Angel Oak
CAPITAL ADVISORS

Measuring Impact in the Angel Oak Financials Income Impact Fund (ANFIX)

January 2023

Q: How does Angel Oak approach environmental, social, and governance (ESG) principles? What is the role of ESG and sustainability within the firm's investment process and at the corporate level?

A: ESG has been critical to Angel Oak's business model since the inception of the firm. We have developed and implemented a companywide ESG integration program that touches many of our business activities. It supports our corporate initiatives through engagement in charitable giving and our diversity, equity, and inclusion initiatives. ESG is embedded in our investment strategies, so we bring sustainable opportunities to our investors. ANFIX was formally designated by prospectus as an ESG-integrated fund in 2019. ESG is also reflected in our mortgage origination, where we lend primarily to underserved borrowers who are self-employed and have nonstandard sources of income, such as gig economy workers. Almost every aspect of our business is strongly aligned with ESG principles and sustainability.

Q: How exactly is ESG implemented or integrated into the investment process at Angel Oak?

A: Angel Oak Capital Advisors (AOCA) developed and implemented a Responsible Investment (RI) Policy in 2018 that governs how we integrate ESG across our public funds, including our mutual fund complex. And, since the inception of our RI Policy, we have integrated ESG across all our public funds and those strategies. As a result, AOCA has a broad-based approach to ESG. We have developed proprietary ESG scorecards and methodologies that use a data-driven approach to measuring and assessing ESG factors across many of the asset classes held in our public funds, including ANFIX.

Q: How is ESG factored into the investment strategy of the Fund?

A: In addition to evaluating the financial strength of each company in which ANFIX invests, we also analyze how well each institution manages environmental risks and opportunities, the potential for positive social impact through their lending and investment activities, and the strength of their corporate governance as evidenced by compliance with relevant regulations. Lending in support of affordable housing projects or starting small businesses, achieving strong evaluations on Community Reinvestment Act (CRA) regulatory exams, and having experienced and diverse boards and management teams are all factors we view favorably when making investment decisions.

The strategy also includes investments in insurance companies, REITs, and other nonbank financial institutions. Angel Oak has developed either scorecards or assessment methodologies for these institutions to assess ESG alignment across all our invested institutions.

Q: How is "E" (environmental sustainability) a component of this strategy?

A: Community banks, which generally represent about 75% of the holdings of the Fund, have relatively benign operations when it comes to carbon emissions—their emissions are mostly from electricity consumption, employee commutes, and business travel. These banks are generally too small to provide credit to large energy or fossil fuel-related companies, so they are not big contributors to carbon emissions even indirectly. Many have eliminated paper from their processes by having electronic loan documentation, for example. Several have retained some degree of work-from-home arrangements implemented during COVID-19, reducing emissions from employee commutes. Many are lending to local recycling centers and solar panel projects or funding water treatment facilities through municipal bond investments, among other examples. Most aspects of a community bank's operations are environmentally friendly because they do not engage in activities that emit much carbon into the atmosphere, and the scale of their operations generally precludes them from lending to companies that do.

Our team is also working directly with the Carbon Disclosure Project (CDP), which helps companies disclose their climate risks so that investors better understand the opportunities and risks presented by those companies. We have funded a three-year project to help our invested companies disclose climate data at an appropriate level for community banks, and several of our invested institutions are now disclosing climate data to the CDP.

Q: How is "S" (social responsibility) a component of this strategy?

A: Community banks are frequently the most important institution in some markets, particularly away from urban centers. They provide capital for affordable housing and small business formation, lend to nonprofits, and help municipalities raise and distribute money throughout their communities. Based on our analysis, many of these banks support charitable organizations, not only by giving money but also by letting their employees have paid time off to participate in community events. We have observed that many also offer financial literacy education in local elementary and high schools and senior living facilities. It is difficult to think of another type of for-profit business model that is more supportive of community development than a community bank.

Q: How is "G" (governance) a component of this strategy?

A: All banks are highly regulated at the national or state level, and governance is evaluated as a component of frequent safety and soundness examinations. In addition to requiring high levels of capital and stringent credit underwriting standards, these regulations also require that banks maintain a code of ethics, IT/data security policies, anti-money laundering policies, and business continuity plans. Their board members must have diverse experience levels and independence. In addition, the CRA implements a broad set of requirements ensuring that banks are lending and investing in their own communities—they are even assigned public ratings reflecting their compliance with CRA standards. Strong governance is a baseline requirement for community banks.

Q: How does Angel Oak create engagement with issuers?

A: Angel Oak's initial due diligence process includes a review of publicly available information as well as calls or meetings with senior bank executives prior to making any investment. This due diligence process includes an evaluation of specific ESG factors that must be addressed by management before any investment is made, and the information obtained from both public sources and management is used to populate our proprietary ESG scorecard. Along with credit considerations, the bank's ESG factors are used to create a score, which is incorporated into the investment decision. Ongoing annual due diligence calls ensure that banks continue to have strong and improving ESG factors.

Given our broad experience in ESG in the community bank space, many institutions look to Angel Oak as a repository of ESG practices. We often field inbound calls from banks asking for advice on ways to strengthen their ESG alignment, and trade groups frequently ask us to join panels and speak at conferences as subject matter experts on ESG alignment in banking.

Q: What does "impact" really mean in the context of ANFIX?

A: Whenever we make an investment, our ESG integration program provides a framework to evaluate environmental or social risks and opportunities associated with that position. Some investments are obviously going to have more ESG alignment than others, but we consider ESG factors across all our mutual funds.

However, we take a somewhat deeper dive into ESG in the Angel Oak Financials Income Impact Fund. Our proprietary scorecard methodology assesses the institution's initial alignment with ESG factors at the time of investment. Ongoing engagement through calls and meetings with our invested institutions allows us to evaluate their internal progress but also to share practices that other banks have successfully implemented. Over time, we can quantitatively track the positive trajectory of our invested institutions using scorecard results at both the institution and portfolio levels.

Q: How is impact measured for ANFIX?

A: We have developed specific metrics that help us measure impact. Our proprietary scorecard assigns scores for individual E, S, and G factors as well as a composite score. We can track impact over time by observing changes in scores, enabling us to tangibly demonstrate to our investors that we are deploying their capital into investments that make a difference. We can monitor the progress of our invested institutions over time because we do not rely strictly on information from public sources; instead, we actively engage with management. We hear directly from CEOs, CFOs, and community relations specialists, and our engagement creates a positive feedback loop—we learn from them, and they learn from us.

Our initial due diligence helps us make investment decisions, but our ongoing engagement is the key to our aspiration to make an impact in the communities served by these banks. Under certain circumstances, we might divest of positions associated with banks that are not showing a positive trajectory on ESG alignment based on our engagement calls and scorecard evaluations. However, this outcome is rare, as the community bank business is well-positioned to align strongly with ESG factors.

Cheryl Pate, CFA®
Senior Portfolio Manager

Johannes Palsson
Senior Portfolio Manager

Rob McDonough
Director of ESG & Regulatory Initiatives

DEFINITIONS AND DISCLOSURES

Investors should carefully consider the investment objectives, risks, charges and expenses of the Angel Oak Mutual Funds. This and other important information about each Fund is contained in the Prospectus or Summary Prospectus for each Fund, which can be obtained by calling 855-751-4324 or by visiting www.angeloakcapital.com. The Prospectus or Summary Prospectus should be read carefully before investing.

On September 22, 2022, the Fund's name was changed to "Angel Oak Financials Income Impact Fund," and certain changes were made to the Fund's investment strategies. As a result, the Fund's performance during periods prior to this date may have differed had the Fund's current investment policies and strategies been in place at those times.

Mutual fund investing involves risk; principal loss is possible. Investments in debt securities typically decrease when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in lower-rated and nonrated securities present a greater risk of loss to principal and interest than higher- rated securities do. Investments in asset-backed and mortgage-backed securities include additional risks that investors should be aware of, including credit risk, prepayment risk, possible illiquidity, and default, as well as increased susceptibility to adverse economic developments. Derivatives involve risks different from—and in certain cases, greater than—the risks presented by more traditional investments. Derivatives may involve certain costs and risks such as illiquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Investing in derivatives could lead to losses that are greater than the amount invested. The Fund may make short sales of securities, which involves the risk that losses may exceed the original amount invested. The Fund may use leverage, which may exaggerate the effect of any increase or decrease in the value of securities in the Fund's portfolio or the Fund's net asset value, and therefore may increase the volatility of the Fund. Investments in foreign securities involve greater volatility and political, economic, and currency risks and differences in accounting methods. These risks are increased for emerging markets. Investments in fixed-income instruments typically decrease in value when interest rates rise. The Fund will incur higher and duplicative costs when it invests in mutual funds, ETFs, and other investment companies. There is also the risk that the Fund may suffer losses due to the investment practices of the underlying funds. For more information on these risks and other risks of the Fund, please see the Prospectus.

ESG investment strategies limit the universe of investment opportunities available to any Fund and will affect a Fund's exposure to certain issuers, sectors, regions, and types of investments, which may result in a Fund forgoing opportunities to buy or sell certain securities when it might otherwise be advantageous to do so. Adhering to a Fund's ESG investment strategy may also affect the Fund's performance relative to similar funds that do not seek to invest in companies based on their ESG impact. Securities of issuers that the Adviser has identified as having favorable ESG characteristics may shift into and out of favor depending on market and economic conditions, and certain investments may be dependent on U.S. and foreign government policies, including tax incentives and subsidies, which may change without notice. ESG determinations are inherently subjective and investors' views may differ as to what constitutes a positive or negative aggregate ESG impact outcome. There is no guarantee that the Adviser's views, security selection criteria, or investment judgment will reflect the beliefs or values of any particular investor. In addition, there can be no assurance that issuers in which any Fund invests will be successful in their efforts to offer solutions that generate a positive ESG impact. When assessing whether an issuer meets any related Fund's investment strategy and criteria, the Adviser may rely on third-party data that it believes to be reliable, but it does not guarantee the accuracy of such third-party data.

Opinions expressed are as of 1/10/2023 and are subject to change at any time, are not guaranteed, and should not be considered investment advice.

The Angel Oak Funds are distributed by Quasar Distributors, LLC.