Climate Strategy of the Church Pension Fund

Approved by the Board of the Church Pension Fund on 17 June 2021

THE CHURCH PENSION FUND

Contents

1 Introduction

Climate change is one of the megatrends of our time, and it also plays a key role in the UN's Sustainable Development Goals. This is a global phenomenon of change that will inevitably affect global societies and economies in the future. First and foremost, climate change strikes the most vulnerable people and environments.

In order to mitigate climate change, humanity must reduce the production of greenhouse gases in the atmosphere. At the Paris Climate Conference in 2015, the international community approved the objective of keeping the average rise of temperature globally well below 2°C compared to the pre-industrial period and seeking measures to limit warming to less than 1.5°C. This objective requires rapid emission reductions. As part of the transition to a climate-neutral economy, the fairness of the transition must also be taken into account. Support must be targeted at regions, sectors and workers facing the greatest challenges. Investors can influence climate change and total emissions by encouraging businesses to engage in low-carbon business and by financing climate solutions.

The Evangelical Lutheran Church of Finland is involved in taking responsibility for mitigating climate change. The Church's Energy and Climate Strategy, the Carbon Neutral Church by 2030, sets concrete goals for the Church and parishes to mitigate climate change and promote a more sustainable lifestyle. According to the Carbon Neutral Church by 2030 strategy, climate targets are taken into account in the Church's investment activities, and the Church does not make direct investments in companies producing fossil fuels.

The Church Pension Fund published its first climate strategy in 2016 and has consistently worked to reduce the carbon footprint of the portfolio. In 2020, based on the ISS ESG[1] climate analysis, the Pension Fund's equity and corporate bond portfolio was in line with a warming of 1.9°C by 2050, whereas the same benchmark index figure was 2.9°C. It is important, however, that the Pension Fund continues to pay attention to emissions on the level of the entire portfolio, develops a strategy for different asset classes and encourages companies, asset managers and decision-makers to bring about change.

The Board of Directors of the Church Pension Fund approved the new climate strategy for the Pension Fund on 17 June 2021. The climate strategy defines the climate objectives of the investment portfolio for the Church Pension Fund and the measures to achieve these objectives. The climate strategy is updated regularly, and the targets are reassessed in accordance with recent research data and possible changes in the investment environment. A working group on responsible investment for the Church Pension Fund participated in the preparation of the strategy.

2 Risks and opportunities related to climate change

The changes brought about by climate change pose new risks and provide new opportunities to investors. In practice, this means that the way that companies and governments manage climate change affects the return on investment and risk development of the Church Pension Fund over time. The work on climate change in the Pension Fund is part of the investment strategy and risk management. The central task of the Pension Fund is to ensure that the pensions of the Church employees are also financed in the future.

[1] An annual climate impact analysis by an external service provider on the investments of the Church Pension Fund.

The economic impacts of climate change on different markets and sectors in the world are multidimensional and vary according to different global warming scenarios. The risks posed by climate change are particularly critical in the sectors of high greenhouse gas emissions, such as utilities, basic industry, and energy.

According to the Task Force on Climate-related Financial Disclosures (TCFD) definition, the risks posed by climate change are divided into *transition risks* associated with the transition to a low-carbon economy and *physical risks* due to global warming. Transition risks are related to changes in regulation, technological development, market behaviour and reputational risk. Physical risks are risks directly caused by climate change, and they are divided into acute and chronic risks. The *return opportunities* brought about by climate change include features such as investment in companies that develop technologies for mitigating climate change or other solutions that facilitate the transition to a low-carbon economy.

- *Transition risks* refer to risks resulting from a transition to a low-carbon future, and they often affect sectors with high carbon dioxide emissions such as fossil fuels, energy production, the automotive and transport sectors, and the cement and steel industries. For example, from the perspective of energy production, it is significant whether future energy has been produced using renewable energy (green) or fossil fuels (brown). Companies that own fossil fuels may see the value of their assets fall due to the transition to a low-carbon economy.

  In particular, the political decisions and changes in legislation may challenge old business models. In general, the later political changes are made, the greater their impact will be on, for example, financial markets. New technological innovations may be considered to offer great potential, but also to be a high risk to companies that are unable to reform their business models. Transition risks also include market risks and reputational risks, such as changed customer consumption patterns and habits. The characteristic of transition risks is that they are very difficult to predict.

  A broader perspective on determining transition risks is to examine the climate strategies of companies. The aim is to assess how well company strategy is aligned with international climate objectives and their capacity to respond to climate change. The shortcomings in the company's strategy can be considered to increase long-term risks in particular. Asset managers must be encouraged to increasingly use resources to assess the climate strategy of companies. In particular, companies that have set targets based on climate science under the Science Based Targets (SBT) initiative can be considered to be aligned with the Paris Climate Change Agreement.

  In addition to the assessment of the company's climate strategy, there are also indicators for investors developed by different service providers that can be used to comprehensively assess the company's capacity to operate in a low-carbon environment. Such metrics are often forward-looking in nature, which is why they support traditional backward-looking carbon footprint calculations.

- *Physical risks* refer to risks directly caused by climate change, such as drought or extreme weather events. Physical risks may be either chronic, such as drought and rising sea levels, or acute, such as storms. The essential physical risks to the Church Pension Fund in the short term are, for instance, weather events affecting companies' assets or properties, which may reduce their value. In addition to this, the risks of insurance companies will increase as extreme weather events become more common. In the longer term, the essential risks relate to the sector, location or activity of the company in an area with chronic physical risks. For example, due to drought, a company's operating conditions may deteriorate, or, as a result of an increase in sea level, real estate property may lose its value.

Climate risks and opportunities have economic impacts, the identification of which may lead to changes in the investment strategy, strategic allocation, exclusion of investments and dialogue with companies, asset managers and decision-makers. The economic impacts of the climate risks may include, for example, production and operational disturbances, supply chain disturbances, loss of the value of balance sheet items, physical damages, an increase in insurance premiums, and changes in resource and production prices and consumption behaviour. Figure 1 summarises the risk framework and risk management perspectives for the investments of the Church Pension Fund in accordance with the TCFD model.

	Risk types	**Practical risks**	**Risk management examples**
TRANSITION	The **regulatory risk** arises from potentially tightening regulation, which may result, for example, in carbon tax, emission allowances and reporting obligations.	-The costs of carbon-intensive companies increase due to carbon tax -The value of fossil fuel reserves owned by the company may decrease	-Exclusion -Carbon footprint reduction -Consideration of tightening regulation as part of the investment process -Fossil fuel stock monitoring -Monitoring technical progress as part of the investment process -Monitoring the company's research and product development budget and spending -Monitoring the resource efficiency of companies -Monitoring corporate supply chain management -The ambition of the company's climate targets and their monitoring
	Technology risks arise as the world changes. Previously optimal technological solutions may be replaced by better alternatives.	-The company's product technology is not resource-efficient enough and does not use sufficient resources for product development -The value of the company's production facilities may decrease as a result of their outdated technology	
	Market risk arises from increased uncertainty and the price fluctuations which it may cause.	-The company's budgeting becomes more difficult due to fluctuations in energy and raw material prices	
	Reputational risk arises from changing customer preferences and the expectations of market operators.	-The company's climate actions may be considered insufficient, in which case customers will prefer the products of competitors	
PHYSICAL	**Acute physical risks** refer to more frequent and more severe weather events, such as floods and hurricanes.	-The production facilities or activities of the company are located in an area where floods or other weather events are more frequent, causing breaks in production or physical damage to property -Insurance companies' risks increase due to more frequent extreme weather events	-Examination of real estate, infrastructure and forest investments from the perspective of physical risks -Monitoring insurance company holdings and their risks -Integrating physical risks into the investment process in equity investments -Monitoring the level of physical risks at the portfolio level -Encouraging companies to take physical risks into account and to respond to them -Examination of the risks of multinational supply chains
	Chronic physical risks refer to long-term changes to the climate, resulting in, for example, higher average temperatures and higher sea levels.	-Property may lose its value if it is too close to the rising sea level -Due to drought, production and farming may become increasingly difficult, for instance in the case of agricultural products	

Figure 1: Climate risks and risk management for the Church Pension Fund investments.

3 Climate strategy objectives and tools

The objective of the Church Pension Fund is to consistently reduce the carbon footprint of its investment activities over time. The Church Pension Fund aims for a carbon-neutral investment portfolio by 2035, provided that the investment environment allows it.

The Finnish Government's carbon neutrality target is set for 2035, but the majority of the national and company-specific carbon neutrality targets set in the world are for 2040–2060, or they have not even been set yet. This poses challenges to the Pension Fund's globally diversified investment portfolio, where the majority of investments are made through fund investments. The investment strategies of all funds will not be fully aligned with the Pension Fund's climate strategy, and a large proportion of asset managers will only aim for carbon-neutral investment activities by 2050.

In practice, the carbon-neutral investment strategy is based on an uncertain future, which is why the Pension Fund must review the set objectives and climate tools at regular intervals. The coverage and comparability of climate data remains limited, which increases uncertainty factors at least in the short and medium term. Controlled reduction of the carbon footprint and adequate diversification of investments are an essential part of the Pension Fund’s risk management.

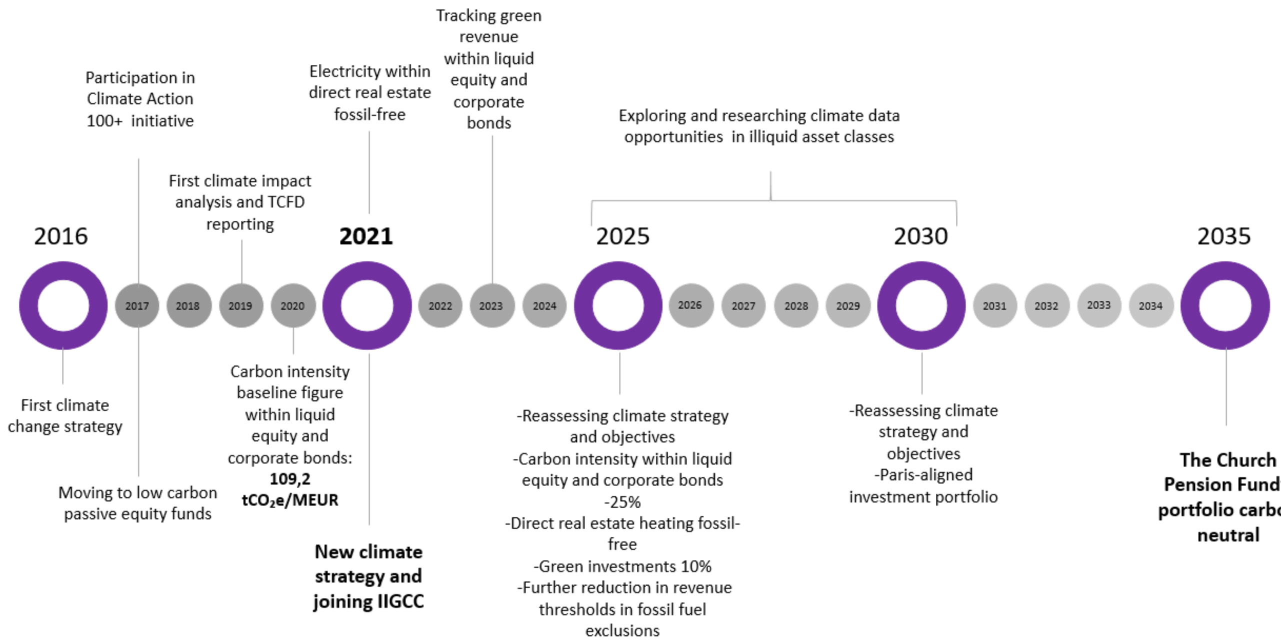

Figure 2: The Church Pension Fund road map to carbon neutrality.

In order to achieve the carbon neutrality target, the Pension Fund has identified three main climate change tools: Carbon footprint reduction, climate solutions investments and engagement. The tools and their implementation methods vary by asset category. The following table describes the tools used by the Pension Fund and the related practical measures and monitoring indicators:

Tool 1: Carbon footprint reduction		
METHODS	**IMPLEMENTATION**	**MONITORING AND METRICS**
Portfolio carbon risk monitoring	The Church Pension Fund annually analyzes its liquid equity and coporate bond portfolio in terms of climate impact, scenario analysis as well as responsibility screening.	-Carbon intensity -Revenue share of fossil fuel related activity -Assessing companies' climate strategies -Monitoring unconventional fossil fuel activity -Carbon Risk Rating -Acute and chronic physical risks -Renewable vs fossil fuel based energy production within utilities -Company fossil fuel reserves (potential future emissions) -Environment-related norm-based breaches
Manager selection and monitoring	The Church Pension Fund favours asset managers who comply with and report transparently on climate change principles.	-Share / number of managers with climate change principles and transparent reporting based on TCFD-recommendations
	The Church Pension Fund favours asset managers who have committed to a carbon neutrality target.	-Share / number of public commitments
Exclusion criteria	The Church Pension Fund excludes direct investments in companies benefitting from fossil fuels.	-Share of strategies implementing exclusionary criteria
	The Church Pension Fund monitors managers' fossil fuel related exclusion criteria.	-Assessment of fossil fuel related investments in the portfolio
Tool 2: Climate solution investments		
METHODS	**IMPLEMENTATION**	**MONITORING AND METRICS**
Thematic funds	The Church Pension Fund increases the share of thematic investments across asset classes.	-Share of thematic funds in the portfolio / asset class
Revenue from green solutions	The Church Pension Fund monitors the green revenues within liquid equities and credit.	-Future development: Monitoring green revenue share in the portfolio based on EU taconomy as well as other related metrics
Tool 3: Engagement		
METHODS	**IMPLEMENTATION**	**MONITORING AND METRICS**
Companies	The Church Pension Fund encourages companies to develop a climate change strategy and related reporting and to set targets for reducing carbon risk.	-Number of climate related discussions with companies, including results -Share of companies with sufficient climate strategy
Asset managers	The Church Pension Fund encourages asset managers to take climate risk into account in their investments and to contribute to companies' climate work.	-Number of climate related discussions with asset managers, including results -Number of asset managers' climate related discussions with companies, including results
Other engagement and co-operation	The Church Pension Fund participates in engagement and climate cooperation with the authorities, decision-makers, organisations, companies and other investors.	-Number of engagement activities, including results

Table 1: Climate tools and indicators used by the Church Pension Fund.

Tool 1: Carbon footprint reduction

Reducing the carbon footprint of the Church Pension Fund includes monitoring the carbon risk in the portfolio, assessing the climate change work of asset managers during the selection and monitoring phase, and applying exclusion criteria to fossil fuels.

- <u>Portfolio carbon risk monitoring</u>
  The main approach of the Pension Fund to monitor the carbon risk of the investment portfolio is an annual climate analysis, scenario analysis and responsibility screening of the liquid equities and corporate bonds. This analysis includes information such as:

  - the carbon intensity of the investments and the weighted carbon intensity[2] (tCO_2e/sales in EUR million)
  - absolute carbon footprint of investments (tCO_2e) Scope 1, 2 and 3 emissions
  - company's revenue share from fossil fuels
  - assessment of the Corporate Climate Strategy (SBT objectives)
  - companies engaged in business related to unconventional fossil fuels
  - the ability of companies to operate in a low-carbon society in the future (Carbon Risk Rating indicator)
  - acute and chronic physical climate risks affecting investments
  - renewable and fossil capacity of the utilities sector (%) in electricity production
  - fossil fuel holdings/reserves (potential future emissions $GtCO_2$)
  - environmental norm violations
  - the share of companies engaged in coal mining operations or fossil fuel business in the portfolio.

  For the time being, the Pension Fund's climate analysis only covers liquid equity and corporate bond investments. The aim is to include other asset classes in the analysis as the analysis tools and indicators in the field develop. For the time being, the Pension Fund monitors the climate change work and reporting of other asset classes through the annual ESG questionnaire.

- <u>Selection and monitoring of asset managers</u>
  The Church Pension Fund makes investments mainly through external asset managers. In other words, the Pension Fund does not in principle analyse individual companies; instead, the identification of risks and possibilities related to climate change takes place mainly at the level of the investment strategy and the asset manager/fund. The Pension Fund favours funds and asset managers that comply with and report transparently on climate change principles. In addition, the public commitment of asset managers to a carbon neutrality target has been highlighted as an important criterion in the selection of funds. The pension fund monitors the climate change work and competence of all its asset managers and funds through an annual ESG survey.

[2] The weighted carbon intensity indicates the CO2 emissions of the Fund's investment objects in tonnes, in relation to sales of EUR 1 million. This figure takes into account the weights of investment objects in the Fund and is comparable between equity and corporate bond funds. The carbon intensity, on the other hand, takes into account the investor's shareholding in the company, but not its weight in the Fund.

- Exclusion criteria
  The Pension Fund avoids companies that have a significant financial risk as a result of climate change and whose activities are not in line with the carbon neutral trajectory. For fossil fuels, the Pension Fund has defined the exclusion criteria used to manage direct investments. In addition, many of the investment funds used by the Pension Fund exclude companies benefiting from fossil fuels.

  The Pension Fund exclusion criteria for **direct investments** are the following:

  - Companies in the mining industry and utilities sector, where more than 15% of the company's revenue comes from coal used to produce energy.
  - Companies in the energy sector where more than 15 per cent of the company's revenue comes from coal, oil or natural gas used to produce energy.
  - Energy industry companies with business related to unconventional fossil fuels (> 0% of revenue): Hydraulic fracturing, arctic oil drilling, shale oil/gas or oil sand.
  - Companies producing and using peat for energy production (>5% of revenue).

  The company may avoid exclusion if it has evidence of reducing the use of fossil fuels. This includes a clear plan to abandon fossil fuels and, correspondingly, to increase the share of renewable energy sources and related projects. These estimates shall be made on a case-by-case basis.

  Most of the **asset managers and funds** used by the Pension Fund have excluded coal mining companies and electricity companies that significantly benefit from coal power from their investment portfolio. Some have even more extensive exclusion criteria in place for fossil fuels. The Pension Fund monitors the exclusion criteria of asset managers and funds and their development through an annual ESG survey. The exclusion criteria for funds are expected to evolve with the increasingly common carbon neutrality targets. The Pension Fund has the opportunity to influence the investment criteria of fund companies as part of a continuous dialogue.

Tool 2: Climate solution investments

The climate solution investments of the Church Pension Fund include selected thematic funds and investing in green solutions.

- Thematic funds
  The Church Pension Fund wants to invest in activities that promote climate change mitigation and adaptation. At the same time, new revenue opportunities will be created. The aim of the Pension Fund is to increase the share of so-called green thematic investments across asset classes. Possible themes include:

  - renewable energy
  - green bonds
  - forests
  - climate change
  - water
  - energy efficiency

- resource efficiency
- green transport
- sustainable farming
- circular economy

The Pension Fund annually monitors the share of thematic investments and related investment commitments of the total investment assets and the different asset classes. The classification of thematic funds is supported by the SFDR Disclosure Regulation, according to which Article 9 funds have a direct positive impact on the environment and society. The aim is that green thematic investments would account for 10% of total investment assets by 2025 (4.4% in 2020).

- Green solutions as part of company revenue
  As part of the work for responsible investment, the Pension Fund encourages asset managers and investment funds to invest in companies that are pioneers in the development of sustainable business models in their sector. The aim of the Pension Fund is to start monitoring the green revenue share of the equity and corporate bond investments when the EU taxonomy on green business is completed in its entirety. In addition, the Pension Fund will continue to study and, where necessary, implement the green turnover indicators developed by other data service providers. The information will be used in the monitoring of the investment portfolio and in continuous discussion with asset managers. The aim is to increase the share of green revenue.

Tool 3: Engagement

Through engagement activities, the Church Pension Fund wants to bear responsibility as an owner and ensure the sustainable development of the investments in the longer term. In order for this to be possible, investee companies must operate on a long-term basis and manage risks in the interests of the owners. If engagement does not produce the desired result with a company or asset manager, the Pension Fund may, as an escalation strategy[3], add the investment object to the monitoring list, reduce investments or sell the investment.

The starting point of the Pension Fund is to engage with companies, asset managers and decision-makers alike in order to promote global climate change objectives. The Pension Fund monitors the number and results of the engagement discussions conducted and reports on them in its annual report on responsible investment.

- Companies
  The Pension Fund encourages companies to develop a climate change strategy and related reporting and to set targets for reducing carbon risk by the following means:

  - Engagement based on the results of the annual climate scenario analysis
  - Engagement based on violations of environmental norms
  - By proactively engaging through various thematic projects

[3] The purpose of the escalation strategy is to attract more attention from the company to the engagement dialogue and its objectives

- Participating in investors' climate initiatives and cooperation forums such as CDP, Climate Action 100 + and IIGCC
- By voting in general meetings in cooperation with asset managers and by promoting ambitious climate objectives.

▪ Asset managers
The Pension Fund encourages asset managers to take climate risk into account in their investments and to contribute to companies' climate work as follows:

  - Engagement based on the results of the annual climate scenario analysis
  - Engagement based on violations of environmental norms
  - Engagement based on the results of the annual ESG survey
  - Through continuous engagement on climate change issues in meetings.

▪ Other engagement and cooperation
The Pension Fund participates in engagement and climate cooperation with the authorities, decision-makers, organisations, companies and other investors. Examples of possible engagement measures:

  - Participation in responsible investment forums such as Finsif and PRI
  - Participation in cooperation at the core of climate change, such as CDP and IIGCC
  - Participation in investor climate initiatives and public statements
  - Participation in climate discussion in the cooperation bodies of pension operators, such as the Finnish Pension Funds and the Finnish Pension Alliance Tela.

4 Climate change work in different asset classes

Climate change tools defined by the Church Pension Fund are used, where possible, in all asset classes. The Pension Fund primarily uses investment funds in its investment activities, and so the evaluation and selection of investee companies is carried out by external asset managers. It is therefore the responsibility of the investment unit of the Pension Fund to select successful, responsibly functioning funds and asset managers as their partners and to cooperate with them to achieve the objectives of the climate change strategy and to develop related activities. The Pension Fund favours funds and asset managers who have set carbon neutrality targets for their own investment activities.

ASSET CLASSES	CLIMATE TOOLS		
	Carbon footprint reduction	Climate solution investments	Engagement
Liquid investments in equities and corporate bonds	X	X	X
Illiquid equity and fixed income investments	X	X	X
Sovereign bond investments	X	X	X
Real estate investments	X		X
Forest investments	X	X	X
Infrastructure investments	X	X	X
Absolute return investments		X	X

Figure 3: Summary of the use of the Pension Fund's climate tools in different asset classes. This entry indicates that the tool is used for the asset class concerned. The use and shape of tools vary by investment.

4.1 Liquid equity and corporate bond investments

In this section, liquid equities and corporate bonds are discussed together because the investee companies are often the same. As regards corporate bonds, it should be noted that green corporate bonds are allocated to certain projects that meet the green criteria. In equity investments, the shareholder has different rights in terms of engagement activities than the corporate bond investor. Participation in the annual general meeting is an example of this.

So far, few companies are carbon-neutral in their activities, and there are few companies offering climate change solutions. Therefore, the most important task of the Church Pension Fund and its asset managers at this stage is to assess companies' emission reduction targets and to monitor and support companies' transition targets. In principle, the Pension Fund **favours companies that will be on a carbon-neutral pathway by 2050** at the latest and encourages other companies to develop their climate work.

The assessment of the transition and carbon neutrality targets of companies may include the following criteria. In terms of the criteria, sectoral and geographical differences must be taken into account.

- A long-term carbon neutrality target at the latest by 2050, based on Science-Based Targets (SBT).
- Short-term and medium-term emission reduction policies according to the 2050 carbon neutrality target.
- The current carbon intensity development is in line with the global carbon neutrality target 2050 (scope 1, 2 and the relevant scope 3 emissions).
- Credible investment plan or business model to achieve objectives.
- Income flows and capital expenditure are in line with the objectives set.
- Clear governance for objectives and the transition.
- Management compensation is linked to the preparation and implementation of objectives and investment plans.
- Scope 1, 2 and relevant scope 3 emissions reporting.

In addition, the aim of the Pension Fund is to **increase investments in** companies and funds offering **climate change solutions** and to **increase the share of corporate bonds promoting green and sustainable development projects**. The EU's green taxonomy activities are part of the assessment of these investments.

The Pension Fund **excludes direct investments in companies that significantly benefit from fossil fuels** and their use (more detailed definition in Chapter 3). The Pension Fund regularly monitors the fossil fuel exclusion criteria for its equity and corporate bond investments. If the investment fund has ownership of fossil fuels, the asset manager must have a clear view of the development of business activities in accordance with the transition objectives. In passive equity index investments, the Pension Fund uses funds that, in addition to other responsibility criteria, take into account companies' transition targets as part of climate change. For equity index funds, the EU Paris-Aligned Benchmark (EU PAB) or EU Climate Transition Benchmark (EU CTB) are preferred.

Engagement is also a key climate tool for the liquid equity and corporate bond investments of the Pension Fund. The Pension Fund encourages *asset managers* to take climate risk into account in their investments and to contribute to companies' climate work.

The aim of the Pension Fund is to directly engage with *companies and sectors* that are not yet on a carbon neutral trajectory and that need support, for example, in reporting on emissions. Engagement is carried out in cooperation with the Pension Fund's asset managers, through investor initiatives or special thematic projects. A central part of planning the Pension Fund's engagement activities is the setting of clear objectives and considering a possible escalation strategy. In its engagement activities, the Pension Fund primarily aims to focus on sectors that play the most critical role in achieving global climate change objectives. These sectors include the utilities, basic industry and energy sector, real estate and construction, and the banking and financial sector. The focus of engagement may also be on selected carbon intensive companies that have a significant weight in the investment portfolio of the Pension Fund, or on companies that otherwise play a significant role in the overall assessment of the climate impacts of the portfolio.

Voting at the annual general meeting in direct shareholdings is a key engagement channel for the Pension Fund. Making or supporting resolutions related to a company's climate work is a possible way of engaging at general meetings. As the Pension Fund's voting at the general meeting takes place in cooperation with the asset managers responsible for segregated mandates, the engagement should be planned together with these asset managers. The Pension Fund will annually assess the AGM participations and voting statistics of the equity funds' holdings, including any shareholder resolutions and voting related to climate change.

4.2 Illiquid equity and fixed income investments

In illiquid equity and fixed income investments, the Church Pension Fund aims at carbon neutrality by **favouring** fund managers who identify and recognize the risks and opportunities associated with climate change mitigation and adaptation to climate change. The Pension Fund **encourages** fund managers to take climate considerations into account as part of their investment and engagement practices, to set carbon neutrality targets for their activities and to report on the potential financial risks and opportunities of climate change in the investment portfolio (according to the TCFD reporting framework). The Pension Fund monitors the progress of the climate work carried out by fund managers through the annual ESG survey.

Illiquid fixed income investments also include the impact investments of the Pension Fund. Impact funds target investments aimed at generating measurable positive social and environmental impact alongside financial return. Some of the impact funds are directly linked to climate change actions (UN SDG 13). Impact investments enable the Pension Fund to channel funding particularly to developing countries and projects that promote local climate solutions and improve people's means of support in the transition phase for climate change.

4.3 Sovereign bond investments

The carbon neutrality target for sovereign bond investments means that governmental and public issuers are committed to working to reduce emissions in line with the objectives of the Paris Climate Change Agreement. So far, few countries are in line with these objectives, which limits the investment universe. Climate change commitments and related carbon neutrality targets of developed and developing countries may differ from each other or have not yet been set.

The Church Pension Fund, in cooperation with its asset managers, strives to **assess issuers' climate change commitments**. The aim is to **encourage** asset managers to integrate climate aspects into investment decision-making and, in particular, to take into account the impact of climate change commitments on issuers' long-term risk profiles. Public scoring models and index data can be used in assessing governmental climate change commitments.

In addition, the Pension Fund takes into account climate solutions from **green and SDG bonds** as part of its carbon neutrality target and encourages such issuances to be increased. The Pension Fund's toolkit also includes **engaging** with asset managers, government decision-making bodies and other decision-makers.

4.4 Real asset investments

Real asset investments of the Church Pension Fund include real estate, forest and infrastructure investments.

4.4.1 Real estate investments

Construction and real estate account for up to 40% of global energy consumption and greenhouse gas emissions, and this sector therefore plays an important role in achieving global carbon neutrality targets. In real estate investments, the carbon neutrality target means that the energy efficiency of properties will be improved, and renewable energy will be adopted. Green criteria should already be taken into account in the planning phase of new construction. Environmental certificates for properties, such as BREEAM and LEED, support sustainable construction. *Physical risks* caused by climate change, such as extreme weather events, can have a significant impact on real estate assets and should therefore be taken into account as part of the risk assessment.

Direct real estate investments

The carbon footprint of the Pension Fund's properties includes carbon dioxide emissions resulting from the heat, electricity, cooling and water consumption of the properties and from waste from the use of the property. Carbon dioxide emissions for properties consist mainly of energy consumption from electricity and heating, which can be reduced by improving the energy efficiency of the properties. The aim of the Pension Fund is to reduce CO2 emissions from direct real estate investments so that the **heat used by all properties will be emission-free by 2025**. The electricity used by the Pension Fund's properties is already emission-free. In the future, the Pension Fund will monitor carbon dioxide emissions from real estate waste and the related compensation possibilities.

In the acquisition phase of real estate, the Pension Fund commissions the necessary due diligence assessments, also taking responsibility aspects into account. Assessments cover matters related to features such as soil, energy efficiency, administration and the background of main tenants. Sustainable transport, the location of the site from the perspective of public transport and the management of life-cycle costs are also assessed. In addition to these issues, it is possible to take into account other innovative solutions and to prepare life cycle calculations for new construction projects.

The Pension Fund consistently promotes the responsibility and climate aspects of real estate investments. The starting point is that each property is in good condition in terms of basic systems and adjustments and works efficiently and according to plan. The aim of the Pension Fund is to monitor the consumption data of all properties on a regular basis (e.g. electricity, heat, water, waste). If deviations are observed during monitoring, the reasons for the deviation and the measures that can be taken to reduce consumption will be examined. Environmental certifications are favoured if they can be implemented, for instance, in the case of a new construction project. Engaging with the tenants also plays a key role in reducing emissions, and a section on taking responsibility aspects into account is added to new rental agreements. In the future, the aim is to plan a coordinated tenant satisfaction survey for all tenants.

<u>Real estate funds</u>
The Pension Fund consistently promotes the responsibility and climate aspects of real estate funds. In the selection and monitoring of real estate funds, the Pension Fund takes into account how the fund manager has included climate change aspects in the investment process and management of properties. The Pension Fund **encourages** fund managers to **set carbon neutrality targets for their investment activities**, which include concrete measures such as reducing CO_2 emissions from real estate properties and improving energy efficiency. The Pension Fund **monitors the progress of the managers' climate work** annually with the support of the ESG survey for real estate funds and the funds' GRESB reports.

4.4.2 Forest investments

Forests play an important role in climate change mitigation. Forests and other types of biomass bind carbon dioxide from the atmosphere and act as significant carbon sinks. On a global level deforestation, for example due to construction and the expansion of agriculture, is one of the main sources of greenhouse gas emissions. The physical risks posed by climate change, such as extreme weather events and changes in the average temperature, can have a significant impact on forest assets.

The objective of the Pension Fund's climate strategy is to **increase investments in climate solutions**, or so-called green investments. Forest investments are included in this investment category. A green classification is not self-evident for forest investments as the carbon sink effect of forests should be increased from the perspective of climate change mitigation. In practice, the growth of the trees must be greater than the removal. Areas where no forest has grown may also be afforested. In addition, sustainable forest management can improve the carbon balance of forest investments. The better the forests grow, the more they also bind carbon dioxide from the atmosphere. By growing high-quality timber, carbon will later be bound to products that are as long-lasting as possible, such as construction materials. The EU's green taxonomy activities are part of the assessment of forest investments.

Preserving natural values is part of overall sustainable forestry. Forest certificates, such as FSC and PEFC, can ensure responsible forest management and the preservation of biodiversity. The objective of the Pension Fund is a 100% certification rate for all forest investments. In the long term, at least 5 per cent of the forest land surface area will be excluded from full economic use, as required by the FSC criteria. Sites of particular value under the Finnish Forest Act are automatically protected.

As the owner of forest investments, the Pension Fund aims to act as a long-term owner and to manage the forest responsibly. Taking biodiversity into account on forest properties is an important starting point, and forest growth and carbon sequestration calculations are made annually. Green energy production can be promoted, for example, by renting land to responsible wind power construction operators. Forests also play a role in promoting the well-being of people, and the recreational use of forests must be taken into account in a variety of ways.

4.4.3 Infrastructure investments

The construction and use of infrastructure projects will have significant impacts on the environment and society in terms of emissions, the use of raw materials and the shaping of local environments. The life cycle of infrastructure investments is long, so it is also necessary to take into account factors related to sustainable development in the investment analysis. These factors include the physical impacts of climate change, changes in environmental legislation, demographic trends, the exhaustion of natural resources, biodiversity and societal crises and conflicts. Different infrastructure projects have their own challenges and opportunities to anticipate and meet the aforementioned future scenarios.

In infrastructure investments, the Church Pension Fund aims at carbon neutrality by **favouring fund managers who recognise the risks and possibilities associated with climate change mitigation and adaptation to climate change**. In new infrastructure investments, the main focus is on renewable energy and related solutions. The Pension Fund **avoids investment strategies that are significantly exposed to the risks of climate change**.

4.5 Absolute return investments

In absolute return investments, the Church Pension Fund aims to determine how fund managers take climate considerations into account in their operations as part of their investment activities. The Pension Fund **encourages** funds and their target companies to report on the financial risks and possibilities of climate change according to the TCFD reporting framework. The annual ESG survey is an important tool for the Pension Fund to communicate on its expectations and to encourage systematic development of responsible investment practices. The asset class also includes thematic funds that aim to benefit from the opportunities offered by climate change. The Pension Fund monitors new thematic investment opportunities as the product universe develops.

5 Climate reporting

The Church Pension Fund reports annually on the progress of its activities and objectives under the Climate Change Strategy. This reporting is part of the annual reporting on the responsible investment of the Pension Fund, which is approved annually by the Board of Directors of the Church Pension Fund. The Pension Fund reports on climate change according to the TCFD recommendations. TCFD (Task Force on Climate-related Financial Disclosures) is an expert group set up by the G20 Financial Stability Board that has prepared voluntary recommendations on climate change reporting for companies and investors. The TCFD recommendations cover issues related to climate change from the perspective of governance, strategy, risk management, metrics & targets.

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