TENAX SUSTAINABLE CREDIT FUND ("THE FUND") – APPROACH TO ESG ASSESSMENT (ARTICLE 10 SFDR)

TRANSPARENCY OF THE PROMOTION OF ENVIRONMENTAL OR SOCIAL CHARACTERISTICS AND OF SUSTAINABLE INVESTMENTS

1. Introduction

1.1 Article 10 of the EU Sustainable Finance Disclosure Regulation ("SFDR") requires financial market participants to publish and maintain on their websites the following information for each financial product:

1) a description of the environmental or social characteristics or the sustainable investment objective;
2) information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product, including its data sources, screening criteria for the underlying assets and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product;
3) other relevant information required by SFDR.

1.2 Against this background, this document summarises the Fund's approach to integration of environmental, social & governance ("ESG") characteristics. For further details, please refer to the Prospectus Supplement and (available at https://www.tenaxcapital.com/Legal/ESG, which sets out the Investment Manager's high level approach to ESG compliance and includes a List of Excluded Activities

1.3 In what follows, Tenax Capital Limited is referred to throughout as "the Investment Manager".

2. Overall investment strategy

2.1 The Fund does not have, as its objective, "sustainable investment" in the technical sense that this term is used in Article 9 of the SFDR. However, the Fund may invest in or lend to undertakings that would qualify as "sustainable investments" as part of a balanced portfolio. The Investment Manager supports the objectives of the United Nation's Sustainable Development Goals ("SDGs"). While the Fund is not managed directly in accordance with the SDGs, the Investment Manager has had a long-standing investment focus on the European mid-corporate and SME sectors. As such, many of the SDG's principles and themes are integrated into the Investment Manager's investment approach, including the promotion of sustained, inclusive and sustainable economic growth, full and productive employment, decent work for all and building resilient infrastructure, promoting inclusive and sustainable industrialisation, and the fostering of innovation.

2.2 The Investment Manager envisages that the Fund's investment strategy will follow an ESG-focused approach. In other words, the Investment Manager will seek to integrate qualitative and quantitative ESG information into its decision making processes, such as portfolio construction and valuation, with the objective of enhancing investment decision making. To this end, the Investment Manager will incorporate assessment of ESG issues into its investment analysis and decision making processes, and will aim to invest at least 60% of the Fund's Net Asset Value in loans and other investments of companies deemed to promote environmental or social characteristics, or a combination of those characteristics and that follow good governance practices (as referred to in the SFDR). Typical ESG metrics include (together or alternatively) (i) environmental issues such as climate concern and efficient use of scarce resources, (ii) social issues such as job creation, labour standards, diversity and operating in high-risk areas, and (iii) governance considerations such as business ethics, independent oversight, executive pay and corporate social responsibility.

2.3 The Fund may invest in companies that the Investment Manager deems to be changing and improving for the better in relation to ESG performance. In such cases, the Investment Manager will seek to keep under review the progress that these companies are making to improve their ESG performance. The Fund may also invest in companies that form part of the supply chain of the ESG-rated issuers in which the Fund invests, such as suppliers and other business partners of these issuers. The Fund may invest in these supplier companies on the basis that their role in the supply chain and/or as business partners may indirectly help an ESG-compliant borrower to promote ESG characteristics, notwithstanding that the companies themselves may not be deemed to align directly with ESG characteristics (as referred to in the SFDR).

2.4 The Investment Manager will seek to lend to, or invest with, borrowers and issuers (i) where fundamental and quantitative analysis suggests an ESG rationale for lending to, or investing with, the company and/or (ii) where the company has independent ESG ratings. Given the nature of private debt markets, the Investment Manager would normally expect to place greater reliance on its own internal analysis, supplemented if needed by other sources such as company sponsors' ESG due diligence reports, than on ESG ratings, which are more common in securities markets. Issuers/borrowers will be encouraged to disclose any ESG standards or certifications to which they seek to conform. The Investment Manager's screening of its investments will be undertaken through a combination of (1) the List of Excluded Activities set out in the Investment Manager's Responsible Investing Policy; (2) proprietary and external quantitative and fundamental analysis; and (3) where appropriate, engagement with borrowers/issuers on their governance. The Fund does not plan to use a reference benchmark designated for the purpose of attaining the environmental or social characteristics promoted by the Fund. This is because there are currently few, if any, such benchmarks available in private debt / direct lending markets.

2.5 With regard to engagement with issuers/borrowers, the Investment Manager may, where appropriate, encourage issuers/borrowers to describe and, where feasible, quantify the ESG benefits of utilising the loan proceeds in the investment documentation, and to position this information within the context of their overarching objectives, strategy, policy and/or processes relating to ESG. In some cases, investment documentation may include specific ESG-related covenants committing the borrower to achieve certain ESG standards, either throughout the lifetime of the loan or progressively over time. Covenants may include regular reporting of ESG milestones. By doing this, the Investment Manager will seek to orient the allocation of loan proceeds to the promotion of ESG characteristics. The Investment Manager has recourse to both internal and external ESG research and may, where necessary, use these resources to verify ESG-related claims made by the issuers/borrowers.

3. Assessment of sustainability risks

3.1 Sustainability risks are environmental, social, or governance events or conditions that, if they occur, could have a material negative impact on the value of the investment in the Fund. Sustainability factors are, as relevant, environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

3.2 In evaluating an investment, the Investment Manager will: (i) aim to identify any sustainability risks it believes could have a material adverse effect on a particular loan or security, or an issuer or borrower, its operations and/or its investment performance; and (ii) to the extent that any such sustainability risks are identified, assess these risks as part of its investment decision making process.

3.3 Sustainability risks may negatively affect certain Fund investments, for example by impairing the value of the Fund's investments. They may arise and affect a specific investment made by the Fund or, alternatively, have a broader impact on an economic sector, geographical region or country, which, in turn, may impact the Fund's investments. These risks could be relevant as stand-alone risks, but may also be linked to other risks to which the assets of the Fund are exposed.

3.4 The Investment Manager recognises that ESG integration is a relatively recent phenomenon in private debt markets. At present, industry practice is evolving, and it is not possible to state with confidence that there is an agreed standard for market best practice. The credit assessment process has always paid attention to governance, but explicit consideration of environmental or social issues has been less common. This gives rise to uncertainty which may itself be a source of compliance risk. In light of this, the Investment Manager will aim to ensure that its approach to evaluating the sustainability risks to which the Fund may be exposed is fully documented. The Investment Manager will also continue to monitor market developments with a view to ensuring that its approach reflects evolving good practice.

4. Compliance with the UN Principles for Responsible Investment

4.1 The Investment Manager will seek to adhere to the UN Principles of Responsible Investment, insofar as these are relevant to the Fund's investment strategy. The UN has recently published detailed guidance on the evaluation of ESG issues in private debt / direct lending markets. The Investment Manager has taken this guidance into account in developing its investment strategy for the Fund.

5 What approach does the Fund take to the integration of ESG characteristics?

5.1 The Fund aims to promote certain ESG characteristics, and to comply with Article 8 of the EU Sustainable Finance Disclosure Regulation ("SFDR"). But it will not have sustainable investment or impact investing as objectives. It is not designed to be SFDR Article 9-compliant.

6 What specific ESG characteristics are promoted by the Fund, and how are they integrated into the proposed investment strategy?

ESG focus

6.1 The investment objectives and strategy of the Fund mainly promote social, rather than environmental, characteristics. SFDR Recital 1 makes clear that the disclosure framework set out in SFDR needs to be viewed within the over-arching framework of the 2016 UN Sustainable Development Goals ("SDG"). The investment objectives and strategy of the Fund include a strong focus on the SME and mid-corporate sectors, and as such the Investment Manager would expect them in many cases to be relevant to SDG 8 ('Decent Work and Economic Growth') SDG 9 ('Industry, Innovation and Infrastructure'), as well as to the detailed targets and indicators for SDG 8 and SDG 9 subsequently published by the UN in 2017.

6.2 The Fund will aim to promote sustainable development by supporting investment in the private loan sector, with a particular focus on loans to SME and mid-corporate companies where fundamental and quantitative analysis suggests an ESG rationale for making the investment or which have independent ESG ratings.

6.3 The Fund does not have as its objective sustainable investment in the technical sense that this term is used in SFDR Article 9. However, the Fund may acquire loans to companies that would qualify for inclusion in an Article 9-compliant fund as part of a balanced portfolio.

Investment strategy

6.4 The Investment Manager's team has over 40 years' combined experience of investment analysis which includes private debt markets. The Investment Manager will manage the Fund actively and will employ a predominantly bottom-up, research-based approach. In practice, this means that we will evaluate potential borrower companies against a range of relevant criteria, including their ability to generate long-term capital growth, as well as environmental and social characteristics. The Investment Manager may use a combination of qualitative analysis and internal proprietary quantitative models to screen potential borrowers. We may supplement this by top-down analysis to identify global or sectoral trends that could give rise to suitable investment opportunities or ESG risks. For example, the Investment Manager may consider how sustainability factors, such as changing consumer tastes or regulatory changes, are likely to affect a specific sector or individual borrower. The Investment Manager will utilise analytical resources from a range of sources, including company sponsors' ESG due diligence reports. We may also use ratings where relevant, although currently these are not a prominent feature of private debt markets.

6.5 The Investment Manager will typically invest a minimum of 60% of the Fund's Net Asset Value in loans deemed to promote, inter alia, environmental or social characteristics, to companies that follow good governance practices. To this end, the Fund will take due account of sustainability factors in its investment strategy. The Investment Manager will consider a range of environmental and social characteristics when making or monitoring the Fund's investment decisions. Environmental characteristics include, but are not limited to, mitigation of and adaptation to climate change, water and waste management, and biodiversity, while social characteristics include, but are not limited to, health and well being, labour conditions, workplace safety, employee welfare and the integrity of supply chains. The Fund will aim to comply with the investor disclosure provisions of SFDR Article 8 to demonstrate how it takes account of ESG characteristics to existing and prospective borrowers.

7. What use, if any, will the Fund make of ESG ratings?

7.1 The main focus of the Fund's investment strategy will be the European loan origination market, and it is envisaged that a proportion of the Fund's portfolio will comprise sub-participations of loans originated by one or more partner banks. Against this background, we expect the investment selection process to place greater reliance on primary research (including fundamental and quantitative analysis) than on ESG ratings. However, it is possible that some borrower companies may receive ESG ratings, in which case the Investment Manager will make use of these in its investment decision making process.

8. Will the investment strategy be aligned with the EU taxonomy?

8.1 The EU Taxonomy is primarily relevant to investments that promote environmental characteristics. The Fund mainly promotes social characteristics, in line with SDG 8 and SDG 9 (see above). To the extent that investment in the SME and mid-corporate sectors, in particular, also promotes environmental characteristics, there may be a degree of alignment with the EU taxonomy, but we would expect this to be less than for a fund mainly intended to promote environmental characteristics.

9. **How will the Fund evaluate ESG issues at each discrete stage of the investment process?**

Governance and oversight

9.1 The Investment Manager aims to have a well-defined investment process that assesses borrowers against a range of sustainability criteria. The end-to-end investment process for the Fund will be overseen by an Investment Committee of the Investment Manager with specialist expertise in private debt / direct lending markets. The Committee will be responsible for reviewing investment recommendations submitted by portfolio managers, approving investment decisions at the inception stage, and providing high level oversight of the portfolio thereafter.

9.2 The Legal & Compliance function within the Investment Manager will perform second-line-of-defence oversight by helping the business to achieve compliance, advising on legal and regulatory requirements relevant to ESG, promulgating relevant policies and standards, and undertaking monitoring checks (e.g. review of Investment Committee minutes) to ensure that all aspects of the investment process comply with agreed ESG-related standards and protocols.

Origination and pre-investment screening

9.3 The Investment Manager will integrate ESG considerations into the process for identifying investment opportunities and originating loans. These considerations may include:

- Applying negative ESG screening (e.g. against the Investment Manager's List of Excluded Activities)
- Identifying any ESG red flags / deal breakers
- Screening against potential grey areas (e.g. involvement in the supply chain of a company engaged in Excluded Activities)
- Consulting external sources of ESG information, such as company sponsors' ESG due diligence reports
- Assessing jurisdictional issues, such as local governance, legal systems, ESG policy and regulation
- Engaging prospective borrowers regarding disclosure, and management, of potential ESG risks

Due diligence and investment approval

9.4 The Investment Manager undertakes detailed analysis to evaluate the credit risk associated with a prospective borrower. Where a loan is being considered for inclusion in the Fund – either because the Investment Manager plans to originate the loan itself or because it has agreed to sub-participate a loan originated by a third party – this credit assessment process may be supplemented by one or more of the following:

- In depth ESG due diligence on the borrower
- Assessment of potential ESG issues over the lifetime of the investment
- Assessment of any limitations in the borrower's capacity to provide relevant / timely ESG-related data
- Inclusion of formal ESG covenants in the loan documentation
- Integration of ESG considerations into the papers submitted to the Investment Committee
- Consideration of ongoing monitoring / reporting requirements

- Assessment of whether the Investment Manager will have any direct influence on the borrower's strategic direction or management team
- Engagement activity with the borrower covering ESG aspects

9.5 The Investment Manager envisages that written proposals presented to the Investment Committee will normally include a section covering ESG considerations. This may be supplemented, where appropriate, by analysis prepared by third parties (e.g. company sponsors' reports). The Chair will invite discussion of ESG aspects, with a view to ensuring that proposed investment transactions are credible from an ESG perspective and not vulnerable to charges of 'greenwashing'. Discussion of ESG issues will be reflected in the Investment Committee minutes.

9.6 This assessment process set out above should, in principle, narrow down the potential investment universe so as to enable the Investment Manager to ensure that the Fund holds a minimum of 60% of its Net Asset Value in investments that promote ESG characteristics. The Investment Committee will keep the composition of the loan portfolio under review to ensure that the Fund meets this requirement on an ongoing basis.

Ongoing monitoring

9.7 Private loans are typically illiquid, so it may not be possible for the Investment Manager to dispose of the Fund's assets at short notice. In light of this, it will be essential for the Investment Manager to undertake ongoing monitoring to ensure that a borrower remains committed to promoting ESG characteristics throughout the life of the loan. This will help to ensure that, where a borrower fails to comply with ESG requirements during the lifetime of the loan, this is more likely to be detected at an early stage, before a situation arises in which it might be necessary for the lender to call an event of default. For ESG-compliant loans, the Investment Manager may undertake monitoring by (i) including covenants in the loan documentation, requiring the borrower to provide information on a regular basis, to evidence compliance with ESG standards and (ii) demonstrating that we, or a qualified third party, have tested and verified borrower performance against agreed standards.

9.8 The Investment Manager will carry out ESG monitoring using a mixture of open-source information and engagement with the borrower company based on its regular reporting. Sources of information may include ESG questionnaires, impact assessments, desk-based research, onsite visit findings, public domain media coverage, and analysis undertaken by other lenders. It is unlikely that a one-size-fits-all approach will be appropriate and, wherever possible, the Investment Manager will leverage its own working relationships with the borrower company or loan originator to obtain a clear understanding of how ESG issues are affecting the company.

9.9 To facilitate ESG compliance, the Investment Manager may also look for opportunities to give borrowers financial incentives to promote ESG characteristics, for example by making provision in the loan documentation to include mechanisms such as an ESG margin reduction trigger. The extent to which the Investment Manager can use such mechanisms will depend on commercial factors, such as the ease with which the borrower can obtain financing from other sources that do not involve this type of conditionality.

Exit

9.10 The Investment Manager will take account of ESG considerations when deciding how best to complete a planned exit from an investment. In general, our approach is to hold loans/bonds to maturity. In some cases, we may take into account potential future refinancing options, particularly where a company is in the process of making ESG improvements and there is a commercial case for providing additional finance.

10. What use, if any, will the Fund make of benchmarks?

10.1 Because the Fund will primarily focus on loan origination in the private debt markets, the Investment Manager does not envisage designating a reference benchmark for the purpose of attaining the environmental or social characteristics promoted by the Fund. At present, there are few, if any, benchmarks that cover a sufficiently large universe of private companies to permit objective positive ESG screening. The Investment Manager will continue to monitor market developments in this area and will keep its approach under review in the event that the position changes.

11. What sustainability indicators are used to measure the attainment of the environmental or social characteristics promoted by this Fund?

11.1 The Investment Manager uses a range of relevant sustainability indicators to use in conjunction with fundamental bottom-up research and ESG ratings (where available). Our current thinking on this is summarised below.

Binding exclusion criteria

11.2 The intention is to make use of certain binding sustainability exclusion criteria. Involvement by an issuer in certain specified activities would normally result in the investment being deemed ineligible. The Investment Manager’s Responsible Investing Policy includes a non-exhaustive List of Excluded Activities which we will use for this purpose. In applying these exclusions, we draw on information from independent ESG rating providers and recognised third party sources.

Non-binding criteria

11.3 The Fund also uses certain non-binding sustainability criteria to aid the investment decision making process. These are integrated into both the top-down and bottom-up screening approach for all investments in the Fund. The UN Sustainable Development Goals will be important in this context. For each proposed investment, it should be clear what ESG outcomes it will help to achieve.

Trigger events

11.4 Should the ESG rating of an investment held by the Fund change to negative, or breach the sustainability exclusion criteria set out above, The Investment Manager will determine how best to remediate the situation e.g. through active engagement with the borrower or, in a worst-case scenario, exiting the investment in accordance with the terms of the loan documentation. The Investment Manager will abstain from participating in similar loans going forward until the identified ESG issue(s) is resolved.

12. What is the policy to assess good governance practices of the investee companies?

12.1 Assessment of good governance will include transparency of ownership and control, board structure and independence, alignment of remuneration, and accounting matters. We will also take account of compliance with generally accepted standards of business integrity. The Investment Manager will seek to satisfy itself that good governance practices are in place.

12.2 Since the Fund does not include impact investing among its objectives, we do not envisage continuous engagement with borrower companies. In practice, the frequency of engagement is likely to vary depending on the nature of the business relationship. However, we consider the strength of corporate governance to be a key driver of sustainable performance, and will therefore embed this within the investment strategy, together with consideration of any adverse information about business integrity issues.

13. What asset allocation is planned for the Fund?

13.1 The Investment Manager will typically invest a minimum of 60% of the Fund's Net Asset Value in securities deemed to promote, among other characteristics, environmental or social characteristics, or a combination of those characteristics, issued by companies that follow good governance practices. See Section 2 ('Overall investment strategy') above for further details.

14. Does this Fund take into account principal adverse impacts on sustainability factors?

14.1 As the Fund does not have sustainable investment as one of its objectives, it does not plan to make formal use of principal adverse impacts. The Investment Manager will use a range of sustainability indicators to assess whether proposed or existing investments are likely to promote ESG characteristics. In light of the planned sectoral focus of the Fund, the Investment Manager would expect the adverse sustainability indicators relating to social and employee matters, respect for human rights, and anti-corruption / bribery matters to be potentially relevant. Some environment-related indicators could also be relevant.

15. Where can I find further details on the investment strategy?

15.1 Further information on the ESG policy of the Fund and the Company's corporate approach to sustainability can be found at https://www.tenaxcapital.com/Legal/ESG.

ANNEX 1: TENAX CAPITAL LIMITED – LIST OF EXCLUDED ACTIVITIES

Under the Responsible Investing Policy, the Investment Manager is prohibited from investing in entities engaged in certain economic activities. These are set out overleaf. This list has been drawn up taking account of DFI policies and internationally recognised good practice. It will be kept under review.

The following activities are excluded:

Production of, or trade in, any product or activity deemed illegal under applicable local or national laws

or regulations or subject to internationally agreed phase-outs or bans as defined in global conventions

and agreements such as certain:

– hazardous chemicals, pharmaceuticals, pesticides and wastes;

– ozone depleting substances;

– endangered or protected wildlife or wildlife products; and

– unsustainable fishing methods such as blast fishing and drift net fishing in the marine environment using nets in excess of 2.5 kilometres in length;

Production of, or trade in, arms (i.e. weapons, munitions or nuclear products, primarily designated for military purposes);

Production of, use of, or trade in, unbonded asbestos fibres;

Production of, or trade in, atomic power or radioactive materials;

Prostitution;

Any businesses, if any of the following activities represents more than a de minimis proportion of such business:

- gambling, gaming casinos and equivalent enterprises;
- tobacco or tobacco related products;
- marijuana production or distribution;
- virtual currencies;
- illegal trade in wildlife;
- pornography / adult entertainment.