Policy on the

Integration of Sustainability Risks

Politik

ANSVARLIG AFDELING
Risk & Regulation

ANSVARLIG
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DATO
15 March 2025

1. Introduction

1.1 This policy establishes IIP Denmark's (IIP) approach to integrating sustainability risks within investment decisions and advisory processes, in alignment with the Sustainable Finance Disclosure Regulation (SFDR)[1] article 3. IIP is committed to responsible investment practices that support sustainable growth and address environmental, social, and governance (ESG) risks and opportunities, recognizing that sustainability risks can have a material impact on investment performance and resilience.

1.2 The policy is intended to enhance transparency for investors, stakeholders, fund managers, and portfolio companies, detailing how sustainability risks are defined, assessed, and integrated into our investment activities.

1.3 This is the inaugural version of IIP's Policy on the Integration of Sustainability Risks. It comes into effect on 15 March 2025 and will be reviewed at least annually and updated as necessary to reflect regulatory developments, industry standards, and best practices in sustainability risk management.

2. Sustainability Risks

2.1 In the context of this policy, sustainability risk is defined as an ESG event or condition that, if it occurs, could cause a material negative impact on the value of an investment[2].

2.2 IIP is an alternative investment platform for institutional investors and professional investors investing in private funds and direct co-investments. IIP primarily looks for fund and co-investment opportunity in or alongside US and European (buy-out or venture) managers. In addition, IIP provides investment advisory services to investors.

2.3 Investing in private markets will always be associated with various types of risks. In addition to more traditional financial risks such as operational risk, liquidity risk, and market risk, financial risks can also arise from sustainability

[1] REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector
[2] SFDR art. 2(22)

risks – an environmental, social, or governance event or circumstance that can negatively affect the value, earnings, and returns of an investment.

2.4 IIP oversees a diverse portfolio of investments across multiple sectors and regions, all of which are subject to sustainability risks. As with other risk factors, sustainability risks are systematically integrated into IIP's investment decision-making processes and investment advisory activities. This includes identifying, assessing, and prioritizing potential sustainability risks associated with the investments to ensure a structured and proactive approach to risk management.

2.5 Generally, sustainability risks are split into three categories: 1) environmental risks, 2) social risks, and 3) governance risks. Sustainability risks can lead to a significant deterioration in the financial profile, liquidity, profitability, or reputation of an investment if the risk is realised and unmitigated.

2.6 By proactively managing sustainability risks, IIP aims to protect the portfolio from potential disruptions while strengthening its long-term resilience and value creation.

2.7 ***Environmental Risks***

2.8 Environmental risks to investment value can be split into various categories with risk pertaining to climate change, biodiversity, and environmental events serving as key examples.

- <u>Climate Change Risks:</u> This category of risk can be divided into Physical Risks and Transition Risks. The risk of declining asset value due to climate change is a global concern, impacting a wide range of sectors and regions, including those found in IIP's portfolio.

  - *Physical Risk* refers to the risk of assets being adversely impacted by extreme weather events (such as heatwaves, drought, floods, and storms) or long-term climate change (such as rising sea levels, ocean acidification, changes in rainfall frequency and volume, changes in land and soil productivity, and reduced water availability). These effects of climate change could disrupt supply chains, increase costs, and impede access to natural resources.

  - *Transition Risk* refers to the potential risks arising from changes in an investment's market conditions, which may occur in response to climate change. These risks may include risks of climate-related regulatory changes (e.g., emissions standards, carbon pricing), shifts in consumer preferences and risk from climate-related litigation.

- Biodiversity Risk: Resource depletion and access to finite natural resources like water and minerals are crucial to certain industries in IIP's portfolio. Risks associated with resource scarcity and depletion of ecosystems could increase operational expense, disrupt supply chains, and increase regulatory pressures.

- Risk from Environmental Events: Environmental pollution and waste mismanagement can result in regulatory fines, reputational damage, consumer backlash, and cleanup costs, impacting the financial performance of an investment. Lack of sufficient sustainability due diligence at fund manager or portfolio company level may increase the risk of environmental events in IIP's portfolio.

2.9 ***Social Risks***

2.10 Social risks encompass a range of factors, including labour practices, employee relations, human rights, and community impacts. These risks can arise from issues such as poor working conditions, violations within the supply chain, corporate union busting, or inadequate stakeholder engagement, all of which can adversely affect a company's reputation and operational stability. The absence of robust processes to identify and mitigate such risks in accordance with international norms[3] could present significant threats to IIP's portfolio performance.

2.11 Examples of potential social risks include:

- Labour Rights Risk: Poor working conditions or violations of labour rights (such as union busting, discrimination, or exploitation) can result in legal liabilities, disruption of operations, and damage to a company's reputation. These factors also affect employee retention and recruitment, as potential employees and top talent may be discouraged from joining companies with poor labour practices. High turnover or difficulty in attracting skilled workers can significantly impact business performance.

- Supply Chain Risk: Violations of human rights, such as child labour, forced labour, or unsafe working conditions within the supply chain, can expose companies to significant legal, financial, and reputational risks, especially as consumers and investors increasingly demand transparency and responsible practices.

- Community Relations Risk: Companies whose operations significantly impact local communities risk operational delays, consumer backlash,

[3] UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct

and additional costs if community relations are not managed effectively.

- Product Safety and Liability Risk: Particularly in sectors like consumer goods and healthcare, failure to meet product safety standards can lead to costly recalls, legal actions, and reputational harm.

2.12 ***Governance Risks***

2.13 Governance Risks refer to the potential negative impacts on a company's performance arising from poor governance practices, such as conflicts-of-interest, aggressive tax planning, lack of diversity and independence on management levels, and corporate misconduct. If not sufficiently managed, governance risks can significantly undermine IIP's portfolio, affecting long-term value and operational stability. Effective governance is crucial for ensuring accountability, strategic oversight, and responsible conduct across the investment lifecycle. Key governance risks include:

- Board Diversity and Independence: A lack of diversity and independence in the boardroom can lead to biased decision-making, poor governance practices, reduced innovation, and potential conflicts of interest, which may negatively influence strategic decisions and overall company performance.

- Executive Compensation and Incentives: Misaligned executive compensation structures, where incentives are based on short-term financial gains rather than long-term goals, can encourage risky behaviour and undermine long-term value creation.

- Corporate Misconduct: Insufficient governance structures to prevent and detect violations of legal or ethical standards, such as corruption, fraud, or exploitation. Corporate misconduct can erode investment value through reputation damage, legal penalties, loss of consumer trust, and financial instability. Ultimately, these risks can result in reduced profitability and hinder long-term growth potential.

- Regulatory Compliance and Responsible Conduct: Governance risks also encompass exposure to legal and reputational risks arising from non-compliance with critical regulations, including the EU's sustainability directives and regulations, national anti-corruption laws, and international guidelines. Failing to adhere to these may lead to fines, legal actions, and significant damage to a company's public image.

3. Integration of sustainability risks in the investment decision-making process

3.1 IIP predominantly engages in investments through a fund-of-funds structure, meaning that investments are made indirectly through an IIP primary fund that allocates capital across multiple underlying funds managed by General Partners (GPs). IIP selects and oversees these GPs, enabling diversification across strategies and sectors, while the GPs actively manage the individual investments within their specific funds. Furthermore, in certain circumstances, IIP also invests directly in portfolio companies selected by a GP when deemed beneficial (co-investments).

3.2 Within the framework of this investment structure, IIP integrates sustainability risk at each stage of the investment lifecycle, including an initial desktop screening, commercial due diligence, decision-making, and ongoing monitoring. This structured approach is designed to identify, assess, and mitigate sustainability risks across the portfolio, ensuring that sustainability considerations are embedded throughout the investment process. The individual steps are outlined below.

3.3 ***Initial Screening***

3.4 Since IIP's fund investments are typically made in blind-pool investment structures, it is not possible to assess the individual portfolio companies before the investment, as these companies are unknown at the time of commitment. As a result, a more thorough due diligence process and a careful evaluation of the fund manager are necessary prior to making an investment decision, especially when compared to investments in public markets. The initial screening phase is therefore crucial for identifying high-level sustainability risks associated with potential investments. This process also serves as a tool for prioritization, enabling the investment team to filter out non-viable opportunities and allocate resources more effectively.

3.5 The initial screening will specifically assess the following:

- <u>Investment Restrictions:</u> Whether the investment mandate of the fund or the GP's selection of portfolio companies in previous funds suggests that the GP may invest in sectors inconsistent with IIP's investment restrictions (box 1).

- <u>Sanctions:</u> Whether any funds managed by the GP have invested in companies that are subject to EU or UN sanctions.

- Aggressive Tax Planning: Whether available information indicates that the GP may invest in companies incorporated or tax-resident in countries listed on the EU's non-cooperative jurisdictions list[4].

- Exclusion list: Whether any funds managed by the GP have invested in companies that are listed on IIP's exclusion list.

Box 1 – Investment Restrictions	
Article 6 funds	Article 8 funds
IIP shall not invest in companies involved in: • **Fossil fuels** - The extraction of coal and oil sands. And energy production based on coal (>20% of revenue). • **Weapons**: – The manufacture or distribution of controversial weapons[5] as well as suppliers of components, services, or development specially designed for the final product. • **Tobacco or vaping** – The production of tobacco or vaping products.	IIP shall not invest in companies involved in: • **Fossil fuels** - The extraction of coal, gas, oil, and oil sands. And energy production based on coal (>20% of revenue). • **Weapons**: – The manufacture or distribution of controversial weapons[5] as well as suppliers of components, services, or development specially designed for the final product. • **Tobacco or vaping** – The production of tobacco or vaping products. • **Gambling** – The provision of products or services related to gambling and betting. • **Pornography** – The production or distribution of pornography and adult entertainment.

3.6 At this stage, any potential investments that do not meet IIP's initial screening criteria are excluded to ensure alignment with IIP's sustainability objectives.

3.7 ***Commercial due diligence***

3.8 Investments that successfully pass the initial screening are then prioritized for further due diligence in order to identify and address any potential sustainability risks alongside other relevant risk factors. At this stage, the fund's mandate is assessed in conjunction with the GP's historical sector focus and portfolio company selections in previous funds, ensuring that both specific and systemic sustainability risks are carefully evaluated.

3.9 IIP's commercial due diligence integrates ESG as a distinct due diligence component, contributing to the overall assessment of any investment opportunity that are to be presented to the Investment Committee.

[4] The EU's list of non-cooperative jurisdictions
[5] Specifically weapons that infringe the following conventions: 1) The Convention on the Use of Certain Conventional Weapons, 2) The Chemical Weapons Convention, 3) The Biological Weapons Convention, 4) The Convention on Cluster Munitions (the Oslo Convention), 5) The Anti-Personnel Landmines Convention (the Ottawa Convention), and 6) The Nuclear Non-Proliferation Treaty.

3.10 As part of the ESG due diligence process, each GP is assigned a rating based on IIP's 1-5 scale, where 5 represents the highest rating and 1 the lowest. A rating of 1-2 may be deemed acceptable if the GP shows a clear commitment to improving its ESG practices. In such cases, tracking the ESG progress of the GP is a key priority of IIP's ongoing monitoring efforts.

3.11 To inform the ESG due diligence process, IIP has furthermore implemented a risk model in order to analyse Adverse Risk Impacts related to investment opportunities. The model utilizes data from an objective source, S&P, and conducts risk assessments on two levels: i) sector and ii) country.

3.12 Before an investment decision is made by the Investment Committee, the identified sustainability risks are considered as part of the broader investment risk assessment. Where significant sustainability risks are identified, they are proactively addressed through early engagement with the GP. Mitigation measures are tailored to the specific circumstances and, where possible, are clearly addressed within the contractual agreements (side letter and Limited Partner Agreement).

3.13 ***Monitoring and active ownership***

3.14 IIP's monitoring process is intended to maintain continuous oversight of ESG progress at GP level, facilitating timely dialogue should any adverse developments arise.

3.15 This process enables IIP to conduct active ownership in the context of private equity investing in order to improve ESG practices and mitigate risk. This involves regular engagements with GPs, tracking of ESG data where available, participation in the GPs' annual general meetings and participation in Limited Partner Advisory Committees (LPAC) when possible. As a limited partner (LP), IIP is committed to ensuring that ESG considerations are prioritized in decision-making and monitoring processes at the GP level.

3.16 Once an investment in a private fund is made, the GP assumes primary responsibility for overseeing sustainability risks within the underlying companies or assets in the fund. The GPs are required to notify IIP if any of these companies breach the ESG-principles outlined in the LPA or side letter. If IIP becomes aware of any breaches, IIP assesses whether the GP is addressing the issue in alignment with the ESG-principles set forth in the LPA and side letter, including IIP's investment restrictions and exclusion list.

3.17 If, despite repeated engagement attempts, the GP does not take adequate action, IIP may choose to exclude that manager from future investment commitments. Additionally, IIP retains the option to divest its stake in the fund by selling to other professional investors, though this is generally not preferred due to potential challenges in securing an acceptable return. For this reason, IIP prioritizes leveraging influence with the GP, potentially in collaboration with other investors, to ensure that the GP addresses the breach in accordance with IIP ESG-principles and international norms.

3.18 ***Co-investments***

3.19 As an experienced long-term investor, IIP has a long track-record of co-investing directly into companies alongside private equity fund managers.

3.20 As is the case with investments in private equity funds, sustainability risks are integrated in the investment decision-making through a due diligence process. Generally, this process follows the same steps as is the case for IIP's investments in private funds. However, as the subject of IIP's assessments in this case is a company and not a fund, IIP's assessment of sustainability risks is adapted to this context.

4. Integration of sustainability risks in investment advice

Under certain contractual circumstances, IIP provides investment advisory services to designated limited partners (LPs) of IIP-managed funds. IIP can provide investment advice to LPs on investment opportunities identified by either the LP or IIP. This may include investment opportunities that do not align with the investment strategies of programs/funds managed by IIP.

4.1 The process for integrating sustainability risks into IIP's investment advisory services mirrors the initial steps of IIP's overall investment decision-making process. Initially, potential investments are screened to ensure compliance with the LP's investment restrictions, sanctions, tax policies, and the exclusion list. Subsequently, each opportunity undergoes a comprehensive commercial due diligence review, during which it is evaluated against various financial risk factors, including an assessment of sustainability risks.

4.2 Once the due diligence process is completed, IIP provides a detailed due diligence report to the LP, outlining identified sustainability risks (as well as other risk factors) and insights into their potential impact on financial performance. The due diligence report is intended to support the LP's assessment and decision-making regarding the specific investment opportunity.

5. Collaboration with Investors and Stakeholders

5.1 IIP recognizes the value of collaborating with other investors and stakeholders to enhance sustainability risk management. By working with other investors, customers, industry groups, civil society, and other stakeholders, we aim to foster best practices in sustainability risk integration. IIP actively participates in investor alliances and networks focused on ESG issues, sharing insights and resources to improve collective understanding and management of sustainability risks.

6. Change Log

Version	Date	Reason for amending policy
1	15 March, 2025	N/A