

# Methodologies related to Sustainable Investments

## Description of methodologies linked to our Policy on Sustainable Investments and the EU disclosure regulation

This document describes the methodologies used in implementing our Policy on Sustainable Investments as well as the fund-specific characteristics. The document describes the definition of sustainable investments under the EU Sustainable Finance Disclosure Regulation §2.17 and the implementation of the data requirements in the taxonomy regulation. Hereafter is a short description of the screening process and how to make decisions in accordance with the policy. Data and due diligence is described at the end of the document.

### Definition of Sustainable Investments in accordance with the EU Disclosure-regulation

Nykredit defines 'sustainable investments' as companies or assets that abide by the Do No Significant Harm (DNSH) and minimum safeguards principles and show good governance while having a sustainable contribution. We define 'sustainable contribution' through a number of different indicators that show a strong alignment of products or services with sustainable impact or excellent performance within board diversity or contribution to the UN Sustainable Development Goals. The approach for this definition is a "pass or fail", where passing a threshold defines if the company is considered a sustainable investment.

### Do no significant harm and minimum safeguards

The Do No Significant Harm (DNSH) and minimum safeguards criteria are implemented through a list of companies that do not meet the criteria. The list is used to check all sustainable investments and any issuer on the list cannot be a sustainable investment.

### DNSH

The DNSH-criteria use information on controversies, severe misalignment with the SDG's and mandatory PAI indicators and involvement in fossil fuel activities as part of the DNSH compliance check.

The thresholds are the following:

Controversies: Screening for involvement in environmental controversies related to UN Global Compact principles and OECD guidelines on multinational companies. A breach will lead to exclusion from sustainable investments.  
 Strong misalignment with the SDG's: Any strong misalignment with the SDG's and sub-goals related to the environment will lead to exclusion from sustainable investments. We use this parameter as a proxy for significant harm to the PAI, where we have mapped the PAIs to SDG

Thresholds and exemptions:

Involvement in activities: Any company involved in fossil fuels will be excluded from sustainable investments provided the following thresholds and exceptions:

Companies that have 5% or more revenue from production, distribution, delivery of equipment to or servicing of production of fossil fuels (thermal coal, oil, gas, or uranium). However, companies are investable if all of the following are met:

- At least 90% of the company's energy sector CapEx in new capacity, on average for the three consecutive years including the last financial year, are in the renewable energy sector.
- Revenue from renewable energy comprises at least 50% of the company's total revenue. This ratio may be calculated on average over the course of 1, 2, or 3 of the last financial years.
- The company has no revenue from tar sand, shale oil, or shale gas, or other fracking activities and/or mining of oil shale and/or extraction in the Arctic region.

Companies that have 5% or more revenue from the generation of power from coal, natural gas, oil, or uranium. However, companies are investable if all of the following are met:

- At least 90% of the company's energy sector CapEx is in new capacity, on average for three consecutive years including the last financial year, are in the renewable energy sector.
- Revenue from renewable energy comprises at least 50% of the company's total revenue from power generation or at least 50% of the company's energy production capacity is based on renewable sources. This ratio may be calculated on average over the course of 1, 2, or 3 of the last financial years.
- The company has no revenue from tar sand, shale oil, or shale gas or other fracking activities and/or mining of oil shale and/or extraction in the Arctic region.

### Minimum safeguards

Any company not in compliance with the following minimum safeguards check will be excluded from sustainable investments:

- Norms violation: UN Global Compact principles, the UN Guiding Principles on Business and Human Rights, ILO conventions, and OECD guidelines on multinational companies.
- Controversial Weapons: Confirmed producers or distributors of controversial weapons defined as anti-personnel mines, cluster munitions, biological weapons, chemical weapons, depleted uranium, white phosphorus, blinding lasers and nuclear weapons outside the Nuclear Non-Proliferation Treaty. No threshold apply.
- Any company involved in production of tobacco will be excluded. No threshold applies.
- Companies that have more than 5% revenue from production or distribution of alcohol, weapons, adult entertainment, or gambling. Companies that have 5% or more revenue from distribution of tobacco.

### Good governance

Governance is assessed through analysis as part of our investment selection, dialogue with companies, analysis of shareholder meeting agendas in the context of exercising voting rights, and monitoring governance related data from external ESG data provider(s).

A company with a poor governance of ESG issues and risks fail the good governance test. This is defined as the lowest or second lowest ESG rating provided by our ESG data provider. Both traditional governance metrics as well as environmental and social are used for this rating.

### Sustainable contribution

A company can have a sustainable contribution in various ways. This can be environmental, climate-related, social or human capital-oriented economic activities, and these can either be in the form of products and services, or through the practices or conduct of the company.

Our definition tries to capture both revenue-related sustainable contribution and those related to the practices of a company. The approach is a "pass or fail" approach, where all the activities of the company is counted as sustainable, if the company pass the thresholds on contribution, governance and DNSH/minimum safeguards. For the investment to be considered to contribute to sustainable development, the investment need to pass one of the following thresholds on contribution:

- More than 20% of the revenue of the company is aligned with the taxonomy or,
- More than 20% of the revenue of the company derives from activities that have a positive impact on sustainability as defined by our ESG-service provider or,
- The company has a positive contribution to any of the 17 SDG's measured by alignment or,
- The company has set a verified Science Based Target, thereby contributing to minimize climate change or,
- The company has a diverse board. This is measured as a representation of the underrepresented gender by more than 40% in developed markets and 20% in emerging markets.

Issuances of green bonds, that comply with either ICMA Green Bond Principles or EU Green Bond Standard, are viewed as sustainable investments, regardless of whether the issuer itself lives up to the definition of sustainable contribution above. Green bonds do, however, have to comply with the governance and DNSH tests, as well as minimum social and environmental safeguards.

## **Taxonomy alignment**

As the reported data on taxonomy eligibility and taxonomy alignment is still scarce, Nykredit uses assessed third party data from our ESG-data service provider in combination with reported data. On covered bonds this is combined with reported data matching the technical screening criteria on housing, which is checked against the DNSH-criteria. Otherwise, the data used is from our ESG-data service provider.

This methodology is also disclosed on the fund website disclosures as well as our data providers.

## **The Policy on Sustainable Investments**

The policy on Sustainable Investments is reviewed annually and is subject to approval by the Board of Directors of Nykredit A/S. The policy contributes to implementing the Nykredit Group's Corporate Responsibility Policy. The Board of Directors is briefed at least annually on Nykredit's corporate responsibility activities, often at the time of publication of the statutory corporate responsibility report. The Group Executive Board makes up Nykredit's Corporate Responsibility Committee.

Nykredit's Forum on Sustainable Investments makes decisions relevant to the implementation of this Sustainable Investment Policy. The Forum will have at least four meetings annually to decide on engagements, possible exclusions and the further develop integration of ESG in the investment processes. The Head of Wealth Management is chair of the Forum, which also has representatives from Asset Management, Group Finance, Sparinvest, Nykredit Portfolio Administration and People and Identity. The Nykredit ESG Team and the Nykredit Asset Management Forum on Sustainable Investments will assist the Forum on Sustainable Investments. The Policy is implemented by the relevant business units, among other things asset management, and these will provide recommendations. The Nykredit Forum on Sustainable Investments as well as the boards of the individual investment funds will annually evaluate the efforts and the need to further develop this policy.

## **Process for screening**

Each quarter the funds are screened for new information on sustainability risks. The screening has specific focus on breaches of international norms and involvement in controversial weapons or production of tobacco. The investment universe is also screened on controversial weapons and tobacco, so any issuer that might an investee company is excluded before an investment occurs. International norms is defined as the ten principles of UN Global Compact, OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organization on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

Information on breaches of international norms will be analysed internally with the assistance of our ESG-service providers. The results of the analysis will be presented to the Forum on Sustainable Investments, which will decide whether to engage with or exclude the issuer. The prerequisite for engagement is a positive outlook for change. Nykredit disclose a list of excluded companies and engagements on breaches of international norms on its webpage. All engagements monitored and will be revaluated at least every two years for reassess the positive outlook. If there is no positive outlook the engagement will end and the issuer excluded.

## **Updates of fund specific exclusion lists**

The general list of excluded companies are applied to all funds. A number of funds have stricter restrictions and these restrictions are implemented through an additional list of excluded issuers. These exclusions is related to both internal norms and sector specific exclusions. As corporate action or new issuance change the universe more frequently these list are updated on at least every two weeks.

The data on relevant on DNSH and minimum-safeguards is also up dated at least every two weeks.

## **Controlling the requirements of the funds**

The sustainability characteristics of the individual funds are monitored ongoing. The requirements defined by the precontractual documents are measured against the actual characteristics of the fund as compiled data from the current issuers in the fund. The results are used for internal controlling as well as the periodic reporting.

Compliance with the exclusion list relevant for the fund is checked on a daily basis. Any company on the list of excluded companies will be blocked for investments in the pretrade compliance procedures.

The performance of the sustainability indicators are controlled at the end of each month.

At the end of every quarter the funds are screened against breaches of international norms as mentioned above. The relevant boards will also receive a report on this frequency.

## Data

The preconditions for investing with the aim of creating value and benefiting society are knowledge and the ability to execute. In this context, high quality data and reliable service providers play an important role. Nykredit obtains data from a variety of different sources. Nykredit receives information from investee companies and combine it with information from public sources such as authorities, international organisations, NGOs and, of course, the media. In addition to this, Nykredit buys data and research from stock brokers and specialised providers of sustainability data-bases. Insights from these sources are included in the investment process and our active stewardship through engagement with the company and voting. The latter is executed through our service providers by proxy voting and active stewardship.

Currently our main providers of sustainability data are:

- MSCI ESG Research
- ISS Proxy Voting
- Sustainalytics

The primary providers of ESG data are MSCI ESG Research, which is used for individual ESG data points, controversies, and ESG ratings; Sustainalytics on controversies and active ownership, and ISS on analyzes of individual corporations and agendas for their annual general meetings.

In addition, reported data from the issuers are used where no other data are available, or where it is deemed that issuer data is of higher quality.

Information from other external parties such as authorities, media, or nongovernmental organizations can be used.

Due diligence is performed on all data sources. Only third-party providers of ESG data who themselves have internal processes for validating and checking the data provided are used. Randomized controls are performed on this data. Should these identify errors, these will be corrected and the data provider informed. Due diligence on data directly from issuers is more extensive than due diligence on suppliers. This applies in particular if there are no figures for data included in the official reporting. For other parties, it applies that data is compared with information that we otherwise have from our data suppliers and the credibility of the source.

Sustainability data is processed through Data Warehouse, which collects all data on holdings, environmental and social characteristics as well as sustainability data. Data is continuously collected in an automated process, which also carries out checks of whether the information is linked to the correct securities. In addition, automated and manual controls are performed with a particular focus on data points that may differ from historical or other data.

For climate data, estimates are used in the following manner. For listed shares, it is no more than 5%. For listed corporate bonds, up to 30% of the data can be estimated. FinansDanmark's methodology for calculating CO2 footprint is used. For taxonomy alignment, estimates from MSCI ESG Research and reported data are used on listed securities, where these are available. To calculate taxonomy alignment for Danish mortgage bonds, reported data that match the technical screening criteria, such as energy labeling class A, is used to identify taxonomy alignment.

In general, data is limited with respect to the amount of concrete, reported data. At the same time, reported data are sometimes not directly comparable due to different calculation methods. This challenge is primarily met by using data from third-party providers of ESG data. In part, these suppliers validate data, and partly, they seek to estimate data by combining other reliable data sources.

In addition, other data from authorities are used, e.g. in connection with government bonds that may indicate challenges. In addition to sanctions, this can in other ways be restrictions concerning the individual country.

In general, the principle applies that if an issuer is given special characteristics such as a contribution to sustainable development, then this must be concretely documented. A special effort is made to identify the negative impact and clarify cases of doubt.

These approaches entail that use of data in the investment process, and the controls, provide a fair picture of the characteristics of the investments.

Nykredit regularly assesses the suppliers and service providers' ability to supply valid data, accurate research and, in relation to engagements, to deliver on Nykredit's requests. At least once a year, we evaluate the quality of the services and collaboration.

#### Process for correction of data

Even though our aim is to have as correct data delivered as possible, there will from time to time be data deliveries that will need to be corrected. This can be due to conflicting data between different providers or new data from the issuer that is considered valid, but might not yet be reflected in the data from the service provider. To ensure the validity of the data and internal transparency of the process. The following process need to be followed, when data has been corrected in the DWH. This does not apply to the ongoing updates from our service providers etc., but only when delivered data is being corrected.

If data need to be corrected the reasoning and the documentation for this need to be presented to the Forum on Sustainable Investments, which will sign off at the first up coming meeting. A decision log on this will be run for internal compliance. Any change which could have a large implication on specific funds will also be reported to customers in the periodic reporting.

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