ELO'S CLIMATE STRATEGY 2020–2025

INTRODUCTION

Climate change is a major systemic risk for the global economy and investment environment. The magnitude of the impacts on the economy and humans depend on the degree to which the climate warms and on the success of the climate change mitigation and adaptation measures.

In the short and medium term, risks resulting from the transition to a low-carbon society are highlighted. Physical risks related to climate change mean extreme weather phenomena, such as floods and storms, and changes that develop gradually, such as rising sea levels. The physical risks will play an increasingly important role if the transition to a low-carbon society fails.

The Paris Agreement sets the objective of keeping the global temperature rise this century well below two degrees Celsius compared to the pre-industrial level. An additional objective of the agreement is to pursue efforts to limit the temperature increase to 1.5 degrees Celsius. Achieving the objectives and the decarbonisation of the global economy requires determined actions from all actors in society. Cooperation between the various actors in society is important in terms of the management of climate change-related risks and the transition to a low-carbon society.

For companies and investors, the transition phase to a low-carbon society involves financial risks as well as opportunities. It is important to ensure that companies and governments implementing the transition also have sufficient resources in terms of capital. At the same time, the climate strategies of companies, the implementation of emission reductions and open reporting on climate risks and opportunities in accordance with the international reporting framework TCFD[1] are essential for a successful transition.

> **Elo commits to an investment portfolio that is in line with the objectives of the Paris Agreement**

Already for several years, Elo has developed its operations in order to take climate change and the related risks and opportunities into account in its investment operations. The weighted average carbon intensity[2] of equity and corporate bond investments has been reduced by 27 and 47 per cent during 2016–2019, which also has been the validity period of the Paris Agreement.

1 Task Force on Climate-related Financial Disclosures

2 Carbon intensity means a company's greenhouse gas emissions related to its turnover (tCo2/USD). Weighted average carbon intensity means the carbon intensity calculated based on the portfolio's weighting. Elo's objective takes into account the Scope 1 and Scope 2 emissions of investments.

In our new updated climate strategy, we commit even more strongly to the objectives of the Paris Agreement and the related measures required to reduce climate risks as well as to climate change mitigation and adaptation measures. Elo's climate strategy supplements Elo's principles of responsible investment.

When the climate strategy for 2020–2025 was prepared, the IIGCC's[3] Paris Aligned Investment Initiative framework[4] recommendations concerning the alignment of investment portfolios with the objectives of the Paris Agreement were considered.

OBJECTIVES OF ELO'S CLIMATE STRATEGY

Elo commits to an investment portfolio that is in line with the objectives of the Paris Agreement. This will be implemented

- by reducing the carbon risk of the investment portfolio through a reduction of the weighted average carbon intensity of the portfolio
- by increasing investments in solutions aiming at climate change mitigation and adaptation
- by considering climate change risks and opportunities in the investment strategies for various asset classes and in the strategic asset allocation and
- by actively engaging with companies and other financial operators ourselves and in cooperation with other parties.

Elo's investment portfolio is widely diversified to various asset classes to ensure returns required by the pension company's basic mission and to manage risks related to the investment markets. With the available tools and methods, there is currently major uncertainty related to the calculation of carbon neutrality at the level of the entire investment portfolio. In addition, estimating how climate change impacts the development of risks and returns in the investment markets is still very challenging.

The tools and methods used for measuring climate risk are still very much under development especially for other asset classes besides listed equities and corporate bonds. Even for listed asset

Elo is an active operator in the decarbonisation of the economy

Elo is an active operator in the decarbonisation of the economy, while taking into account the requirements of the basic mission of a pension company and the changes in the investment markets. The key objective of the climate strategy is the decarbonisation of the real economy.

Mere portfolio changes based on the prevailing situation reduce the current climate risk of investments, but not necessarily in the future. In addition, portfolio changes made by individual investors have a limited effect on the reduction of total emissions at the global level.

Operational changes in companies and cooperation between various actors in society are necessary in order to achieve objectives. Furthermore, companies must ensure a socially sustainable transition (just transition[5]) when transforming their operations towards low carbon society.

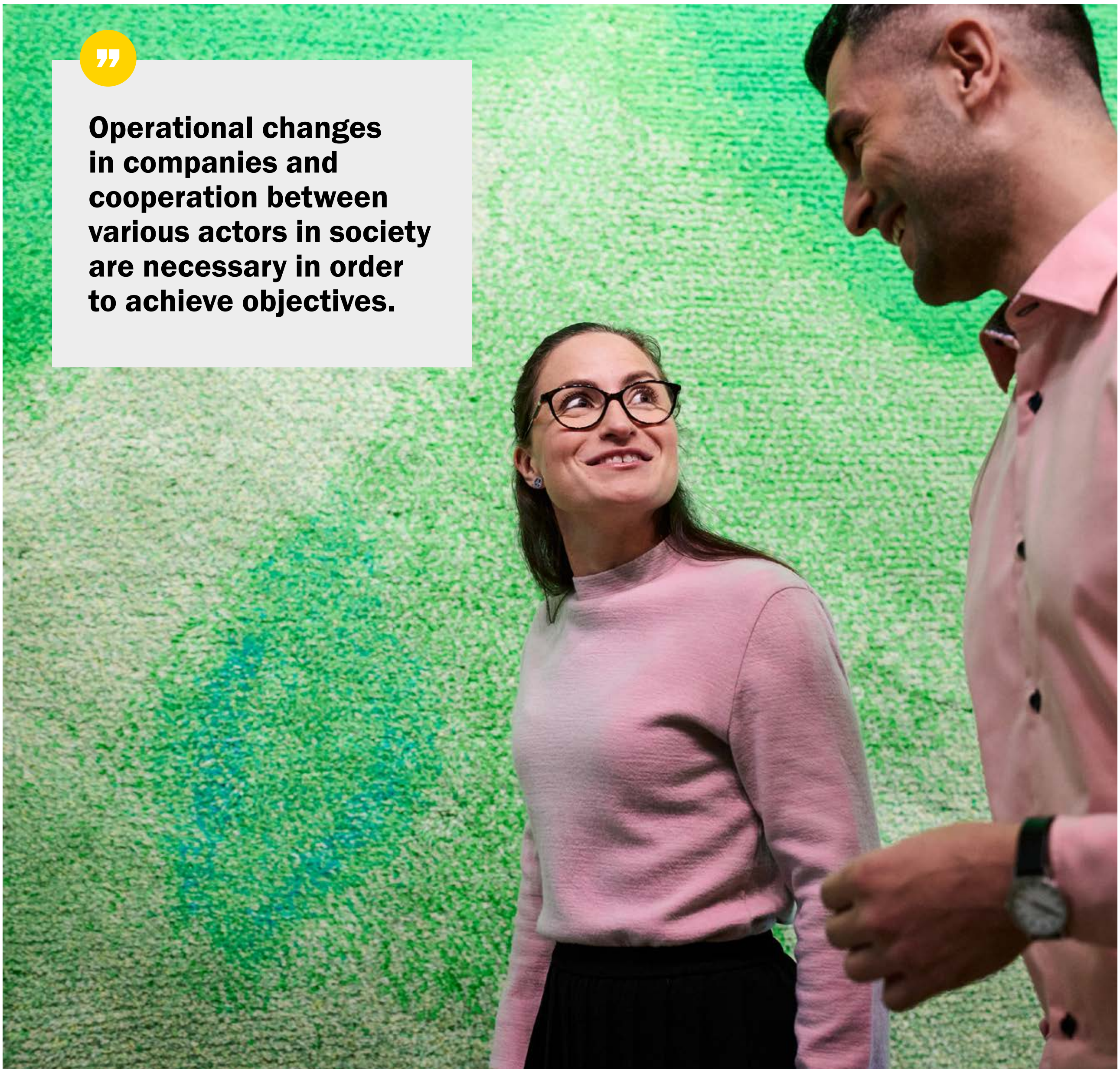
3 Institutional Investors Group on Climate Change
4 https://www.iigcc.org/download/net-zero-investment-framework-consultation/?wpdmdl=3602&masterkey=5f270ef146677
5 Just transition means addressing the structural and regional challenges of the transition in a socially sustainable way. This could mean, for example, retraining staff in carbon-intensive industries or reorienting skills.

classes, the coverage, quality and uniformity of company-specific data are challenges in objective setting and the related follow-up. The problems related to the coverage and quality of data also seem to affect compliance with the increasing regulation concerning investors. In addition, it is challenging to estimate the climate related rate of change regarding politics, legislation, technologies and companies. Continuous development of personnel's competence plays a particularly important role in the implementation of climate strategy.

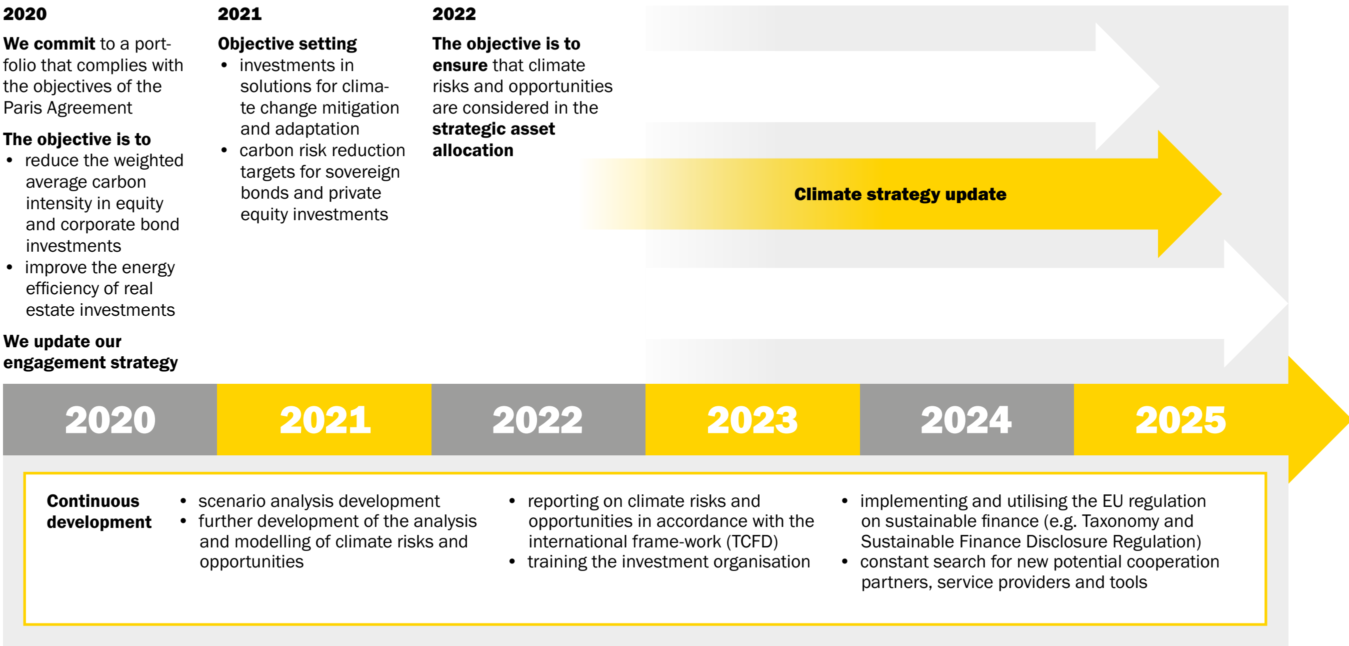
Elo commits to transparent and open reporting on the implementation of its climate strategy and the achieving of objectives. We are committed to reporting the financial impacts of our own climate risks and opportunities in accordance with TCFD's reporting framework and we will continue to develop our reporting.

Elo will update its climate strategy and the related objectives on a regular basis. The path to achieving objectives is not straightforward but varies depending on the development of the financial and investment environment and the changes in companies. In addition, the above-mentioned development of the tools and methods for estimating the impacts of climate change and the volume, quality and uniformity of available data are factors affecting the updating of the climate strategy.

> **Operational changes in companies and cooperation between various actors in society are necessary in order to achieve objectives.**



ELO'S CLIMATE STRATEGY ROADMAP 2020–2025



Elo's new climate strategy is based on a roadmap with a phased objective setting for various asset classes and, later, for the allocation level. In the first phase of the new climate strategy, the focus is on reducing the carbon risk for listed equity and corporate bond investments and real estate investments.

Subsequently, the focus will be on solutions for climate change mitigation and adaptation, a review of other asset classes and the development of a scenario analysis as part of strategic asset allocation.

Objectives set in the first phase (2020):

- mitigating the carbon risk by reducing the weighted average carbon intensity
- of equity and corporate bond investments by 25% during 2019–2025.
- reducing the energy consumption of real estate investments by 10% with regard to district heat and by 5 % with regard to electricity during 2019–2025.
- updating the engagement strategy in accordance with the climate strategy objectives

Objectives set in the second phase (2021–2022):

- setting the target for climate risk mitigation in a manner suitable for government bonds and private equity fund investments
- investments in solutions aiming at climate change mitigation and adaptation
- considering climate risks and opportunities in the strategic asset allocation

The investment portfolio's weighted carbon intensity, that is, the greenhouse gas emissions weighted by using the portfolio weights divided by net sales is the metric recommended in TCFD's reporting framework. The benefit of carbon intensity is its comparability for equity and fixed income investments and various sectors. As a metric, it focuses on the history and as it takes net sales into account, it does not consider all factors that are essential for modelling the climate risk in various sectors. We also need forward-looking metrics and we need to assess the total risk related to the climate at the present time and in the future for all managed assets.

Asset class-specific objectives will be set through a phased approach. The objectives will take into account the available research data on climate change and the development of the available tools for the financial modelling of climate risks and opportunities, as well as the development of the volume and quality of data.

CONTINUOUS DEVELOPMENT STEERS OPERATIONS

The tools and methods for modelling climate risks and opportunities still involve a lot of uncertainty. Continuous development and researching the latest scientific data are a major part of the implementation of Elo's climate strategy roadmap.

At the asset class level, considering climate risks and opportunities is part of investment planning. For equity and corporate bond investments and real estate investments, the existing climate risk tools are utilised and the possibilities of using new tools are investigated for all asset classes. Utilisation of the EU's taxonomy for sustainable finance, the EU Taxonomy[6], plays a key role when assessing climate effects. Internal and external reporting related to climate risks and opportunities is developed on a continuous basis. TCFD's reporting framework is used for external reporting and the developments in EU regulations concerning reporting are monitored.

The analysis of climate risks and opportunities is developed at the portfolio level for both transition-related and physical risks. As part of this work, we are developing methods for performing scenario analyses. Our objective is to include the consideration of climate risks and opportunities in the strategic asset allocation during 2022.

Continuous training and competence development for Elo's investment organisation play a major role in the roadmap implementation.

ENGAGEMENT

Engagement with investments by ourselves and together with cooperation partners is central to Elo's climate strategy. With engagement, investments are encouraged to reduce their emissions and develop solutions for climate change. It is important that climate change and its effects are considered in the company's strategy and target setting. We require that carbon-intensive companies present

Engagement with investments by ourselves and together with cooperation partners is central to Elo's climate strategy.

6 Criteria for determining when financial operations are sustainable in terms of the environment and society. Economic activity must essentially promote at least one out of six environmental objectives. The first phase of the taxonomy focuses on measures for climate change mitigation or adaptation.

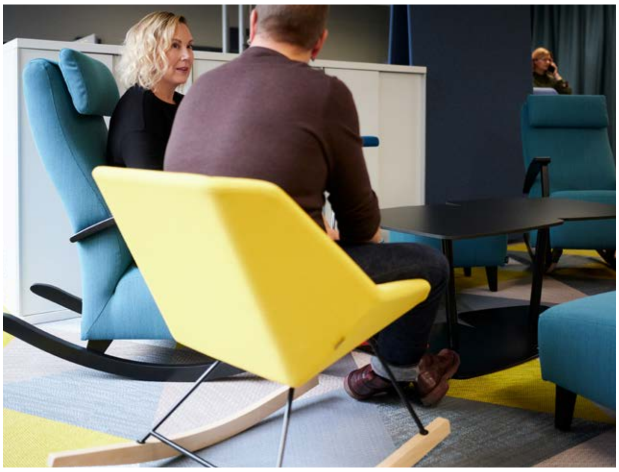
reduction plans for emissions and report on their progress. In addition, we recommend that companies commit to the objectives of the Science Based Targets initiative. Companies must ensure that the transition to a low-carbon society is also socially sustainable.

We strive to engage with fund managers so that they take climate change into account in their investment strategy and commit to the objectives of the Paris Agreement.

We recommend that both companies and fund managers report on their climate risks and opportunities in accordance with TCFD's reporting framework[7], including an estimate of the business effects of climate change.

We update our engagement strategy in accordance with the new climate strategy and its focus areas. We vote actively in shareholders' meetings while considering the objectives of our climate strategy. Together with our cooperation partners, we will participate in initiatives that we feel are important (IIGCC[8], CA100+[9]) and actively take part in engagement projects.

In addition, we cooperate with managers and market parties in order to promote the consideration of climate issues. We are constantly searching for new potential cooperation partners, service providers and tools.



TAKING CLIMATE CHANGE INTO ACCOUNT IN RELATION TO VARIOUS ASSET CLASSES

Listed equities and corporate bonds

Our objective is to reduce the climate risk of our portfolio and increase investments in climate solutions. For listed equity and corporate bond investments, the interim objective on the path towards an investment portfolio meeting the objectives of the Paris Agreement is that the weighted average carbon intensity of portfolios is reduced by 25 per cent during 2019–2025. When the new objective is taken into account, the total reduction in carbon intensity for 2016–2025 is approximately 45 per cent for equity investments and approximately 60 per cent for corporate bond investments.

In terms of climate change, the most important sectors are carbon-intensive industries, such as oil and gas, the generation of electricity and mining. We are scaling down the largest emitters and companies depending on fossil energy sources who have no clear reduction plans for greenhouse gas emissions and we will look for cleaner investments. We nevertheless ensure that we have a balanced portfolio diversification. In index investments, we will annually increase the share of low-carbon index funds. In corporate bonds, we increase investments in green bonds and actively investigate funds that take climate change mitigation and adaptation into account.

In its principles for responsible investment, Elo has specified that it excludes from investments companies for which more than 25% of their net sales is related to coal production or the use of coal in energy production without a clear strategy for reducing coal use. Going forward, we will assess whether the above-mentioned limits should be tightened.

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We will reduce the weighted average carbon intensity of listed equity and corporate bond investments by 25% between 2019–2025.

7 The Science Based Targets initiative (SBTi) encourages companies to commit to objectives that are based on science, through which they can reduce their carbon dioxide emissions.
8 Institutional Investors Group on Climate Change
9 Climate Action 100+

Sovereign bonds

Regarding sovereign bonds, we investigate tools and develop methods for more detailed modelling and determining of climate risks and opportunities before actual objective setting.

The increasing importance of climate change effects is also reflected in sovereign bond investments. The countries included in the investment universe differ significantly in terms of their geographic location, economic structures and development level. Geographical location and the structure of the economy contribute to a country's vulnerability concerning the physical risks resulting from climate change, such as the onset of drought, floods and heat waves.

However, the development phase of different countries and their possibilities to move towards a low-carbon society vary greatly, for example, in terms of the economic structures. Areas to be analysed from the perspective of climate risks include, among others, environmental policies, economic vulnerability in extreme circumstances, the degree to which the country economy is dependent on the production and export of fossil energy and the possibilities and ability to successfully transition to a low-carbon society.

Private equity fund investments

For private equity fund investments, we aim to mitigate climate risks by favouring in fund selection managers whose investments typically focus on sectors with restricted or minor climate risks. Furthermore, we include climate change considerations even more strongly in the fund investment strategy as a part of our own due diligence process.

Our aim is to engage fund managers so that they will consider the effects of climate change as part of their own responsibility practices by highlighting themes that are important to Elo, such as the monitoring and reduction of the carbon footprint of investments. We recommend that funds report on their climate risks and opportunities in accordance with TCFD's reporting framework.

Regarding private equity investments, we develop methods for more detailed modelling and determining of climate risks and opportunities and clarify our objectives as the development work progresses.

Investing in renewable energy has been a key part of Elo's infrastructure investments and we continue to investigate new investment opportunities.

Real estate investments

In 2017, Elo joined the energy efficiency agreement applied to rental housing properties and commercial properties (VAETS[10] and TETS[11]). The agreement applies to all real estate in which Elo is a direct majority owner, that is, to the majority of direct real estate investments. Significant investments have already been made during the validity period of the energy efficiency agreements for the real estate sector. The 7.5 per cent savings required by the agreements will most likely be achieved during the agreement period.

Elo has decided to set a new additional target measuring energy efficiency: 10 per cent savings for district heating and 5 per cent savings for electricity during 2019–2025. This is measured through the actual lower specific consumption of properties in a comparable base and it takes into account the effect of the property's actual use. This year, reducing energy consumption was introduced for the majority of direct real estate investments as one metric that steers operations. The intention is to extend the metrics to all real estate directly owned by Elo.

In addition, our objective is to increase the use of renewable energy sources and recycling of material in our real estate investments. All apartments fully owned by Elo in the Helsinki metropolitan area, Tampere and Turku will be equipped with sensors measuring temperature and humidity.

> **A new additional objective will be set for real estate investments – 10 per cent savings for district heat and 5 per cent savings for electricity during 2019–2025.**

10 Rental Housing Property Action Plan (VAETS)
11 Action Plan for Commercial Properties (TETS)

We aim to achieve the objectives by transferring to green electricity by 2022 in all properties owned by Elo and by transferring all directly-owned real estate to the scope of the energy efficiency agreement for the real estate sector, by investigating more extensive utilisation of solar energy for commercial properties and by increasing the recycling of plastic in order to improve the recycling rate. Green energy is already used in the majority of properties.

The possibilities to save energy are considered in renovation projects, site maintenance and annual repairs. Elo continues to report emissions and waste volumes for its real estate investments.

Hedge fund investments

For hedge fund investments, we aim to apply the industry's best practices and develop methods for more detailed modelling and determining of climate risks and opportunities before agreeing on objectives.

We aim to engage with fund managers so that they will consider the effects of climate change as part of their own sustainability practices by highlighting themes that are important to Elo, such as the monitoring of the carbon footprint of investments. When making investment decisions, the managers' responsibility practices are analysed from the perspective of both the manager's own internal actions and the funds' investment operations. We are actively investigating new investment opportunities linked to climate change and the related regulation.

We recommend that funds report on their climate risks and opportunities in accordance with TCFD's reporting framework.

Corporate finance

Corporate financing provides opportunities to find investments that help mitigate climate change. In the future, considering climate change in the company's strategy may become a competitive factor, as global companies plan their own subcontracting chains. Elo aims to actively highlight themes it considers important and engage with companies so that they would take climate risks into account in their operations.

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