Climate policy for Elo’s investments 2023–2030

CLIMATE POLICY FOR ELO'S INVESTMENTS

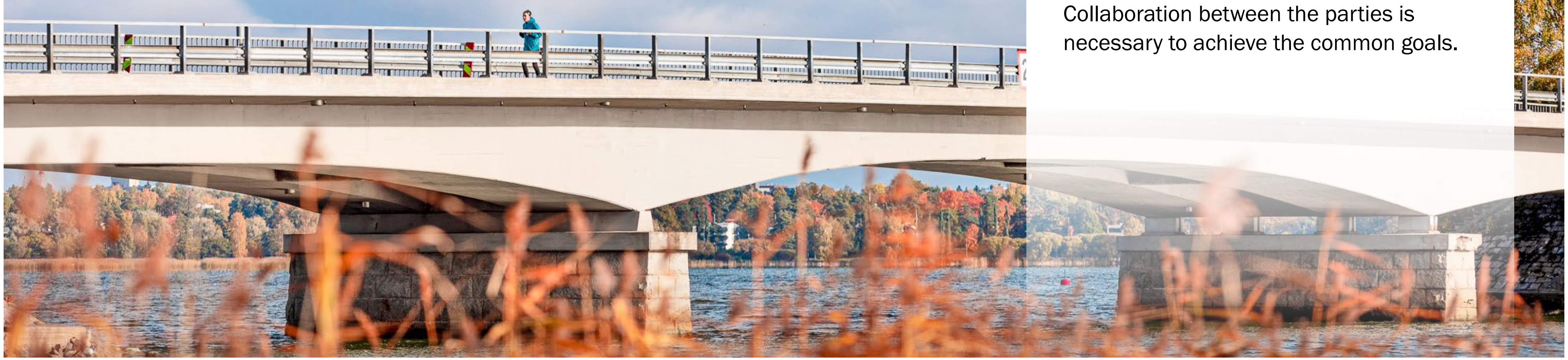
Climate change is a major systemic risk for the global economy and investments. The magnitude of the impacts on the economy, ecology and humans depend on how much the climate warms and the success of the climate change mitigation and adaptation.

Climate change poses physical and transitional risks. Physical climate risks are associated with extreme weather events, such as floods and storms, and changes that develop gradually, such as rising sea levels. The transition to a low-carbon society presents both financial risks and opportunities for companies and investors. It is important to ensure that companies and governments also have sufficient capital resources for the transition. Rapid climate action is needed, but the transition must also be just and orderly to minimize the overall risks in the long term.

The Paris Agreement sets the goal to limit the increase the global temperature to 1.5 degree Celsius. Achieving the goals of the Paris Agreement and a net zero future requires determined action by governments, companies, investors and other actors in society. A successful transition to a low-carbon society relies on collaboration between different parties.

An orderly and just transition

Elo is actively contributing to the transition to a low-carbon economy. In the climate policy for its investments, Elo takes into account the requirements for securing pensions as well as changes in the operating environment and the financial market. The key objective of climate policy is changes in the real economy. Emission-based portfolio changes alone might not contribute to an orderly and socially just transition or a reduction in global emissions. Collaboration between the parties is necessary to achieve the common goals.



OBJECTIVES OF ELO'S CLIMATE POLICY FOR INVESTMENTS

Responsibility is one of the main drivers of Elo's strategy and values. We ensure adequate solvency in all market situations and manage pension assets in a cost-effective and responsible manner. We have systematically developed our responsible investment practices and will continue their determined development.

Elo has identified climate change as a significant sustainability risk that may have a negative impact on investments. We disclosed the first climate policy for investments in 2017. The climate policy was updated in 2020, when interim targets and a roadmap until 2025 were set. In this climate policy the roadmap will further specified and extended until 2030.

Elo is committed to a Paris aligned investment portfolio. The goal requires a holistic approach: decarbonising the portfolio, supporting an orderly and just transition, investments in climate change mitigation and adaptation solutions, and engagement and collaboration. In 2021, Elo joined the Net Zero Asset Owner Commitment of the Paris Aligned Investment Initiative (PAII). The commitments and goals of the framework are integrated in Elo's climate policy for investments. The recommendations of the framework and the coverage of different asset classes are constantly developed. Elo participates in the development through the IGCC (Institutional Investors Group on Climate Change).

Elo is committed to transparent and open reporting on the climate policy implementation and the achievement of the objectives. Elo reports on climate risks and opportunities annually and continuously develops its reporting.

Carbon footprint

In its 2021 report, the Intergovernmental Panel on Climate Change (IPCC) outlined that global greenhouse gas emissions should be reduced by about 50 per cent from 2016 by 2030. The EU aims to cut its emissions at least by 55 per cent compared to 1990 by 2030.

Elo has set carbon footprint reduction targets in its investment activities and reports extensively on various carbon footprint indicators. For listed equity and corporate bond investments, the objective is that the weighted average carbon intensity (WACI) of portfolios is reduced by 25 per cent by 2025 compared to the 2019 level and by 60 per cent by 2030. The target covers the direct and indirect scope 1 and 2 emissions of the investee companies.

Elo has published the WACI of listed equity and corporate bond investments since 2016 and reported in accordance with the recommendations of the TCFD[1] framework since 2018. WACI, the greenhouse gas emissions divided by turnover and weighted by using the portfolio weights, recommended by TCFD. The benefit of WACI is its comparability for equity and fixed income investments and various sectors. It is a backward-looking metric that takes turnover into account, but it does not consider all factors that are essential for assessing the climate risk in different sectors. We also need forward-looking metrics and to assess the climate risks now and in the future for all managed assets. For this, we use climate scenario analysis, for example.

Elo's goal of a net zero investment portfolio will be achieved

- by decarbonising the investment portfolio,
- by increasing investments in sustainable solutions,
- by reducing the share of fossil fuel production in investments,
- by assessing the climate change risks and opportunities in all asset classes and in the investment strategy and allocation work,
- by assessing the alignment of the investees' objectives and strategies with the goals of the Paris Agreement, and
- by engaging with companies and other stakeholders, both individually and in collaboration, in line with the climate policy.

In addition to WACI, we also monitor and disclose other carbon footprint metrics of our listed equity and corporate bond investments. With regard to absolute emissions, we report separately the scope 1 and 2 emissions and the upstream scope 3 emissions of these investments. In direct Finnish real estate investments, in addition to carbon footprint, we also monitor and disclose emission intensity, energy consumption, water consumption, waste volume and recycling rate.

The goal of direct Finnish real estate investments is carbon-neutral energy use by 2027. We have joined the TETS and VAETS energy efficiency agreements[2] for the real estate sector. In addition, our aim is to save five per cent of the specific consumption of electricity and 10 per cent of the specific consumption of heat by 2025 compared to the 2019 level. All electricity purchased by Elo has been renewable since 2020, and we will gradually switch to renewable district heat.

Companies do not yet comprehensively report their carbon footprint, especially in unlisted assets. If available, we use reported data in our carbon footprint disclosures. Otherwise, the service providers' estimates are used in the calculations. Estimated data causes inaccuracies, and therefore it is important that companies report their carbon footprint extensively and transparently. Not all asset classes yet have established ways to calculate their carbon footprint. We are actively monitoring the development and aim to expand the carbon footprint measurement to more asset classes.

Sustainable solutions

Sustainable solutions refer to activities that aim to respond to societal challenges, such as climate change mitigation and adaptation. Elo's objective is to increase investments in such activities in direct listed equity and corporate bond investments, as well as in infrastructure investments.

For listed equity and corporate bond investments, our objective is to double the investments in sustainable solutions by 2030 compared to the 2021 level.

Investments in renewable energy is a key part of Elo's infrastructure investments, and our goal is to increase investments in sustainable solutions. In addition, we monitor the opportunities provided by the development of technologies in green transition, such as the hydrogen economy and the production of green hydrogen, as well as carbon capture and storage. We report the annual carbon sink and carbon stock of our forest investments.

In indirect investments, we aim to invest in funds that comply with Elo's objectives. In hedge fund investments, for example, we are actively investigating new investment opportunities linked to climate change and the related regulation.

In Finnish direct real estate investments, we are actively exploring the possibilities of increasing our own energy production. Our goal is to use renewable energy produced on site in 30 per cent of the sites by 2030. In addition, our goal is that 15 of our commercial properties will be environmentally certified by 2030. The share corresponds to approximately 67 per cent of the value of commercial property investments. We will also introduce the Nordic Swan label or equivalent certification for our own housing by 2025.

Fossil fuels

Fossil fuel industry is a major cause of greenhouse gas emissions and climate change. A just transition requires investments in green energy and an orderly exit from fossil fuels. Especially in the transition phase, other sources of energy are also needed to compensate for the fluctuation of renewable energy production. We regularly monitor the share of fossil and renewable energy production and capital expenditure in our investments.

Elo excludes from its direct listed equity and corporate bond investments companies that derive more than 15 per cent of their turnover from activities related to coal production or the use of coal in energy production without a clear strategy for reducing it. We are developing engagement processes to accelerate the coal phase-out.

With regard to oil and gas production, Elo is particularly critical of Arctic drilling and unconventional oil production (oil sands and shale oil and gas). We monitor these sources of energy production and will develop more detailed actions for engagement and exclusion.

Assessing the climate change risks and opportunities

We integrate the recommendations of the IIGCC Net Zero Investment Framework for net zero investment portfolio and map high climate risk companies. The industries with high emissions and exposure to transition risks, such as the oil and gas industry, electricity and heat production, the automotive and transport industry, manufacturing and the mining industry, are considered the most significant sectors in terms of climate change. Ambitious carbon footprint reduction targets and transition plans are particularly important for these sectors. In the future, we will be increasingly using the low-carbon sector roadmaps.

In listed equity and corporate bond investments, we are scaling down the largest emitters and companies depending on fossil energy sources who have no clear emission reduction plans, and we will look for cleaner investments. We nevertheless ensure that we have a balanced portfolio diversification.

In fund investments, we use the industry's best practices. As part of the due diligence process, we analyse how fund managers are managing climate change issues in their investments. For private equity fund investments, we aim to mitigate climate risks by favouring funds whose investments typically focus on sectors with limited or low climate risks.

In our sovereign bond investments, we have developed an analysis tool to assess the climate change risks and opportunities. The possibilities of different countries in low carbon transition vary greatly due to factors such as economic structures and development stages. From a climate perspective, factors analysed include environmental policies, economic vulnerability in extreme weather events, reliance on fossil fuel production and exports, as well as the possibilities and ability for a successful transition to a low-carbon society.

The climate risks associated with Elo's real estate investments are managed with careful target analysis and assessed as part of risk management.

In our allocation and investment strategy work, we identify the financial impacts of climate risks and opportunities by using scenario analyses, for example. Climate change risks are also covered in Elo's annual risk assessment. However, there are still uncertainties involved in the financial modelling of the physical and transition risks.

Engagement and collaboration

Engaging with investees individually and in collaboration is a key part of Elo's climate policy for investments. Through engagement and active ownership, we encourage investee companies to consider the material climate change effects on their operations and the impacts of their activities on climate change (known as double materiality). Through these efforts, our aim is to drive change towards a low-carbon economy.

Elo actively monitors how the companies align their objectives and actions with the goals of the Paris Agreement. It is important that climate change and its effects are considered in the company's strategy and target setting. We encourage companies to commit to targets and a roadmap in line with the Science Based Targets initiative (SBTi). For direct listed equity investments, the target is for the majority to have a science-based target by 2030[3].

It is crucial for companies and governments to ensure that the transition to a low-carbon society is also socially just and sustainable. Just transition, for example, means providing opportunities for retraining, updating skills or redirecting skills towards sustainable activities.

We are engaging with fund managers to integrate climate risks in their strategy and commit to the objectives of the Paris Agreement. In 2022, we surveyed the decarbonisation and net zero targets of Elo's fund managers and how they manage the climate change risks and opportunities. We will continue our engagement work on the basis of the survey and monitor the development of practices.

We recommend that both companies and fund managers report on their climate risks and opportunities in accordance with TCFD, including an assessment of the climate change effects on their business. In addition, we recommend that companies report their direct and indirect greenhouse gas emissions (scope 1, 2 and 3) on an annual basis.

The majority of Elo's listed equity investments are made directly. We vote at general meetings in accordance within our climate policy. We constantly review our voting guidelines.

We actively collaborate on climate-related initiatives that we consider important. We have joined various networks and initiatives such as the IIGCC, Climate Action 100+ and the Climate Leadership Coalition. We support various initiatives, such as the Transition Pathway Initiative and the Investor Statement on Just Transition as well as CDP's climate change, water and deforestation initiatives. Furthermore, we collaborate with asset managers and market participants to enhance the consideration of climate issues.

Continuous development

We invest pension assets in a profitable and secure manner to ensure our customers receive the pensions they have earned – both today and in the future. Elo's investment portfolio is widely diversified across various asset classes to ensure sufficient returns and manage market risks. We take into account the evolving research on climate change, as well as the frameworks, tools, and data available for assessing the financial climate risks and opportunities when setting our targets.

Elo updates the climate policy for investments and its objectives at least every three years. The path towards achieving these objectives is not linear and depends on the financial and investment environment, as well as the changes the companies make. The global political environment, regulations and the energy market also impact on the progress of the green transition. In addition, the climate targets, achieving them and transparent reporting play a vital role in the success of the transition.

Elo sets more specific targets for asset classes gradually. The methodologies are still under development, especially for asset classes beyond listed equity, corporate bond and real estate investments. The scenario analyses also involve uncertainty, and their results are considered to be indicative.

Continuous development and following the latest scientific information are a major part of the implementation of Elo's climate roadmap. This requires regular training and deepening of expertise in Elo's investment organisation.

Approved by the Board of Directors of Elo
on 27 February 2023

1 Task Force on Climate-related Financial Disclosures
2 The objective of energy efficiency agreements for commercial and rental housing properties is to achieve a 7,5 percent reduction by 2025 from the 2017 level
3 The objective concerns the sectors for which an objective has been defined by the SBTi

CLIMATE ROADMAP 2023–2030 FOR ELO'S INVESTMENTS

2015

- Commitment to measure and disclose carbon footprint of our investment portfolio
- Investor member in CDP

2017

- First climate policy for Elo's investments
- Joining IGCC investor network and Climate Action 100+

2018

- First TCFD report

2019

- Joining IIGCC Paris Aligned Investment Initiative

2020

- Updated climate policy for Elo's investments
- Direct Finnish real estate investments: purchased electricity 100% renewable
- Joining CLC

2021

- Joining IIGCC Net Zero Asset Owner Commitment

2023

Updated climate policy for Elo's investments

Direct listed equity and corporate bond investments:

- coal max. 15% / revenue

2025

Listed equity and corporate bond investments:

- WACI -25%

Direct Finnish real estate investments

- Nominal energy consumption of heat -10% and electricity -5%

2026

Direct Finnish real estate investments

- Environmental certificates of own real estate production

2027

Direct Finnish real estate investments

- Carbon-neutral energy use

2030

Listed equity and corporate bond investments

- WACI -60%
- Sustainable solutions x 2 (for direct investments)

Direct listed equity investments

- Most of the investee companies have SBT

Direct Finnish real estate investments

- Minimum of 15 commercial properties have environmental certificates

Continuous development

- Engagement
- Collaboration
- Voting at general meetings
- Assessing the service providers and ESG-tools
- Scenario analysis
- Risk management
- Investee analysis
- Internal analysis tools
- Sector-specific analysis
- Regulation
- Training
- Remuneration