VL Asset Management Limited
以立投資管理有限公司

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Tackling Climate-related Risks

Disclosure Statement

"There is a real situation, that can't be denied, but it is too big for any individual to know in full, and so we must create our understanding by way of an act of the imagination."

- Kim Stanley Robinson, *The Ministry for the Future*

Preface

Climate change is a global problem that does not respect national borders.

The problem is that human activity is producing greenhouse gases. Much of our everyday life involves burning fossil fuels, which released carbon dioxide into the atmosphere, making the blanket thicker. This results in global warming.

Climate change is more than just global warming. About one-third of our carbon dioxide emissions are absorbed by the oceans, where they react with seawater to form a weak acid.

This results in ocean acidification, a lowering of the ocean's pH. Furthermore, the oceans are becoming warmer as they absorb much of the extra heat energy being trapped by the atmosphere.

This extra heat initially goes into the surface ocean, where for example it can supply more energy to hurricanes, making these storms more ferocious. The acidity and extra heat are also slowly being mixed down into the deep ocean, with worrying implications for ecosystems and habitats.

Back on land, climate change is starting to change precipitation (rain or snowfall) patterns. A warmer atmosphere holds more moisture, and extreme precipitation events are getting more frequent in some regions. However, other land regions are getting drier thanks to warming and changes in atmospheric circulation.

General consensus from scientists and politicians is that human greenhouse gas emissions need to be rapidly reduced and stopped by mid-century to avoid some of the most dangerous impacts that climate change could throw at us.

Rising sea levels will flood cities and result in migration. Global warming increases the threat of invasive pest species to agriculture and the spread of disease. Ocean acidification threatens the health of coral reefs and may compromise the fisheries that depend on them. Businesses and companies are also affected by climate change.

We need therefore to work together as a global community to tackle climate change and, in particular, as a licensed corporation licensed by the Securities and Futures Commission in Hong Kong (the "SFC"), we shall endeavor to do that by observing the climate-related risks requirements under the Fund Manager Code of Conduct and the relevant requirements and standards set out in the SFC's Circular to licensed corporations - Management and Disclosure of Climate-related Risks by Fund Managers.

Investment Management

As value investors, our portfolio managers customarily apply fundamental analysis to their investment targets to assess whether they are suitable for investing and to their existing holdings for monitoring.

Climate-related risks are some of the many risks and considerations our portfolio managers take into account ordinarily in their investment process. In that sense, our portfolio managers will not be doing something that is radically different from what they have been doing.

Accordingly, apart from the usual practice of examining the fundamental and valuation of an investment target company, the portfolio manager will also pay attention to the climate change related measures being adopted by that company for its stock selection process. In case there are developments materially affecting the operations and financials of the target company, the portfolio manager shall reassess the risk and return profile of the target company and evaluate its impact toward our portfolios. Based upon the information gathered, the portfolio managers can then formulate an optimal strategy for achieving portfolio investment objectives while taking into account of potential climate change risk factors. The impact of climate change is a non-negligible force in the investment community and its influence on investment return becomes more visible as time goes by. The portfolio managers must keep abreast with the latest progress in the overall policy direction and ecosystem development.

That said, the task has lately been made less hard because more and more listed companies are now required to produce ESG/ sustainability reports on a regular basis on how their businesses and operations might be affected by climate change and how they might bring changes to our climate. So our portfolio managers shall begin their task by systematically studying the ESG/ sustainability reports produced by their investment targets and listed companies in which they have invested for and on behalf of our clients and in the process identifying material physical and transitional risks that may arise due to climate change, integrating such material risks and evaluating related impact on performance.

The physical risks mentioned above are typically defined as risks which arise from the physical effects of climate change and environmental degradation such as wildfires, storms, and floods, whereas transitional risks result from policy action taken to transition the economy off of fossil fuels.

Our portfolio managers will also pay attention to whether their investment targets and/ or existing holdings are involved in activities/ industries that entail high carbon emission and/ or energy consumption and, if yes, how will that factor in their investment management process. Examples of activities/ industries entailing high carbon emission and/ or energy consumption include mining, oil refining, transportation, chemical production, agriculture and animal husbandry and we note that some asset management firms have chosen to conduct risk-based exclusion and negative screen to avoid investing in those industries. We shall not take that approach, at least, not initially, and shall consider them on an individual basis as we believe that each business is different and it affects the climate and gets affected in different ways.

Whilst it is undeniable that climate change has added an extra layer of difficulty for our portfolio managers in their investment management process and it has become more important for the portfolio manager to be able to discern those companies that can adopt and make smooth transition in this evolving environment and hence add value to the portfolio, we have observed (and take comfort) that in general companies with reasonably good ESG scores will face less or find ways to overcome climate-related risks.

Also, despite climate change being a challenge or a threat, it may generate opportunities for investors and the opportunities are twofold: energy conservation within existing infrastructure in developed economies and integration of resource efficiency in new commercial construction in emerging markets. Our portfolio managers will take that into account in their investment management process.

Governance

Within our corporate structure, we plan to tackle climate-related risks at the following four separate levels and times:

- Monthly investment meetings – It is the practice of our portfolio managers to meet in the first week of each month to discuss investment ideas and review individual holdings. Going forward, part of those discussions and reviews shall be devoted to identifying material physical and transitional risks that may arise due to climate change, integrating such material risks and evaluating related impact on performance in relation to our investment targets.

- Climate-change task force meetings - Our operations team meet every Tuesday to discuss operational issues. As from December 2022, the meeting on the last Tuesday of the month (or, if that day shall be a public holiday, the business day immediately following) shall be reserved for discussing and reviewing climate-related risks.

- Quarterly risk meetings - A risk meeting is held towards the end of each quarter during the year attended by our portfolio managers and operations team. This shall provide an opportunity for our portfolio managers and operations team to compare notes on their evaluation of climate-related risks faced by funds/ portfolios managed by us for our clients and, where appropriate, to drill down on specific holdings.

- Board of directors - Our board of directors, comprising all the directors of our company for the time being (the "Board"), shall bear the ultimate responsibility in relation to how we tackle climate-related risks. In this regard, commencing 2023, the Board shall meet towards the end of each calendar year to assess the efforts expended, to review the policies adopted, to consider any variation of the investment management and/ or risk management processes undertaken, to determine the requirement of additional resources (including engaging external consultants and sending staff to related external courses) and to determine if additional communication with clients and/ or potential clients is necessary.

Risk Management

As mentioned above, our operations team will dovetail the work of our portfolio managers in gathering information from the relevant listed companies on how they affect the environment and how they are affected by climate change, evaluating such information, designing templates and/ or metrics, including carbon emission intensity and overall trend, to help capture climate-related risks and, where necessary, issuing warnings to our portfolio managers on significant risks found.

We have observed that a phenomenon known as greenwashing has surfaced increasingly, which is the practice of marketing a company or organization so they appear more environmentally friendly or more ecological (more natural, healthier, free of chemicals, recyclable, less wasteful of natural resources...) when in practice its activities pollute the environment. Greenwashing is therefore considered abusive or misleading because the company improperly positions itself as more green than it actually is. Some companies having issued green bonds and fearing that they might be subjected to higher interest rates or face penalties if certain green criteria are breached might employ greenwashing to avoid making higher interest payments or paying penalties. Regulations and legislations have sprung up to combat greenwashing. The operations team will, if appropriate, help gather such regulations and legislations and screen against greenwashing.

Our risk management team will ensure the implementation of continuous assessment of the potential impact of identified risks related to climate changes on our portfolios. It will monitor and manage these risks on an ongoing basis. It may engage and liaise with external consultants to gain the necessary expertise on tackling climate-related risks.

Disclosure

Starting with this Disclosure Statement, we shall from time to time (but in any event no less than once every year) make appropriate disclosures to our existing and potential clients/ partners on governance, investment management and risk management on our efforts to tackle climate-related risks.

It is our obligation to let our stakeholders well informed of our views and measures taken for the latest developments related to climate change and their impact on our company structure, strategy and the portfolios under our management. In case of any material changes, we will update you via our company website in a timely manner.

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