Statement

01 July 2021

Climate and energy statement

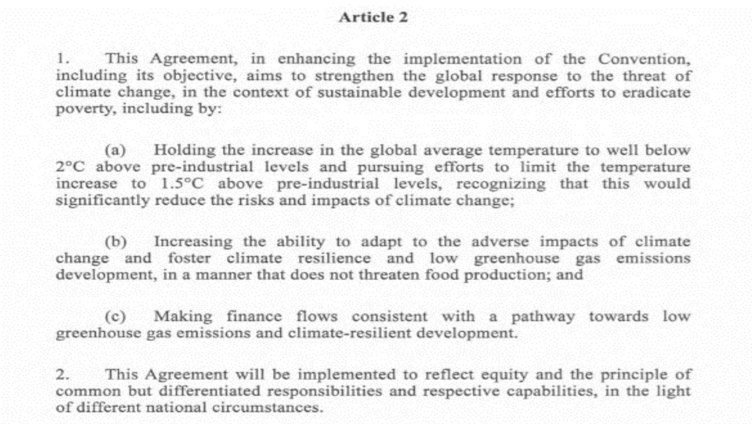
Finnfund‘s mission is to build a better world by investing in sustainable and profitable businesses in developing countries. Fighting climate change plays an integral part in fulfilling this mission. Climate change is the greatest global challenge of our time. We acknowledge that climate change affects developing countries the most. The poor and women living in rural areas will be hit hardest, which is another reason why these groups are at the focus of Finnfund’s work.

1. Global push for carbon neutrality

In order to increase Finnfund’s positive impact, it is essential to build partnerships, mobilise funding and raise the level of ambition. Collectively, we all are committed to reaching the Sustainable Development Goals (SDGs) by 2030 and to implement the Paris Agreement.

The coalition of European Development Finance Institutions (EDFI) has published their shared statement on climate and energy finance. The Statement includes commitments to align with the Paris Agreement, increase climate finance and phase out fossil fuels. The statement recognises that Development Finance Institutions (DFIs) are diverse and some institutions will go even further in certain areas of implementation.

With its Climate and Energy Statement, Finnfund expresses its commitment to the objectives of the Paris Agreement and explains what this commitment means in practice for its portfolio management, investment process and measuring of the portfolio’s carbon footprint



Article 2

1. This Agreement, in enhancing the implementation of the Convention, including its objective, aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by:

(a) Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change;

(b) Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production; and

(c) Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.

2. This Agreement will be implemented to reflect equity and the principle of common but differentiated responsibilities and respective capabilities, in the light of different national circumstances.

Finnfund’s statement complements the Finnish Government’s commitment to achieve carbon neutrality by 2035 and echoes elements of that commitment: ambitious objectives, increased resourcing to reduce emissions and building up carbon sinks and stocks. Finnfund’s investments are a key part of Finland’s official climate financing

As we release our statement, the COVID-19 pandemic is ravaging the world and generating an urgent need to ‘build back better and greener’. The impact of COVID-19 is all the more pronounced in developing countries where Finnfund invests, underscoring the provisions of the Paris Agreement on “the context of sustainable development and efforts to eradicate poverty” and making the “different national circumstances” increasingly relevant.

In the spirit of the Paris Agreement and the Agenda 2030 for Sustainable Development, Finnfund commits to financing the just transition of developing economies to resilient, low-carbon societies by 2050, while supporting just economic development and poverty reduction in these countries.

This statement complements our overarching Sustainability Policy, which outlines our practices and processes to ensure high sustainability standards in our operations.

In the process of developing this statement, we studied the EU Taxonomy Regulation, and will observe it as far as it applies to developing countries where we operate.

2. Finnfund's ambition

We want to take the lead among development financiers in the transition to a net-zero carbon future, while supporting the broader sustainable development agenda. To realise that ambition, we have identified three building blocks.

We are committed to:

1. Keep our investment portfolio net carbon negative and align all new investments with the Paris Agreement.
2. Make € 1 billion worth of new investments in climate finance by 2030.
3. Push for more systematic, harmonised and transparent climate finance disclosures and reporting

2.1 Stay net carbon negative

In 2019, Finnfund portfolio carbon emissions were 107 000 tCO2-equivalent and carbon removals 291 000 tCO2-equivalent[1]. In other words, Finnfund's investment portfolio is net carbon negative.

Finnfund will aim to keep our portfolio net carbon negative[2]

The net carbon negative portfolio stems from our sizeable forestry investments. As our portfolio grows, so will inevitably our investees' combined emissions. Neutralising increased emissions and staying carbon negative will depend on how our investees reduce emissions and how we invest going forward. More specifically, increasing carbon sequestration will depend on new investments in afforestation and maximising the utilisation of timber for long-lived wood products.

In addition to working to keep our portfolio net carbon negative, we will align **each investment with the Paris Agreement objectives** and country or sector pathways to net zero emissions by 2050. The national and sectoral pathways are still a work in progress.

The conformity assessment of investments against the Paris Agreement objectives will be crucial to ensure alignment of investments in high-emitting sectors and industries that are critical for countries' economic and social

[1] GHG protocol, IFI working group and new methodology for sequestration to be incorporated in Joint Impact Model.
[2] Calculation on three-year rolling averages.

development[3]. The assessment methodology will have to rely on existing information such as that presented in Nationally Determined Contributions, Long-Term Strategies or National Action Plans for Adaptation or other national or sectoral strategies to ensure the most feasible technical and economic solutions.

Finnfund will work with other Development Finance Institutions to develop harmonised and transparent methodologies and approaches to ensure investment alignment with the objectives of the Paris agreement.

2.2 Make €1 billion worth of new investments in climate finance by 2030

At the end of 2020, approximately 40% (€290m) of Finnfund's portfolio can be classified as climate finance.

This is not enough. If funding is available, Finnfund will commit **€1 billion in climate finance** by 2030. We will continue to invest both in mitigation and adaptation as both are of vital importance for continued and elevated well-being in the emerging economies.

2.3 Push for systematic, harmonised and transparent climate finance disclosures and reporting

Credible and efficient climate finance depends on robust and harmonised definitions and methodologies. Climate considerations must be more firmly incorporated into decision-making processes, and climate impacts reported in a credible and transparent way.

We reiterate our commitment to the continuous improvement and harmonisation of best practices in climate financing, including reporting and disclosure. We will discuss this below in more detail.

Harmonised approach to increase mitigation financing

We will strive to continuously increase our financing for climate change mitigation activities, including energy efficiency. We will use the multilateral development banks' (MDB) common list for classification of activities for climate change mitigation finance. These activities cover investments in renewable energy, low-carbon and efficient energy generation, energy efficiency, agriculture, forestry and land-use, non-energy GHG reductions, waste and wastewater, transport and low-carbon technologies.

We will also align with the International Financial Institutions Technical Working Group (IFI TWG) harmonised approach on GHG accounting in renewable energy, energy efficiency and transport, and the list of harmonised GHG accounting standards the working group has adopted, including the harmonised grid emissions factor data set.

We wish to complement the existing best practices with a new, improved methodology for calculating carbon removals in forestry investments. The new methodology will increase the accuracy and credibility of carbon sink calculation and make it more comparable with the GHG emission

[3] Such as fertilisers, construction, metal, mining and energy.

calculations. When finalised, the methodology will be presented to the IFI TWG and to the Partnership for Carbon Accounting Financials (PCAF) for adoption.

Finnfund position on fossil fuels

We will adhere to EDFI's revised exclusion list[i] to exclude coal and fossil fuel financing in all our investments including all new direct financing, all new indirect equity through new commitments to investment funds, and new dedicated lending[4] via financial institutions. Under exceptional circumstances, Finnfund may finance gas-fired power plants until 2030. Any new financing will be clearly justified, specified and publicly disclosed[5].

Most economies where we invest, especially in Sub-Saharan Africa, suffer from unreliable and expensive grid electricity. In these countries, transitioning towards carbon neutrality by 2050, while ensuring clean, affordable and reliable power, may in instances require gas-fired power plants (see box).

In addition to being aligned with the Paris Agreement, investments using fossil fuels must be deemed critical and highly beneficial for economic, social and human development.

Low access to electricity is holding Africa back
Recent research points to the critical importance of grid electricity to countries' economic development. The International Energy Agency argues that low access to electricity supply is holding back Africa's economic development, limiting progress in improving health and well-being. In Africa, investments in power infrastructure are among the lowest in the world, despite the immense need to expand and upgrade power systems, including generation and grid networks.

According to the IEA Sustainable Development Scenarios, the energy sector will see significant changes where renewable sources, especially solar and wind, will replace fossil fuel-based power generation. To make these changes possible, electricity systems in emerging economies will continue to need substantial numbers of conventional power plants to ensure security of supply. Integrating variable wind and solar power will require dispatchable capacity to maintain a stable power supply. New technologies like battery storage and demand response can provide flexibility to the grid. It would, however, be difficult or unaffordable to fulfil all electricity needs with a power system that relies only on renewables, storage or demand response. (IEA 2020: Secure, Sustainable and Affordable Power Systems in Emerging Economies)

For gas power investments this would mean investments where a gas power plant is technically and economically the most feasible solution for clean, affordable and reliable power generation to the electricity grid and customers. This means investments in peaking or back-up power plants that are critical to preserve reliability and stability of the grid and will thus both allow increasing introduction and ensure maximum utilisation of solar and wind power in the grid.

We will continue to invest in hybrid-power, off-grid or mini-grid solutions where the majority of the power is generated by a renewable source, such

[4] "Dedicated lending" is defined for these purposes as financing conditioned by a use of funds clause specifying that such financing will be used for one or more of the purposes described.
[5] A harmonised tool for assessing alignment with Paris Agreement objectives is being developed and will be published once it is finalised.

as solar, but needs to be backed up by battery storage and/or diesel generators.

In all new investments in power production using fossil fuels, we will publicly disclose the assessment methodology for alignment with the Paris Agreement.

Reinforcing the role of businesses in adaptation, climate resilience and biodiversity protection

Based on the findings of the Intergovernmental Panel on Climate Change (IPCC), it is evident that people who are already most vulnerable and marginalised will also experience the greatest impacts. The poor, and particularly women, primarily working in natural resource sectors such as agriculture in developing countries, are expected to be disproportionately affected by climate variability and change.

There are human, environmental and economic imperatives to urgently increase adaptation financing[6] and the Global Centre on Adaptation calls for revolutions in understanding what adaptation means, how it must be considered in planning, and how to best increase its financing.

The IPCC definition of adaptation highlights two dimensions of adaptation: *avoiding harm as well as exploiting beneficial opportunities*. Defining adaptation risk management or possible opportunities requires context- and sector-specific climate risk assessment on both the economic activity and its operating environment. Finnfund has developed and will apply an adaptation risk assessment and opportunity identification approach that is suited for the geographies and sectors where we work, including gender finance. The approach will align with the identified action tracks and with the National Adaptation Plans to address both risks and opportunities in adaptation for strengthening resilience. The approach will cover both the investee and its operating environment levels and is hoped to increase results-based private sector adaptation finance.

Climate change is closely bound to another major threat to our humanity: biodiversity loss. All Finnfund's investments are screened for their potential impacts on biodiversity and natural habitats. All investees are required to 1) avoid and mitigate negative impacts on biodiversity and to protect and conserve biodiversity, and 2) to maintain or increase the benefits from ecosystem services both at local and global levels.

Finnfund requires its investees to demonstrate that no net loss of natural habitats and biodiversity values is taking place. Investees are also required to apply measures for pollution prevention and sustainable, efficient resource use. The specific measures and detailed requirements are drawn from the IFC Performance Standards and sector-specific guidelines, and sector-specific certification schemes.

Finnfund recognises the importance of Nature-Based Solutions in adaptation and in combatting biodiversity loss. In all investments that require adaptation or biodiversity protection or promotion, Nature-Based Solutions are sought and prioritised.

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[6] In 2019, the MDBs committed USD 12 billion in adaptation finance in low and middle-income economies. Of this, six percent was for private sector recipients or borrowers, 94 percent was for the public sector.

More emphasis on climate considerations in decision-making and reporting

Climate change has profound impacts on businesses globally. Hence, it poses both risks and new opportunities to businesses operating in Finnfund's target markets, across sectors. Climate considerations are integrated into Finnfund's decision-making process, including anticipated CO2 emissions, avoided emissions or sequestration as per international standards.

Together with other EDFIs, we declare to adopt and make disclosures consistent with the recommendations of the Task-Force on Climate-related Financial Disclosures (TCFD). Alignment with the TCFD framework requires that we integrate climate-related matters into our decision-making and reporting, more precisely by considering the climate issue in our governance, strategy, risk management and metrics and targets. As a part of this, we will improve transparency regarding the climate-related risks and opportunities in our portfolio.

We have started preparations to integrate climate issues into our decision-making and processes, and we will make our first TCFD-aligned disclosures in 2022.

Finally, though the carbon hand- and footprint of our own operations is marginal compared to our portfolio, we take pride in ensuring that our own home base is in order as well. We will continue to avoid unnecessary travel and improve and increase energy efficiency and energy saving activities at our office. We have achieved the WWF Green Office Certificate and our office building has been awarded with the first ever Excellent-level In-Use environmental certificate in Finland.

Discussions and cooperation with various stakeholders and experts have been a key element in preparing this statement.

This statement has been approved by Finnfund's Board of Directors. It is valid as of 1.7.2021 and will apply to all projects from that date onwards.

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[i] 1) Coal prospection, exploration, mining or processing; 2) oil exploration or production; 3) standalone fossil gas exploration and/or production; 4) transport and related infrastructure primarily used for coal for power generation; 5) crude oil pipelines; 6) oil refineries; 7) construction of new or refurbishment of any existing coal-fired power plant (including dual); 8) construction of new or refurbishment of any existing HFO-only or diesel-only power plant producing energy for the public grid and leading to an increase of absolute GHG emissions; or 9) any business with planned expansion of captive coal used for power and/or heat generation,