

Integration of Sustainability Risk Considerations

| August 2025



Schroders' Sustainability Risk Definition and Philosophy

Under Article Three of Regulation (EU) 2019/2088 (the Sustainable Finance Disclosure Regulation or 'SFDR'), certain Schroders entities are required to demonstrate how they integrate sustainability risk considerations into their investment processes.

This document describes how sustainability risks are factored into the investment management processes of Schroders entities that are directly subject to the SFDR's requirements. It demonstrates how our Investment teams seek to deliver long-term risk-adjusted returns whilst incorporating the consideration of sustainability risks consistent with client preferences.

This document applies to the following Schroders entities:

- Schroder Investment Management (Europe) S.A. and branches
- Schroder Real Estate France
- Blue Orchard Asset Management (Luxembourg) S.A.
- Schroder Real Estate KVG MbH

Definitions

Sustainability Risk

A sustainability-related event or condition that, if it occurred, could cause an actual or a potentially material negative impact on the value of investments.

Integration of Sustainability Risk Considerations

The process of identifying, analysing and incorporating relevant and material sustainability risk factors, which we believe may have a material impact on an investment's future value, into investment decision-making and stewardship activities. It also encompasses ongoing portfolio monitoring and active engagement with the management teams of investee companies or assets.

Active ownership

The use of the rights and position of ownership to influence the activities or behaviour of investees.

Schroders' philosophy

Our purpose is to create prosperity together. Our vision is to partner with our clients, providing trusted advice and to invest in the assets and markets that matter to them, building their future prosperity through excellent investment outcomes. In our view, sustainability risks and industrial trends are intrinsically linked to the performance of many investments over the long term. Investee companies and assets face competitive pressures from a wide range of sources, on a larger scale and at a faster pace than ever before. Our investment teams no longer have a choice over whether to seek exposure to sustainability risks and opportunities; all portfolios may be impacted.

We believe that considering financially material sustainability factors across the investment strategies we manage, in line with those strategies' investment objectives, can help us to deliver our purpose. Where appropriate, we also engage with many investee management teams and/or their key stakeholders and vote on our clients' shareholdings with the objective of improving investee company or asset performance. We may choose to make an investment with a more challenging sustainability profile if we believe the opportunity is consistent with the relevant investment strategy and has an appropriate risk-adjusted return profile.

We recognise that tackling social and environmental challenges will require a reallocation of capital over time and have therefore developed a range of specific sustainability, thematic and impact strategies, for clients who have environmental and social preferences.

Integration of sustainability risk considerations

Sustainability risks could be investee company or asset specific, or impact multiple investee businesses. Examples of sustainability risks that could negatively affect the value of a particular investment may include the following:

- **Environmental:** extreme weather events such as flooding and high winds, pollution incidents, damage to natural capital, biodiversity or marine habitats;
- **Social:** labour strikes, health and safety incidents such as injuries or fatalities, product safety issues;
- **Governance:** accounting fraud, discrimination within a workforce, inappropriate remuneration practices, failure to protect personal data; or
- **Regulatory:** new regulations, taxes or industry standards to protect or encourage sustainable businesses and practices may be introduced.

We integrate sustainability risk considerations into our research and investment decisions across Investment teams and asset classes with the aim We confirm the integration of sustainability risk considerations by our Investment teams using an internal accreditation framework, which assesses their capacity to analyse sustainability considerations.

Our approach is pragmatic: we want to integrate financially material sustainability risk considerations into established investment processes rather than create separate processes. Our Investment teams should be able to articulate and demonstrate how relevant issues are identified, investments are examined, and how they monitor and manage emerging sustainability risk considerations in relevant investment cases. The extent to which sustainability risks may be relevant to an investment process will depend upon considerations like the materiality of an issue, investment objectives, the policy of the strategy/client and the investment universe. The central Sustainable Investment team provides research, proprietary models, and support throughout these steps.

Investment teams complete an accreditation proposal at least bi-annually, which describes how sustainability risks are considered in their relevant investment processes. The accreditation process is managed independently from the Investment teams by the Sustainable Investment team so that there is consistency across asset classes.

To achieve accreditation status, Investment teams:

- Articulate their investment philosophy;
- Describe the key steps of their relevant investment processes and the role ESG factors may play in these;
- Describe their approach to active ownership (as appropriate for their asset class);
- Describe how they identify, assess and monitor climate-related risks and opportunities, as relevant;
- Describe any ESG training they have undertaken; and
- Evidence practical implementation of ESG integration through at least three new case studies.

For certain businesses acquired more recently, we have not yet accredited the integration of sustainability risks into investment decision-making. A small portion of our business where the integration of sustainability risks is not practicable or possible is also excluded, for example, certain legacy businesses or investments in the process of being liquidated, and certain joint venture businesses.

Proprietary sustainability models, tools and frameworks

We have invested in developing a range of proprietary research models and tools to gain insights into social and environmental investment factors, which can be used to assess financial risks and opportunities and help inform investment decisions where relevant to a particular investment strategy. We may also supplement our proprietary models and tools with ESG data from third-party sources.

Proprietary models may be used by our Investment teams to support the assessment of sustainability risks and opportunities, along with supplementary metrics from external data providers and our own due diligence, as appropriate to the goals of any given strategy. This analysis may form a view of the potential impact of sustainability risks on a specific investment or an overall investment portfolio and, alongside other risk considerations, the possible impact of such risks on investment returns over time. Such models are also utilised to help meet various ESG-related product requirements. However, the use of any given tool or model by an Investment team will depend upon factors like the asset class and the investment objectives and policy of the strategy/client.

Our suite of proprietary models and tools include CONTEXT™, SustainEx™, ThemEx™ and our Climate toolkit (which includes both proprietary models and third-party inputs), as well as a number of team-specific tools, frameworks and models. The models are generally focussed on public market investments only.

CONTEXT™ supports the integration of sustainability risks by using a selection of data to assess a company's relationship with material stakeholders such as customers, suppliers, regulators and employees. This tool is interactive and customisable, enabling our investment analysts to select and weigh material sustainability trends for each sector and select the most relevant metrics for assessment in any given case. The tool gives our analysts the flexibility to make company-specific adjustments to reflect their specialist knowledge.

SustainEx™ provides an estimate of the potential social and environmental 'costs' or 'benefits' that an issuer may create on a net basis. It does this by using certain metrics with respect to that issuer and quantifying them positively (for example when a company pays 'fair wages') and negatively (for example when a company emits carbon), to produce an aggregate notional measure of the effect that the relevant underlying issuer may have on society and the environment. The model enables our Investment teams to integrate sustainability risk considerations by assessing issuers with regard to such measures, and the risks they face if the social and environmental 'costs' they externalise were to be pushed into their own financial costs.¹

ThemEx™ seeks to measure the alignment of a company's products and services to a range of sustainable investment themes, including Schrodgers' "Super Themes" (climate change, demographic shifts, natural capital management, societal change, technological innovation) and the UNs' Sustainable Development Goals (SDGs). Alignment is estimated systematically based on the company's revenue from its underlying business activities. ThemEx's revenue data is taken from third party sources. In the absence of reliable third-party data sources to extend ThemEx to private market investments, we have developed a private assets SDG Alignment framework aligned with the ThemEx methodology to enable the assessment and reporting of SDG alignment across both public and private universes.

We have also developed a suite of climate tools, which assess companies' exposure to climate risks and opportunities, the mitigating actions they are taking, and the outcomes of those actions.

¹SustainEx utilises and is reliant on, and subject to the limitations of, third party data as well as Schrodgers' own modelling assumptions, and the outcome may differ from other sustainability tools and measures. Like any model, SustainEx will evolve and develop over time as we continue to assess, refine and add to the metrics and their relative contributions.

Active Ownership

We believe that constructive and committed engagement with management teams at the companies and assets we invest in is a key element of our responsibilities as investors and a clear demonstration of the value we can bring to our clients' investment returns over time. That is why we have a firm-wide commitment to active ownership, with many of our analysts and fund managers undertaking engagements directly.

Our Engagement Blueprint for listed assets, originally published in 2022, outlines the six priority themes for our engagement: climate change, natural capital and biodiversity, human rights, human capital management, diversity and inclusion, and corporate governance.

Our Engagement Blueprint for private assets, published in 2024, aligns to the wider Group priority themes while highlighting asset class and strategy specificities, notably taking into account our level of influence and the illiquid nature of private assets.

Investment teams and strategies that invest through third party managers, such as certain Wealth Management teams, are encouraged to align their engagement approach to Schroders' priority themes in relevant cases.

Where we have engaged repeatedly with an investee company or asset and seen no meaningful progress, we may escalate our concerns. Decisions on whether and how to escalate are based on the materiality of each issue, its urgency, the extent of our concern and whether the company has demonstrated progress through previous engagements. The possible actions we may take to escalate an engagement are outlined in the Engagement Blueprint for listed assets.

Some asset classes afford investors voting rights. We recognise our responsibility to make considered use of voting rights. We vote on both shareholder and management resolutions.

The overriding principle governing our approach to voting is to act in line with our fiduciary responsibilities in what we deem to be the interests of our clients.

Our approach to investing in different asset classes

We recognise that different asset classes and investment strategies may require different approaches to the integration of sustainability risks in investment decision-making. Below, we have set out some specificities to particular asset classes.

Company analysis (Equities and bonds)

We believe that our awareness and analyses of material sustainability risks enhances our fundamental understanding of a company's value and its ability to deliver attractive long-term returns, whether through its share price or dividends paid, or in its ability to service and repay its debt.

We pay attention to how a company manages relationships with its key stakeholders such as its customers, employees, suppliers and regulators, as well as its impact on the environment and local communities. We believe this focus aligns with our position as debt and/or equity investors on behalf of our clients.

Some of our teams invest through a quantitative approach. They identify sustainability risks or 'signals' that have been empirically shown to improve the expected risk or return profiles of our clients' portfolios. These factors are used in some cases to arrive at a composite ESG score per company and are also used in portfolio construction to determine position sizing.

For privately held companies, sustainability analysis is rooted in our internal Raising Impact, Sustainability and Engagement ('RISE') framework. This proprietary methodology examines the potential materiality of seven focus areas: climate change, conservation, workforce, diversity, equity and inclusion ('DE&I'), community impact, transparency, and policies and practices.

Sovereign analysis

Our approach to integrating sustainability risk factors into investments in supranational, sovereign, and sub-sovereign bonds involves identifying material issues through detailed fundamental and quantitative analyses, focusing on governance quality, political stability, social cohesion, resource management, and environmental challenges, including climate-related physical and transition risks. Proprietary tools such as Sovereign SustainEx and Municipal US Sustainability Explorer (MUSE) quantitatively assess the sustainability profile of issuers. Sustainability risk assessments can influence portfolio construction by guiding issuer selection and determining their weighting, with issuers presenting high risks potentially being excluded from investment. Active ownership involves systematic engagement with sovereign and sub-sovereign issuers, encouraging better ESG practices, improved sustainability targets, and enhanced transparency, with engagement outcomes tracked carefully.

Convertible bonds analysis

The blend of individual elements that make up a convertible bond – bond, equity and right of conversion – produces an asset class that has unique risk-return characteristics. Sustainability risks may be one of the factors that affects an issuer's creditworthiness. Sudden shocks are often more costly than gradual credit declines. From a sustainability risk perspective, this means that we are concerned with sharp moves driven by new information, particularly around controversies. Analysis of sustainability risks is therefore part of our fundamental, bottom-up research, the idea generation process, the modelling and pricing of convertibles and hence has an impact on the top picks in each region.

Multi Asset analysis

Our approach to multi-asset investing goes beyond allocating just by asset class; instead, our research, asset allocation and portfolio construction are based on an analysis of the fundamental drivers of risk and return called 'risk premia'. We believe that asset classes are proxies for risk premia – they are essentially baskets of returns that an investor receives for taking on exposure to the systematic risks associated with an investment. In some cases, an asset class may be represented by macro risk factors. For example, global equities are exposed to economic, inflation and sustainability risks. Some sub-asset class allocation decisions are also exposed to more specific risks.

Our approach to sustainability considers both a top-down view when allocating to asset classes and a bottom-up view when selecting securities.

From a bottom-up perspective, we delegate security selection to the underlying Investment desks as we allocate to funds across Schroders. Every Investment desk has their own sustainability accreditation document, which is independently reviewed by the Sustainable Investment team.

From a top-down perspective, the foundation for all Multi-Asset investments is the research carried out by the Strategic Investment Group – Multi-Asset (SIGMA). The research effort is organised into six risk premia groups. The aim of the groups is to utilise both quantitative and qualitative approaches to assess opportunities within each risk premium and come up with a medium-term return view for that premium. Sustainability risks are considered by the risk premia groups where they are material.

In addition, long term asset class return and risk forecasts are adjusted for the impact of climate change in our optimisation process. We have a three-step approach adjusting for the physical costs, transition costs and stranded assets.

Securitised credit analysis

When investing in US securitised credit, sustainability risk considerations are incorporated into fundamental cash flow analysis of underlying collateral assets, with specific attention given to asset quality, borrower health, alignment of interests, and impact on the environment. We apply a structured ESG evaluation framework known as IDEALS Scorecards, which systematically assesses environmental, social, and governance risks specific to each asset sector, assigning ratings that directly influence our security risk profile analysis.² Additionally, we enforce sector-specific prohibitions on investments involving activities that fail minimum sustainability standards. Climate-related risks are identified using Federal Emergency Management Agency (FEMA's) National Risk Index to assess physical risks at the asset level, and we actively engage with industry bodies to enhance transparency, disclosure, and education around sustainability practices.

²IDEALS stands for Inclusion, Diversity, Equity, Accountability, Leadership and Sustainability.

Insurance Linked Securities ('ILS') analysis

ILS are primarily linked to the (re-) insurance of natural catastrophe, mortality and pandemic risks, and extreme events that can cause severe disruption to individuals' lives and the communities they live in. Our approach to integrating sustainability risk considerations focuses on the covered risks, sponsors of, and structures used for such transactions.

By nature, certain types of ILS products, such as catastrophe bonds, in themselves are already exposed to social and environmental trends such as climate change. We follow and examine the trends we believe will emerge over the investment horizon and consider their potential impact on returns. For example, we adjust Natural Catastrophe models to reflect our own views on the frequency and severity of extreme weather events. In non-weather related ILS we seek to avoid investing in risks that may contain ethical or social concerns (for example where investment returns are dependent on the outcome of insurance lottery jackpots or life settlements).

Depending on the type of sponsor, we consider different sustainability risks to help us assess the quality of the sponsor and to ensure that stakeholders' interests are aligned.

Real estate

Real estate investing on behalf of our clients carries the responsibility to understand and manage ESG impacts (both positive and negative), to deliver resilient investment returns for the long term and manage exposure to material risks. We believe that understanding and improving the impacts of real estate investment sits alongside our priority to maximise returns for our clients in a manner consistent with our funds' risk profiles.

We also believe that understanding these issues and their impacts is integral to our investment process and may be applied to all aspects of real estate investment across the lifecycle stages of: acquisition and ownership, asset management, property management and operation (which may be provided by third parties), renovation and construction. For example, we conduct pre-acquisition ESG due diligence to understand the sustainability credentials and risks and to reflect into our investment decisions. Post-acquisition, sustainability objectives are established for each asset. Implementation follows throughout the asset holding period and reviews are regularly conducted (e.g. typically twice a year at portfolio level).

The environmental factors of most importance to us include energy, carbon and water use and efficiency, as well as waste management and disposal, pollution, physical climate risks and biodiversity. From a social perspective we are interested in optimising the tenant experience, fostering community relationships and contributing to local prosperity. We are also focused on good governance of our assets and portfolios including, for example, compliance with building regulations, oversight of third-party property managers where they may be responsible for the daily support to a building, and ensuring product level reporting meets regulation and industry best practice.

Infrastructure finance

Schroders makes infrastructure investments in both public and private markets via a range of Investment teams. The long-term nature of this asset class makes understanding and managing sustainability risk issues particularly critical. As investors on behalf of our clients who generally look to hold to maturity, sustainability risk analysis is fundamental to the investment decisions we make. These considerations are both a driver of infrastructure growth (e.g. the energy transition shift to low carbon transport) and potential sources of risk (e.g. poor governance can lead to mismanagement of infrastructure assets with real human costs as well as financial implications).

Specifically in respect of renewable infrastructure and energy transition equity investments, we may consider potential sustainability risks such as the environment, workplace standards, health and safety practices, environmental management, supply chain, community engagement and employment (where possible). Sustainability risks are considered prior to investment as part of early-stage screening, detailed due diligence and the Investment Committee's decision-making, and managed post-acquisition in accordance with our wider asset management practices.

Sustainability risk considerations also form a core part of our investment process in our infrastructure debt business and we have developed a comprehensive toolbox to perform a qualitative and quantitative risk assessment of contemplated transactions. Our selection phase includes a preliminary ESG assessment of the transaction and then a thorough review of the due-diligence package and report findings. These feed into an ESG scorecard and inform the sustainability opinion presented to the Investment Committee. The subsequent execution and ongoing monitoring phases include a quarterly report on any noticeable ESG-related issue and the collection of ESG data points on an annual basis to monitor ESG performance at portfolio level. Where relevant and appropriate, we also engage with our counterparties.

Third party manager selection

A number of Investment teams across the Group invest through third party managers. To integrate sustainability risk considerations into our manager selection process, we first examine the manager at firm-level, where we aim to understand if the consideration of sustainability risks is a central part of the firm's ethos and investment and corporate culture. Secondly, at the investment strategy level, we assess the extent to which the manager integrates sustainability risk considerations within their own investment processes. We do this using ESG questionnaires which have the same overarching objective of seeking to understand external managers' sustainability approach. Taken together, these questionnaires contribute to our research and analysis on the suitability of the external fund manager for inclusion in our portfolios.

Manager selection teams at Schroders are an additional step away from asset or security selection. Our active ownership approach therefore is focused on engaging with our external managers to increase the robustness of their own sustainability risk integration and their active ownership practices.

Commodities

Our commodities teams invest in both commodity futures and commodity producers (equities). The latter is covered under the Company Analysis section above. Sustainability risks can influence commodity prices and therefore we integrate these considerations into our forecasts for commodity market returns. We use our proprietary tools (e.g. SustainEx™) as well as our own understanding of specific commodity markets, to identify key sustainability risks that may impact either the supply or demand of the commodities in which we trade.

Other asset classes

Asset classes not explicitly referenced above integrate sustainability risk considerations in line with the principles set out at the beginning of this document, and in a manner appropriate for their particular investment processes and the sustainability risks they are exposed to.

Schroders

Important information

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