

Swedfund

Swedfund's Guiding Note on Climate

2024-05-30



Guiding Note: Climate

Guiding notes describe Swedfund's view and process for the implementation of the key sustainability themes that are defined in Swedfund's Policy for Sustainable Development and Anti-Corruption such as Climate, Decent Work, Gender and Human Rights. We recognize that the key sustainability themes are closely interlinked and overlap, however only one theme is described per guiding note. Guiding notes are updated regularly as our work develops. We welcome stakeholder feedback to continuously improve our work.

1. Background and Strategic Intent

Climate change is one of the biggest challenges the global community is currently facing and one of the greatest barriers to development. Climate change severely affects private and public sector businesses, livelihoods and has a negative impact on inclusive growth and sustainable development. Climate change and poverty go hand in hand, and the impacts of climate change are disproportionately burdening developing countries. Additionally, groups in vulnerable situations, including, in many contexts, women, are likely to be disproportionately affected by climate change. An effective response to climate change has the potential to avoid further inequity, but also needs to be aligned with goals concerning poverty eradication, sustainable development, just transition and gender equality.

Therefore, Swedfund has committed to align with the goals of the Paris Agreement¹, which aims to limit global warming well below 2, preferably to 1.5 degrees Celsius compared to pre-industrial levels. In line with this, Swedfund shall:

- i) invest in low emission pathways and climate resilient development; and
- ii) contribute towards net zero emissions.

Swedfund seeks to fully integrate climate considerations in the investment process rather than handling it as a stand-alone issue. Swedfund's climate lens aims to systematically integrate a climate perspective to (i) identify relevant climate risks in our investments and portfolio, (ii) manage the material climate impacts of our investments and portfolio, and (iii) identify

¹ <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>

opportunities for Swedfund to support its investments and portfolio to combat climate change in developing countries.

1.1 Key Focus Areas

In order to align with the goals of the Paris Agreement, actions are required at (i) portfolio level (ii) sector level and (iii) individual portfolio companies. We aim to apply Swedfund's climate lens to all Swedfund investments during the investment period, i.e. at the initial due diligence, during the portfolio active ownership phase and during the exit phase.

1.2 Definitions

Swedfund defines a climate investment as an investment that leads to a net reduction of greenhouse gases (GHGs)² (mitigation project) or investments that support the adaptation to the adverse impacts of climate change (adaptation project). These definitions are applied to all current and potential investments to determine whether an investment can be classified as a mitigation or adaptation project. Also, Swedfund is inspired by the definitions and safeguards agreed in the EU Taxonomy³.

1.3 Collaborations and Stakeholder Engagements

Collaborations. Within the area of climate, Swedfund seeks partnerships to further develop its climate strategy and implementation of the strategy into the investment process. Swedfund is a strategic minority investor and therefore collaborates with carefully selected partners to align efforts and amplify impact. For example, the *European Development Finance Institutions' (EDFI)* harmonization agenda aims to develop a common approach on climate. Swedfund is also a member of the *Swedish Investors for Sustainable Development*. Additionally, Swedfund is a signatory to the *Task Force for Climate-related Financial Disclosures (TCFD)*⁴.

Stakeholder Engagements. Swedfund recognizes the importance of conducting structured stakeholder dialogues and having meaningful consultation associated to our activities and investments and with relevant partners such as NGOs, CSOs, environmental and sustainability organizations, communities, groups of peoples, individuals and others and aim to embed this into the investment process.

² Greenhouse gases (GHGs) include carbon dioxide, methane, nitrous oxide and fluorinated gases

³ https://ec.europa.eu/info/publications/210421-sustainable-finance-communication_en#taxonomy

⁴ <https://www.fsb-tcfid.org/>

1.4 Measurement & Goals

Swedfund's climate targets by 2045 are ambitious. Specifically, Swedfund's climate goals as specified by our owner, the Swedish government, are:

1. **Swedfund's investment portfolio shall be climate neutral by 2045**, which means that the GHG emissions from the portfolio should be net zero according to the IPCC's definition⁵.
2. In addition, the **portfolio's average GHG emissions per invested SEK shall decrease over time** (i.e. the average carbon intensity of the portfolio), using 2020 as a baseline.

2. Climate Lens Process

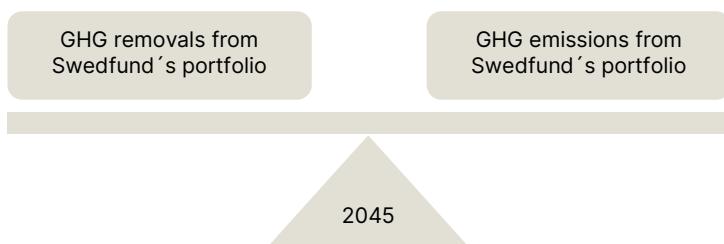
Sustainability is a core pillar of Swedfund's investment process. Climate-related and environmental aspects are an integral part of Swedfund's investment strategy. We apply IFC's Performance Standards in our investment processes and management, as well as additional climate screening questions. As a recent development, the investment process also includes a dedicated climate lens, entailing an integrated approach to analyse investment opportunities from a climate perspective. The climate lens drives our investment strategy, is integrated in the Environmental and Social Due Diligence process and is applied to all current and potential projects. The climate lens aims to address climate throughout the entire lifetime of an investment and to ensure that this is regularly monitored under active ownership.

The climate lens is applied at (i) portfolio level (ii) sector level and (iii) at the individual portfolio company.

2.1 Portfolio Level

Our aim at the portfolio level is to have an investment portfolio that shall be climate neutral by 2045, meaning that the absolute GHG emissions (Scope 1, 2 and 3) from the portfolio should be net zero.

⁵ Net zero emissions are achieved when anthropogenic emissions of greenhouse gases to the atmosphere are balanced by anthropogenic removals over a specified period (<https://www.ipcc.ch/sr15/chapter/glossary/>).



Swedfund will take action to align our financed absolute emissions to a net zero by 2045 pathway. To pursue alignment with the Paris Agreement, Swedfund is also committed to tracking our portfolio and its associated emissions, to take appropriate action to ensure alignment and set relevant mid-term targets.

Swedfund has recently undertaken a project with an external advisor to assess the alignment of Swedfund's portfolio with the Paris Agreement, on the basis of the Beyond 2°C scenario by the International Energy Agency (IEA) ⁶. The assessment was completed across our three core sectors, energy and climate, healthcare and financial institutions. The results show a high alignment of Swedfund's portfolio with the Paris Agreement indicating that our investment strategy is well aligned with our portfolio level climate target. Further, the assessment is an important step in order to set relevant targets and actions on the portfolio level.

In order to track performance, Swedfund estimates the climate impact of our portfolio companies (Scope 1, 2 and 3). Annually, Swedfund calculates the financed GHG emissions of our portfolio in accordance with the GHG Protocol⁷. The results are reported in the Swedfund Integrated Report⁸. This measurement enables us to understand the climate impact of our portfolio and to assess potential actions in our portfolio companies focused on reducing their emissions. Additionally, we will report the GHG emissions per invested SEK to report against the owner goals. Together with other European Development Finance Institutions CDC Group (UK), Finnfund (Finland) and FMO (Netherlands), we are currently developing a new forest carbon sequestration calculation tool (FRESCOS). The tool aims to calculate the total amount of carbon removals through investments in forestry projects.

2.2 Sector Strategy

Swedfund aims to systematically integrate and expand climate-related perspectives in all our activities across our three core sectors: (i) Energy & Climate (ii) Financial Inclusion and (iii) Healthcare.

⁶ This scenario is defined as being consistent with a 50% chance of limiting average future temperature increases to 1.75°C

⁷ <https://ghgprotocol.org/>

⁸ <https://ir.swedfund.se>

Energy & Climate Sector

Swedfund will invest in climate, low emission pathways and climate resilient development as part of the Energy & Climate sector. Since 2015, Swedfund has focused on renewable energy production and distribution, in line with SDG 7 and no longer makes direct investments into fossil fuels.

Recognising that climate investments encompass a wider remit than sustainable energy production, Swedfund will invest in other sustainable climate mitigation projects such as energy efficiency, resource efficiency, water, waste to energy and waste management.

Even though the focus of Swedfund's climate strategy is to reduce the emissions of the portfolio companies, investments in carbon removal projects are required in order to reach our goal of a carbon neutral portfolio by 2045. We envision starting to assess investment opportunities in carbon capture or storage projects, for example by investing in sustainable forestry and potential new economic models and technological innovations for carbon sequestration.

Financial Inclusion Sector

Within the Financial Inclusion (FI) sector, Swedfund will focus on supporting the green transition of our financial institutions. We recognize that financial institutions need to shift their sector focus to finance low carbon activities. By reducing the exposure of the financial institutions to emission intensive sectors, they will be able to reduce transition risks, including the risk of stranded assets.

When making investments in Financial Institutions, Swedfund will seek to support the financing of climate change activities in our investee companies, including (a) climate risk assessments in FI portfolios; (b) climate initiatives to mitigate climate impacts, including for example energy efficiency improvements, renewable energy, waste and resource efficiency; (c) the development of green or sustainable finance products and initiatives; (d) climate adaptation initiatives, such as insurance products to increase adaptation to physical climate risks.

Healthcare Sector

In the Healthcare sector, Swedfund seeks to maximize the implementation of solutions in our portfolio companies that contribute to improved energy mix, energy usage, energy efficiency and resource efficiency (e.g. installation of solar panels and implementation of energy efficiency plans).

2.3 New Investments

When evaluating a new investment opportunity, Swedfund carefully considers climate risks and climate impacts associated with that specific company, sector and market.

2.3.1 Concept Clearance Phase – Initial Impacts and Risk Analysis

During the concept clearance phase, a preliminary assessment of projected climate impacts and risks is undertaken. Here, an indication is made if the project is expected to (i) qualify as a climate investment (i.e. a mitigation or adaptation project); (ii) have potentially significant GHG emissions; and/or (iii) be vulnerable to climate risks (either physical or transition risks). This is captured as part of the concept clearance memorandum that is subject to approval by the Investment Committee and guides the level of climate assessment that is performed during due diligence.

2.3.2 New Investments – Climate Impact and Climate Risk Assessment

During due diligence, the climate impact and risks of the potential investment is assessed in more detail, if found to be relevant during concept clearance:

1) Climate impact assessment

- Ex-ante projected GHG emissions from the project over the financial lifetime are obtained from the investee or calculated using Swedfund's GHG emissions model, if the project is estimated to have potentially significant GHG emissions⁹;
- Implications for Swedfund's climate targets and carbon budget are considered;
- Potential actions to reduce emissions are considered at this stage, discussed with the investee company and included in the ESG Action Plan (ESGAP).

2) Climate vulnerability and risk assessment

- Using an internal climate risk tool, potential physical¹⁰ and transition¹¹ climate risks are screened in new investments;
- If physical risk hotspots are identified, a deeper analysis is performed using the World Bank Climate and Disaster Risk Screening Tool;
- If transition risk hotspots are identified, additional research is undertaken on the country's climate policies, regulations and potential risks for the sector;
- Adaptive actions should be discussed with the investee company and actions potentially included in the ESGAP.

⁹ Emissions will also be calculated and evaluated ex-post as part of Swedfund's annual portfolio accounting.

¹⁰ Extreme temperatures, extreme precipitation, flooding, drought, storm surges and sea level rise.

¹¹ Risks from the transition to a low carbon economy, such as policy and legal changes, reputational impacts, shifts in market preferences.

2.3.3 Active Ownership – Monitoring and Support

During the ownership phase, Swedfund seeks to create value in relation to the climate impact and risks in our underlying portfolio companies. Annual data on GHG emissions is collected from the companies' sustainability reports, where available, or otherwise estimated using Swedfund's portfolio emissions calculation model. The reported emissions levels are compared and assessed regularly against the Swedfund's climate targets and carbon budget.

As part of active ownership, Swedfund will support its portfolio companies through technical assistance to support the implementation of the climate requirements in the ESG Action Plan, including efforts to reduce emissions, identify climate risks and support adaptation. Swedfund's portfolio companies operate in developing countries, which contribute to a very low share of global emissions, and are small to medium-sized companies with a limited carbon footprint. Given this context, we think it is important that our focus at this stage is on activities to support emissions reductions, mitigate climate risks, and adapt to changing climate conditions. We strive to build greater understanding and competence among our portfolio companies on climate related goals and increase their knowledge and maturity to enable them to take the necessary actions and develop tools required to reinforce a climate- and environment friendly agenda.

2.3.4 Exit - Assessment of Withstanding Impact and Residual Risks

An integral commitment of Swedfund's responsible ownership is to assess the (i) results of risk mitigating and value adding activities, and subsequently the (ii) withstanding impact of Swedfund's engagement in the company's continued activities.

An assessment of Swedfund's withstanding impact in climate will be assessed during the exit process. Depending on the climate risk profile of the project, the climate vulnerability assessment will be applied to the project and the findings from the analysis are documented in the Exit report.

2.4 Applying the Climate Lens Process to Swedfund's own Footprint

Swedfund strives to minimize its climate impact in its own operations and our GHG emissions (Scope 1-3) are calculated and reported annually¹². The Stockholm office is located in an energy efficient building and we purchase 100 per cent renewable electricity. We strive to minimise the number of flights and reduce the need for physical meetings, when possible. Swedfund has chosen to continue carbon-offsetting the company's climate impact. Swedfund sees this as a supplement to the company's active climate work,

¹² <https://ir.swedfund.se>

where the intention is to finance climate-improving measures on par with emissions that cannot be reduced immediately. The intention is to offset through projects which are locally based, do not have unexpected adverse environmental or societal impacts, and contribute to long-term reductions in emissions.

Swedfund is a signatory to the Task Force for Climate-related Disclosures and systematically assesses climate risks in our investments.

3. Further Information

For further information and feedback, please contact Swedfund's ESG & Impact team – johanna.raynal@swedfund.se.

Swedfund's Climate Lens Process

