrence of similar incidents.

**Achievements:**
Open discussion with C-level at the borrower which gave us insight into internal investigation with expert advisors, strengthening of reporting lines and review of safety issues with a direct report to the C-level.

**Conclusion:**
Following our engagement, Capital Four concluded that the borrower had taken the necessary actions to build solid processes, reporting lines and a governance structure which limit the risk of a similar situation re-occurring.

## Engagement case 3: GHG Emissions Disclosure

**Engagement type:**
Direct engagement with treasury at the issuer.

**Industry:**
Basic industries.

**Issue:**
Borrower has disclosed limited information with regards to its GHG emissions.

**Objectives:**
Aim to seek more up-to-date information on GHG emissions.

**Achievements:**
Company has publicly stated that they will issue a sustainability report in Q1 2023, incl. GHG emission data.

**Conclusion:**
Capital Four does not expect the company to provide further disclosure prior to their sustainability report in Q1 2023. Until then, we will therefore have to use estimated emission data for the borrower.

## Engagement case 4: ESG Transparency

**Engagement type:**
Direct engagement with treasury at issuer.

**Industry:**
Services.

**Issue:**
Borrower didn't respond to ESG questionnaire and provided very limited sustainability disclosure.

**Objectives:**
Dialogue with borrower on material sustainability factors and data points required by investors.

**Achievements:**
Open dialogue with borrower, who afterwards responded to the full ESG questionnaire and published a more comprehensive ESG presentation.

**Conclusion:**
Capital Four acknowledged the additional disclosure, which provided better insight, but will continue to encourage further details and data in both ad hoc information sharing and periodic reporting.

# TCFD

Capital Four has decided to start reporting on the recommendation of the TCFD. This is part of our work to be transparent on our climate-related initiatives and risks. This is our first TCFD disclosure.

## Governance

**Board oversight of climate related risks and opportunities**
The CEO reports to the Board of Directors at Capital Four. The CEO ensures that Capital Four has a Responsible Investment Policy in place which includes assessment of sustainability risk. This includes climate-related risk and is implemented through our strategy implementation framework. Specific sustainability-related goals are set out annually in relation to the strategy. One of our key goals was to deliver our first TCFD report during 2022.

**Management's role in assessing and managing climate related risks and opportunities**
The management team is responsible for oversight and implementation of the strategy framework, with project groups delivering action plans to reach the deliverables. The management team is further responsible for Capital Four's effort on climate at an operational level. All employees at Capital Four are responsible for acting in accordance with the firm's ESG and climate-related objectives and upholding the firm's policies and procedures.

In our capacity as an investment manager, the Investment Committee is responsible for integrating sustainability risk into the investment process and are the sole owners of the investment decision. All investment analysts are responsible for integrating sustainability and climate-related risk and opportunities into the investment analysis on a day-to-day basis. The head of research is responsible for driving and developing ESG and climate integration analysis in the investment process and for development of ESG related data analytics tools.

## Strategy

**Impact of climate-related risks and opportunities on the businesses, strategy, and financial planning**
In our investment activities, we believe climate-related risks and opportunities can impact the valuation of investments. This can affect the performance of our investment products. We focus on companies' GHG emission and CI, as a first step in analysing the climate impact in each investment we make. Read more.

Based on our work with carbon emissions data, we have developed new investment strategies directly linked to carbon emissions. The strategies promote environmental characteristics by including CI in the investment decisions and a commitment to always have a lower portfolio WACI than that of a general market index. Read more.

We believe investing with a carbon focus will not materially restrict the universe in which we invest. We believe that increasing data quality and development of decarbonization strategies of investment companies will over time positively influence the attractiveness of the investment strategy.

To continue our strategic work on climate it is our intention to sign up to Net Zero Asset Mangers Initiative during 2022.

Capital Four is committed to allocate further resources to our sustainability efforts. We have a dedicated ESG team within the research department, which has been allocated further resources during the year. Significant investments have been made to gather ESG and climate data from all investments and to enhance data analytics tools.

We do not deem our operations to have a material exposure to climate-related risk. Our buiness is mainly centered around a few office locations (leased), and we are able to have a flexible working environment. Capital Four is committed to pursue carbon neutrality of our corporate activities.

**Climate resilience**
We acknowledge that climate risk and opportunities can have a financial impact on our investment decisions, and we will continue to work on how to take this further into account in our investment processes. We do not currently apply climate related scenarios to investments, in part due to lack of data, but at any point in time we can view the WACI of a portfolio versus it's benchmark (split by sector or ful aggregation). We have currently not performed scenario analysis of climate change resilience of our investment strategies.

# Risk management

**Assessment of climate-related risk**
All investment issuers are analysed and assessed against material sustainability risk factors determined for the industry in which they operate. This includes climate-related risks. See table 2 for an overview of material sustainability factors for each industry. Individual investments can be assessed based on their decarbonisation and climate strategies. This is included in our continued risk/return assessment of our investment decisions.

**Managing climate-related risks**
The Investment Committee is responsible for investment decisions. Sustainability risk, including inherent climate-related risk, is incorporated into the investment analysis by our investment analysts, with support from the ESG team.

Engagement with portfolio companies can be used to encourage emission reduction, and climate-related risk challenges are considered. In our private debt strategies, we can directly link environmental or climate-related KPIs to the economics of the financing facility. Read more.

During 2021, we introduced new firm-wide investment restrictions on any direct investments in companies which generate a majority of revenue from coal mining or energy products, Arctic drilling or oil sands.

The operation team is responsible for overseeing compliance with the investment mandate, which for some strategies is directly linked to environmental characteristics. For these specific strategies, CI at a portfolio level becomes a binding investment constraint, which can lead to investment rejection or portfolio reconstruction to align with commitments.

At Capital Four, all full-time employees (FTE) are able to work remotely. This reduces business risk in the unlikely event of physical climate risk materializing (simultaneously) across our locations. All IT infrastructure and data are further handled through the cloud, limiting our business risk.

# Metrics and targets

**Metrics and targets – investments**
Across our investment universe, we currently use carbon emissions data in addition to Capital Four's ESG scoring to assess climate-related risk. CI and WACI are used at investment portfolio level and benchmark level. Selected strategies will be managed according to a WACI threshold depending on liquidity and asset class. ESG scoring and WACI is part of our continuous reporting to clients. We can calculate carbon footprint on our investment companies at fund level, but we are not able to compare it with a benchmark due to the lack of data. Read more. In the investment strategies overview we present this data on our investments.

Capital Four includes sustainability-linked KPIs into the financing structure of selected borrowers in our private debt strategies, which can often be directly aligned with emission disclosure and reduction targets. During the last year, Capital Four has made 15 new direct lending agreements as part of our private debt strategy, that have SLL features in the loan documentation.

**Metrics and targets – operations**
For our corporate activities and operations, we calculate scope 1 and 2 GHG emissions as well as parts of scope 3 emissions. Read more.

**Table 3: Greenhouse gas emissions from Capital Four's corporate activities**

| | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| **Scope 1 CO2e (tonnes)** | 0 | 0 | 0 | 0.9 |
| **Scope 2 CO2e (tonnes)** | 15.2 | 14.2 | 15.2 | 14.1 |
| **Scope 3 CO2e (tonnes)** | 236.9 | 179.1 | 25.9 | 19.9 |
| **Total scope 1 - 3 CO2e (tonnes)** | 252.1 | 193.3 | 41.1 | 34.9 |
| **Total CO2e per FTE (tonnes)** | 4.85 | 3.17 | 0.53 | 0.46 |

# Sustainability of Corporate Activities

Capital Four is not only focused on the sustainability in our investment activities but also on our own actions and the sustainability of these across environmental, social and governance themes.

## Environmental Footprint

**GHG emissions**
We are committed to reducing our corporate carbon footprint.

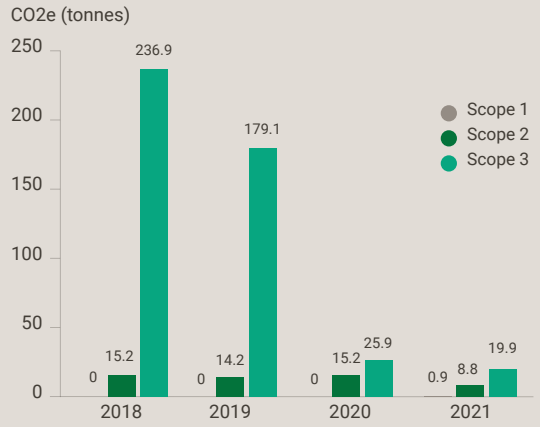
In 2021, we began mapping and calculating our corporate carbon footprint according to the Greenhouse Gas Protocol[8]. CO2e emissions based on scope 1, scope 2 and scope 3 of our corporate activities are shown in figure 10[9].

Covid 19 initiated the common use of Virtual meetings, both for internal and external meetings. We learned the efficiency of offering virtual access to internal meetings to all relevant stakeholders, and today all our internal meetings are either fully virtual or hybrid. Around 50% of our external meetings are also continued to be held as virtual - with a mutual recognized benefit. Any carbon emissions from flying, we offset with high-grade carbon offsetting schemes. Additionally, Capital Four offers transit passes for employees through a gross salary scheme to encourage the reduction of carbon emissions in daily commuting.

To further reduce our carbon footprint, we started sourcing guarantees of origin on all electricity purchased in 2021. This ensures that the electricity we use originates from renewable energy sources.

**Figure 9: GHG emissions**

**Location-based approach**




**2021 Market-based approach**

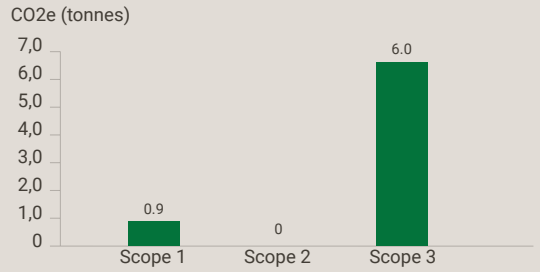
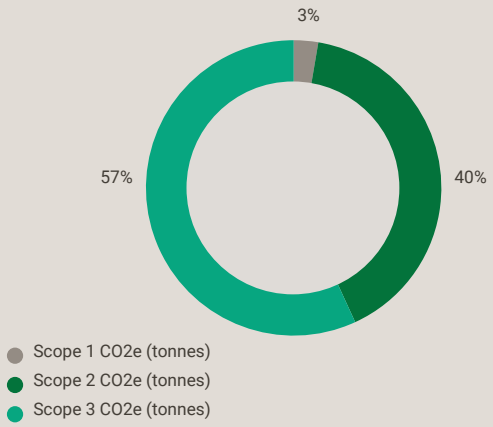



**Figure 10: GHG emissions 2021**




**Data included in scope 1-3 calculations:**

**Scope 1 GHG emissions:**
- GHG from travel by company hybrid car

**Scope 2 GHG emissions:**
- GHG from electricity consumption

**Scope 3 GHG emissions:**
- GHG from business travel by plane, train and taxi
- GHG from paper consumption

[8] For more information see: https://ghgprotocol.org/corporate-standard
[9] Scope 1 emissions are defined as direct emissions from sources controlled by the company. Scope 2 emissions are defined as indirect emissions arising from the energy consumption of the company. Scope 3 emissions are defined as other indirect emissions such as emissions from travel and the supply chain. For more information on our calculation of GHG emissions, please see the methodology section

**Waste and recycling**

Capital Four aims to reduce office waste and increase recycling. For example, all employees are provided with tablet computers which helps decrease our paper consumption. At the Copenhagen office, we sort waste and recycle ink cartridges and bottles. To reduce single-use plastic products we have installed water aerators in the office and introduced reusable water bottles.

In 2021, Capital Four generated 4.72 tonnes of waste. This was higher than the previous year due to employees returning to work, post COVID-19 pandemic, which resulted in more days spent in the offices.

**Table 4: Waste generation and recycling**

| | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| **Total waste generation (tonnes)** | 2.26 | 3.59 | 3.05 | 4.72 |
| **% of waste for recycling** | 52% | 50% | 55% | 48% |
| **Waste per FTE (tonnes)** | 0.05 | 0.07 | 0.05 | 0.06 |

## Diversity, Equity and Inclusion

Capital Four has formed a working group with broad representation of different functions, seniority (including active involvement of our CEO), geographies and genders that is collaborating with external input from a consultant to develop a DEI Policy. The working group will work on initiatives and targets that will further our progress in fostering a diverse and inclusive workplace.

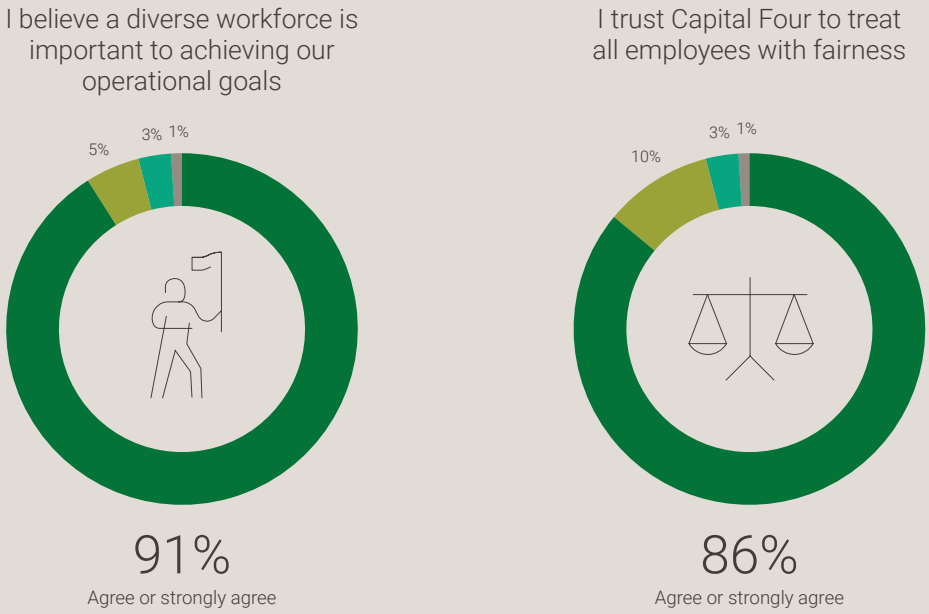
In our project roadmap, we have completed the initial workshops and conducted a survey across all employees to set the focus for the initiatives and establish a baseline read-through of our current standing across D,E, and I. An outcome of the project work is a DEI Policy that will be presented end of 2022 and a governance structure for how to keep focus and follow progress on the targets and the effectiveness of the initiatives.

We acknowledge that female employees in general are underrepresented at Capital Four, as well as in the wider financial sector. We believe it is important for us to be able to attract female employees, as well as employees with different backgrounds, since diversity and inclusion foster a better workplace and decision-making.

At Capital Four we:

- Foster a culture where colleagues can thrive and accomplish great outcomes together.
- Believe that by encouraging diverse perspectives in all that we do, we create an environment that supports and cultivates good decision making.
- Aim for a workplace where our people can learn and grow to create a positive impact for our stakeholders and on society around us.
- Build our values on respect between colleagues. We do not tolerate harassment or discrimination, and we respect our employees' right to freedom of association.

**Figure 11: Capital Four DEI company survey across all employees**




## Workforce

In 2021 we continued to grow our workforce, which has grown on average 15% per year since 2018. Meanwhile, our retention rate remains high at an average of 94% during the past four years. This helps anchor the Capital Four culture.

Currently, 26% of employees at our Copenhagen office have an international background and 21 different nationalities are represented.

**Table 5: Employees**

| | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| **Total FTEs** | 46 | 53 | 65 | 74 |
| **Total headcount** | 62 | 89 | 102 | 107 |
| **Employee turnover** | 2% | 9% | 5% | 9% |
| **Internal staff transfers** | N/A | N/A | 2 | 3 |
| **Share of employees with international background** | 31% | 28% | 23% | 26% |

Students have always been an integral part of our workforce and we take pride in developing our own talent. This is also why Capital Four is launching a two-year graduate programme in September 2022, as a new initiative as part of our talent attraction and development efforts. The graduates will do an internal rotation where they will work in another department for six months and go to our US affiliate office for three months. Throughout the program, there will be several educational blocks focusing on soft skills, such as personal development, communication and case challenges.

The program currently has nine graduates enrolled, of which six are women and three are men.

**Figure 12: Employee groups**

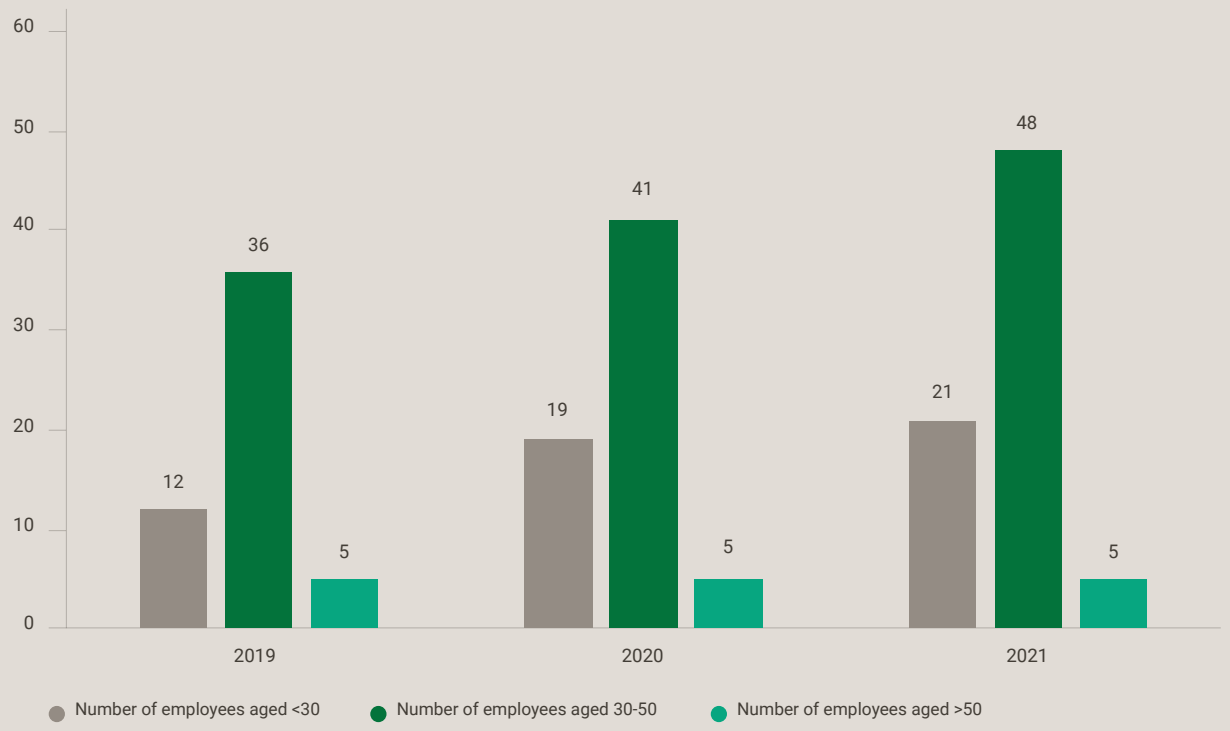
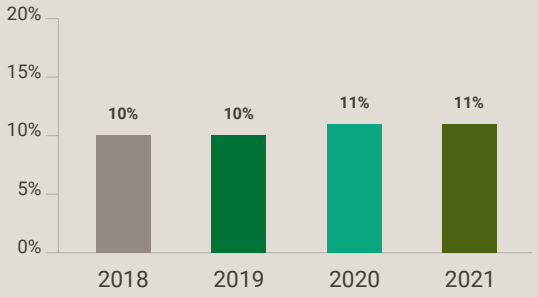



**Table 6: Gender balance**

| Gender balance (total) | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| Female | 28% | 28% | 29% | 31% |
| Male | 72% | 72% | 71% | 69% |
| **Gender balance (management)** | **2018** | **2019** | **2020** | **2021** |
| Female | 18% | 25% | 25% | 25% |
| Male | 82% | 75% | 75% | 75% |
| **Gender balance (Board of Directors)** | **2018** | **2019** | **2020** | **2021** |
| Female | 0% | 0% | 0% | 0% |
| Male | 100% | 100% | 100% | 100% |

Our gender pay ratio continues to remain stable in 2021. As comparison, the average unadjusted gender pay gap in the Danish finance industry is around 20% and around 34% in the UK banking industry[10].

**Figure 13: Average unadjusted gender pay ratio – yearly pay**

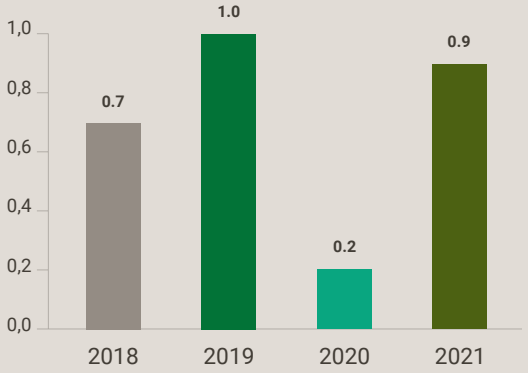



The ongoing wellbeing of our employees is important to us, and we offer our employees a flexible working environment, with the possibility of working an average of two days a week from home or remotely when required.

A Health and Safety committee has been established at Capital Four, with the objective of ensuring that employees are safe, healthy and happy in the workplace. As part of this process, a workplace survey is carried out at least every three years. All employees are asked to evaluate their job satisfaction as well as their physical and mental wellbeing. The results of the survey are evaluated by the Capital Four Health and Safety committee.

In 2021, we had an increase in the number of sick days compared to 2020. However, the 2020 figures were impacted by the COVID-19 pandemic. The 2021 sick rate figures are in line with figures prior to the pandemic.

**Figure 14: Sick leave per FTE (days) per year**




Capital Four offers attractive pension contribution and private health insurance to permanent FTEs. As part of our value for long-term relationships with our employees, FTEs participate in the company's long-term incentive program. Our employees can thereby have a share in the long-term value creation, in addition to their salary, bonus, pension and insurance benefits.

**Education and training**

We encourage the development of our employees and support ongoing education, skillset improvement and professional development. This includes supporting all employees in attending relevant training courses, obtaining professional qualifications, and subscribing to relevant and professional literature and journals. To strengthen individual career development, we offer a mentorship program for all FTEs and a buddy program for our part-time students.

During 2021, we have had ongoing education of our investment staff within key sustainability areas, focusing on themes such as new regulatory requirements, SFDR implementation and norm-based screenings. Additionally, we have had training relating to GHG accounting. However, the number of education hours was affected by the COVID-19 pandemic. Further strengthening the competencies of our employees through education will be a key focus area in the coming years.

Capital Four has in previous years held and participated in several events with Nordic universities, such as Lund University and Copenhagen Business School, to help educate and encourage development of professionals. Capital Four was a sponsor of the CBS Finance Competition, and a partner in the work on “Integrating ESG and illiquid assets for students and business”. Capital Four has also had master thesis collaborations with Lund University and with University of Copenhagen.

We also host in-house educational and networking events for students and young professionals as a way to promote career development with Capital Four.

[10] Source: Børsen, read more and GOV.UK Gender pay gap service read more

## Governance

Capital Four believes that strong governance and ethical business practices are fundamental in order to ensure clients' and stakeholders' trust, and to maintain successful investment activities.

All employees are responsible for complying with our Code of Conduct and all Capital Four policies and procedures relevant for their respective positions.

Every employee is given an overview of the firm's policies and procedures along with the mandatory annual compliance training. The training covers the firm's Code of Conduct and other relevant policies and procedures as deemed necessary.

All new employees attend information meetings, to be informed about the activities that go on in the various departments at Capital Four, such as investment, research, trading, human resources, compliance, business development and legal. Our employee handbook outlines the employee's rights, benefits and expected conduct.

Capital Four's focus on responsible business conduct also covers our suppliers. We aim for all suppliers to adhere to the principles laid out in the UN Global Compact and have introduced it as a requirement for all new suppliers that we engage with from December 2021. If Capital Four becomes aware of any severe issues related to breaches of the principles of the UN Global Compact by a supplier, we will engage in dialogue with the supplier. If we do not deem the answer of the supplier to adequately address the issue, we may terminate the contract. Capital Four will rely on policy-level assurance provided to Capital Four by the suppliers and will not perform our own supplier audits.

**Remuneration**
The Boards of Directors of the entities in Capital Four Holding have adopted a joint remuneration policy with the objective of attracting, retaining, developing and rewarding the employees who contribute to creating value for Capital Four and its clients. The policy ensures that the overall remuneration model is aligned with sound and efficient risk management principles. The members of the Board of Directors of Capital Four are compensated only with fixed remuneration, if any, and not with any variable remuneration. The members of the Management Board of Capital Four are compensated with a fixed and a variable remuneration component, subject to the limitations of variable remuneration. No employee at Capital Four is entitled to a remuneration of €1 million or more per financial year.

**Table 7: CEO pay ratio**

| | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| **CEO pay ratio – versus median salary** | 288% | 288% | 302% | 289% |

**Risk management**
We have a strong focus on risk assessment. We regularly assess Capital Four's risk of being misused for the purposes of money laundering or financing terrorism. We assess the risk of bribery, corruption and money laundering pursuant to our internal policies and procedures when we conduct business.

Know Your Customer (KYC) procedures are carried out on every current and potential client. We have a whistleblower system in place for any suspicion of financial compliance violations related to our organization. In 2021, we expanded the whistleblower system to further cover harassment matters that can be difficult to report through conventional channels. We also have a gifts, events and lobbying policy as part of our Code of Conduct to avoid any conflicts of interest. Each year, we conduct training of our employees including matters related to anti-corruption and bribery.

IT security risks and cyberattacks continue to be a significant issue for today's businesses. The Capital Four Group Policy for IT Security describes the security principles for our cyber security system and the principles for employees to follow in order to keep confidential information safe. The security principles include two-factor authentication in systems at all times. Cyber security systems and policies are updated on a continuous basis to adapt to any new and emerging cyber security threats. The Capital Four Group Policy for IT Security is given to employees to read at the time of employment. Additionally, all Capital Four employees receive annual training in cybersecurity policies.

**Table 8: Compliance incidents and training**

| | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|
| **Number of incidents of non-compliance with data protection and privacy policies and procedures** | 0 | 0 | 0 | 0 |
| **Percentage of employees trained in cybersecurity guidelines and policies** | 100 | 100 | 100 | 100 |

## Charitable Giving

At Capital Four, we are dedicated to supporting various non-profit organizations. Each year, employees decide which charities to support with a monetary donation from the firm. Normally, our charity donations are made at the end of the year, but due to the tragic events unfolding in Ukraine, Capital Four decided to donate an amount per employee to the Red Cross, earmarked for Ukraine, in March 2022.

**2017:**
Danish Cancer Society

**2018:**
Julemærkehjemmet (The Christmas Seal Homes)
Unicef

**2019:**
Rigshospitalets Børne og Unge Program (Rigshospitalets Children and Youth Program)
Esrum Kloster (Esrum Monastery)

**2020:**
Danish Cancer Society
Coalition for Rainforest Nations
WWF – World Wildlife Fund

**2021:**
Mentorbarn (Mentor Child)
Kwera

**2022:**
Red Cross for Ukraine

# UNGC Communication On Progress

**Declaration of support**

To our stakeholders,

I am pleased to confirm that Capital Four, with the publication of this sustainability report, reaffirms its support for the Ten Principles of the United Nations Global Compact in the areas of Human Rights, Labor, Environment and Anti-Corruption. We have integrated our annual Communication on Progress into our annual sustainability report, to show the way in which we contribute to the UN Global Compact principles.

In this report, we describe our actions to continually improve the integration of sustainability, including the UN Global Compact and its principles, into our culture and daily operations. As an investment manager, we acknowledge that our main impact on our planet and society does not come from our corporate activities; rather, our main impact comes from our investments. We therefore have a major focus on integrating sustainability throughout our investment process.

**Sandro Näf**
CEO, Partner

**Human rights**

1) Businesses should support and respect the protection of internationally proclaimed human rights in their area of influence; and
2) make sure that they are not complicit in human rights abuses.

— Responsible Investing (page 8-9)
— ESG in the Investment Process (page 20-25)

**Labour**

3) Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
4) the elimination of all forms of forced and compulsory labor;
5) the effective abolition of child labor; and
6) the elimination of discrimination in respect of employment and occupation.

— Responsible Investing (page 8-9)
— ESG in the Investment Process (page 20-25)

**Environment**

7) Businesses should support a precautionary approach to environmental challenges;
8) undertake initiatives to promote greater environmental responsibility; and
9) encourage the development and diffusion of environmentally friendly technologies.

— Responsible Investing (page 8-9)
— ESG in the Investment Process (page 20-25)
— Sustainability of Corporate Activities (page 32-39)
— ESG Investment Cases (page 19 and 26)
— Engagement Cases (page 28-29)
— Carbon Data (page 10)
— TCFD (page 30-31)

**Combating corruption**

10) Businesses should work against corruption in all its forms, including extortion and bribery.

— Responsible Investing (page 8-9)
— ESG in the Investment Process (page 20-25)
— Sustainability of Corporate Activities (page 38)

# About This Report

The presented data for Capital Four's corporate activities, excluding Capital Four's activities in the US, covers the period 1st of January 2021 to 31st of December 2021. The financial data presented in the report was up-to-date as of June 2022.

This report covers the entities in Capital Four Holding, excluding Capital Four US INC.

The report was produced in collaboration with Position Green, an independent third-party advisor.

**Disclosure of Capital Four's commitments**
This sustainability report contains information relevant to Capital Four's ESG commitments.

See the UNGC Principles references on page 40 and TCFD reporting on page 30.

## Data methodology

**Capital Four's carbon footprint**
The GHG emissions of Capital Four are calculated according to the Greenhouse Gas Protocol. All GHG emissions are reported as tonnes of $CO_2$ equivalents (t.$CO_2$e), and comprise $CO_2$e emissions from energy consumption, business travel and paper consumption. The data covers Capital Four's corporate activities in Copenhagen and is calculated according to the location-based approach of the GHG Protocol.

The total energy consumption of Capital Four is sourced from Capital Four's internal accounting system. Only electricity consumption is included in the $CO_2$e calculation from energy consumption.

**Carbon data methodology**
The emission factors used for electricity consumption are based on the average emission factors for Denmark, sourced from the International Energy Agency (IEA).

The total number of kilometers of business travel is sourced from Capital Four's accounting system. For the $CO_2$e calculation, all kilometers of business travel are assumed to have taken place via plane, as it has not been possible to divide data into business travel by air and by land. The total paper consumption is sourced from Capital Four's internal accounting system.

The emission factors used for calculating the $CO_2$e emissions from business travel and paper consumption are sourced from the UK Government, Department of Environment, Food and Rural Affairs (DEFRA).

**Waste and recycling**
The total waste generation and the amount of waste for recycling are sourced from an estimate based on how much waste Capital Four has on a daily basis.

**Number of employees**
The number of FTEs, employee headcount and employee groups are sourced from our HR System, Mindkey. All employees are registered in this system.

FTEs are calculated using the "ATP methodology".

The percentage of employees with an international background is calculated as the number of non-Danish employees employed by Capital Four, divided by the population of salaried employees in Capital Four.

Gender balance is sourced from our HR System, Mindkey.

Gender balance for management is sourced from our HR System, Mindkey, and calculated by counting the number of male and female employees in the management group.

**Gender pay**
The average unadjusted gender pay gap is calculated as the difference between the average gross hourly earnings of male and female paid employees, as a percentage of the average gross hourly earnings of male paid employees, based on monthly full-time base salary across all salaried employee groups.

**Education hours**
The total number of education hours is sourced from our manual registration of education pursued by employees and is calculated manually.

**CEO pay ratio**
The CEO pay ratio is calculated as the annual total compensation for the highest compensated individual, compared to the median annual total compensation for all employees (excluding the highest-compensated individual).

**Incidents of non-compliance with data protection and privacy policies and procedures**
The data is sourced from our incident register in accordance with our Procedure for Internal Reporting of Incidents.

**Employees trained in cybersecurity guidelines and policies**
At Capital Four, we have mandatory cybersecurity training of all employees yearly. All participants need to register and verify their attendance at each training session. Data is sourced from this register.

# Data Tables

## Capital Four Environmental data

| Data point | Unit | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| $CO_2e$ from travel by company car | Tonnes | - | - | - | 0.9 |
| Scope 1 GHG emissions | Tonnes | - | - | - | 0.9 |
| $CO_2e$ from electricity consumption | Tonnes | 15.2 | 14.2 | 15.2 | 14.1 |
| Scope 2 GHG emissions | Tonnes | 15.2 | 14.2 | 15.2 | 14.1 |
| $CO_2e$ from travel by plane | Tonnes | 232.2 | 172.2 | 21.3 | 13.9 |
| $CO_2e$ from paper consumption | Tonnes | 4.7 | 6.8 | 4.7 | 6.0 |
| Scope 3 GHG emissions | Tonnes | 236.9 | 179.1 | 25.9 | 19.9 |
| Total electricity consumption (purchased electricity) | MWh | 72.9 | 93.4 | 90.1 | 91.2 |
| Annual business travel by plane | Km | 1,270,637 | 952,793 | 116,911 | 75,654 |
| Annual use of company cars | Km | - | - | - | 13,000 |
| Total waste generation | Tonnes | 2.26 | 3.59 | 3.05 | 4.72 |
| Waste for recycling | Tonnes | 1.18 | 1.78 | 1.67 | 2.27 |
| Waste per FTE | Tonnes | 0.05 | 0.07 | 0.05 | 0.06 |

## Capital Four Social data

| Data point | Unit | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| Total FTEs[13] | Number | 46 | 53 | 65 | 74 |
| Total headcount | Number | 62 | 89 | 102 | 107 |
| Gender balance - total | Percentage women | 28% | 28% | 29% | 31% |
| Gender balance - management | Percentage women | 18% | 25% | 25% | 25% |
| Gender balance - executive management | Percentage women | 0% | 0% | 0% | 0% |
| Gender balance - Board of Directors | Percentage women | 0% | 0% | 0% | 0% |
| Female employees aged <30 | Number | 1 | 2 | 4 | 3 |

[13] FTE numbers for 2018-2020 have been restated due to a methodology change

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|---|---|---|---|---|---|
| Male employees aged <30 | Number | 6 | 10 | 15 | 18 |
| Female employees aged 30-50 | Number | 11 | 13 | 16 | 19 |
| Male employees aged 30-50 | Number | 20 | 23 | 25 | 29 |
| Female employees aged >50 | Number | 1 | 1 | 1 | 1 |
| Male employees aged >50 | Number | 3 | 4 | 4 | 4 |
| Average unadjusted gender pay gap - yearly pay | Percentage | 10% | 10% | 11% | 11% |
| Share of employees with international background | Percentage | 26% | 26% | 28% | 29% |
| Sick leave | Number of days | 37 | 58 | 12 | 70 |
| Sick leave per FTE | Number of days | 0.8 | 1.1 | 0.2 | 0.9 |
| Sick leave per employee | Number of days | 0.6 | 0.7 | 0.1 | 0.7 |
| Employee turnover | Percentage | 2.0% | 9.0% | 5.0% | 8.7% |
| Total number of hours spent on education | Number of hours | 78 | 749 | 518 | 415 |
| Education hours per FTE | Number of hours | 1.7 | 14.1 | 8.0 | 5.6 |
| Education hours per employee | Number of hours | 1.3 | 8.4 | 5.1 | 3.9 |

## Capital Four Governance data

| Data point | Unit | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| CEO pay ratio - base salary | CEO to median employee | 288% | 288% | 302% | 289% |
| Number of incidents of non-compliance with data protection and privacy policies and procedures | Number | 0 | 0 | 0 | 0 |
| Percentage of employees trained in cybersecurity guidelines and policies | Percentage | 100% | 100% | 100% | 100% |

## Abbreviations used in this report

**CBS** Copenhagen Business School
**CI** Carbon Intensity
**CLOs** Collateralized Loan Obligation
**ELFA** European Leverage Finance Association
**FTE** Full-time employee
**GHG** Greenhouse gas
**SBTi** Science-Based Target initiative
**SFDR** Sustainable Finance Disclosure Regulation
**SLL** Sustainability-linked loan
**SPT** Sustainability performance target
**TCFD** Task Force on Climate-Related Financial Disclosures
**WACI** Weighted Average Carbon Intensity

CAPITAL
FOUR

Capital Four
Per Henrik Lings Allé 2, 8th floor
2100 Copenhagen Ø

Capital Four Management
Fondsmæglerselskab A/S
CVR: 30 59 30 65

Capital Four AIFM A/S
CVR 35 67 06 37