

Adopted by VER's Board of Directors, 26 April 2023



## Climate Report 2022

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# Climate Report

## 1. Introduction

The State Pension Fund (VER) is a state-owned pension investor which is tasked to contribute to future pensions and equalise the cost arising out of pension expenditure. VER's activities are based on long-term objectives, and responsible investing and sustainability lie at the core of VER's investment operations. Under the Act on the State Pension Fund, VER is required to ensure that the investments it makes are secure, profitable, sufficiently liquid and appropriately diversified. As a governmental pension fund, VER must give due consideration to climate change as part of its long-term investment activities.

As VER finds it necessary to develop its sustainability reporting in response to the evolving operating environment, it has decided to release its own climate report. The Task Force on Climate-related Financial Disclosures (TCFD), an expert group appointed by the G20 Financial Stability Board, has issued global reporting guidelines for financial reporting by companies and investors on climate-related risks and opportunities faced by companies and/or investors. The TCFD's reporting guidelines cover climate-related topics in areas such as corporate governance, strategy, risk management, metrics and targets. A common reporting framework contributes to a better understanding of climate risks and facilitates comparison across industries, increasing business owners' understanding of the impacts of climate change on their operations. VER's climate reporting draws upon the TCFD's recommendations, where applicable.

## 2. Corporate Governance

*This section provides a description of how VER's management assesses and manages climate-related risks and opportunities at the portfolio level. Additionally, it defines the Board of Directors' responsibility for climate-related issues.*

VER's long-term investment policy is determined by VER's Board of Directors. The Board approves an investment plan and a risk management plan annually. Additionally, the Board adopts the Principles for Responsible Investing which are updated annually at the same time as the investment and risk management plans. VER's Principles for Responsible Investing address not only the climate risks but also other sustainability risks. The principles are also submitted to the Investment Consultative Committee for the review of the investment plan. Matters related to responsible investing and sustainability are addressed by the Board at least every quarter. During 2022, VER updated its Principles for Responsible Investing and amended its policy regarding shareholder control. These are the primary tools that VER uses to steer responsible investment activities and climate action.

VER's executive management and management team monitor the various themes related to sustainability while developing VER's responsible investment activities. VER's executive management determines the execution policies serving as a basis for issuing instructions and developing practical procedures. A few times a year, VER's management holds discussions focused on sustainability matters, followed by practical implementation by teams tasked to improve performance in the various areas.

VER's sustainability analyst is responsible for developing VER's sustainability policy in consultation with VER's management and the management team. Portfolio managers monitor the sustainability performance of their portfolios implementing VER's Principles for Responsible investing. Investment teams and Risk Management Committee review the climate report prepared by an external service provider on a quarterly basis. VER's portfolio management, executive management and sustainability analyst engage in a dialogue with companies and asset managers on sustainability-related matters.

### 3. Strategy

*This section outlines the impact of current and future climate-related risks and opportunities on VER's operating environment, strategy and financial planning.*

Climate change will have a range of material economic impacts on markets and industries. VER believes that climate change will prove to be one of the biggest global megatrends in the near term. Climate change affects all asset classes, creating risks and opportunities. Climate change risks are the most critical in sectors with high greenhouse gas emissions, such as industrials, energy and utilities.

Climate-related risks will have a significant effect on the future investment environment and the impact of these risks will be reflected in policy decisions and market mechanisms. VER expects the international climate policy to tighten in the near future, creating new opportunities and risks for investors. VER's mission as an investor responsible for investing pension assets securely and profitably compels it to consider climate change as part of the big picture.

The TCFD divides the risks caused by climate change into transition risks and physical risks. Transition risks are the risks associated with the transition to a low-carbon economy through regulatory changes, technological advancement, market behaviour and reputational risks. Physical risks are risks caused by climate change directly. The physical risks are subdivided into chronic and acute risks. On the flip side of risks, there are also opportunities for generating returns. Companies that develop technologies to mitigate and adapt to climate change will benefit from it.

Companies with high carbon intensity have a greater carbon risk, which means that they face a higher transition risk in pursuing a carbon-neutral economy. Transition risks will materialise if climate policy, changes in consumer behaviour and technological advancement make high-emission business models economically unviable. VER uses carbon footprint and carbon intensity to identify transition risks. Of the companies operating in high carbon-intensive sectors, it is important to identify those with potential to reduce carbon intensity. One long-time risk identified by VER is the increasing price of using coal.

VER set its first carbon footprint target in 2019, after which it has been reviewed annually. Additionally, on 3 February 2020, the Finnish Government adopted a roadmap for achieving the national carbon neutrality target. At this juncture, VER mapped out the carbon footprint of its investments and drew up a plan for measures to reduce the carbon risk of its investments.

In its 2022 Principles for Responsible Investing, VER added a new climate target to achieve a carbon neutral portfolio by 2050. Efforts are made to reduce the carbon footprint of the portfolio in order to improve long-term returns and diminish risks. VER's another objective is to reduce the carbon intensity of its entire equity portfolio by 30% by the end of 2025, and by 50% by the end of 2030 relative to the 2019 level. Steps will be taken to keep the carbon intensity of the liquid corporate bond portfolio below the benchmark index. As part of its objective to reduce the carbon footprint

of the entire portfolio, VER will explore the possibility of measuring and setting a target for the carbon intensity of illiquid investments.

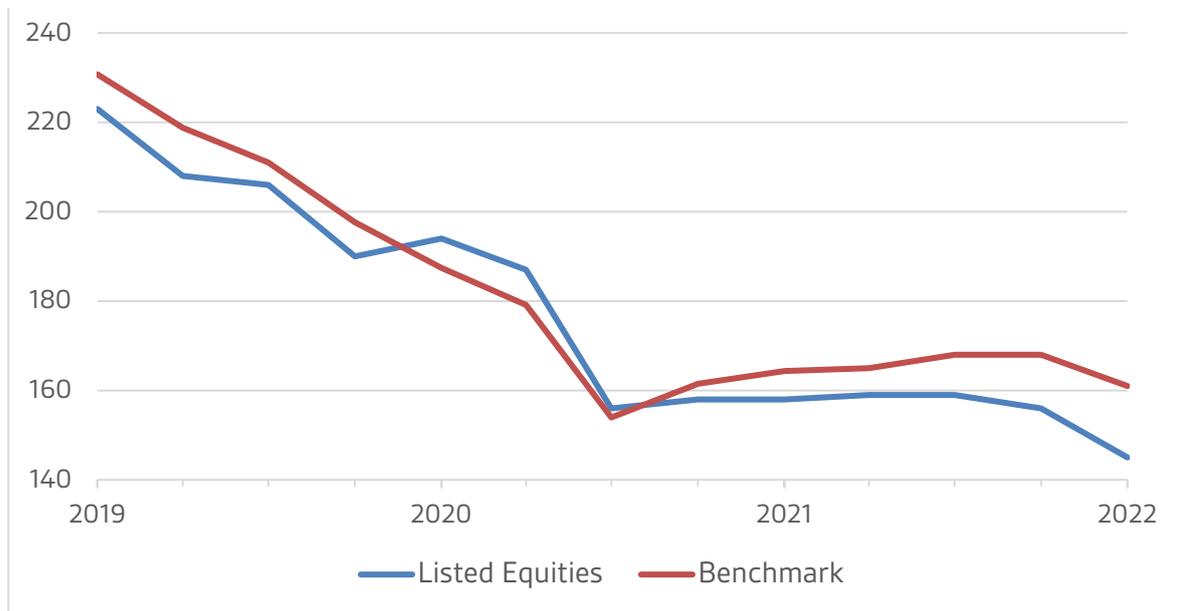
## 4. Targets and Metrics

*This section describes the metrics used by VER and the progress made in attaining the climate targets.*

VER finds it important to establish tangible and measurable targets. VER recognises the climate risk as a significant sustainability risk, which it monitors by measuring various climate indicators. Over the past few years, VER has put in place a reporting system and a set of metrics and is seeking to extend it to other asset classes beyond listed equities and liquid corporate bonds at the same pace as emission data evolves.

The figures related to the carbon footprint of the portfolio have been determined on the basis of the data provided to VER by an external service provider. The carbon footprint of VER's portfolio has been determined separately for listed equities and liquid corporate bonds. In setting climate targets, VER uses the weighted carbon intensity recommended by the TCFD. VER's long-term objective is to achieve carbon neutrality in the entire portfolio by 2050. The timeframe for attaining this objective was chosen in view of the globally dispersed nature of VER's portfolio and the geographical diversity of each country's carbon neutrality goals. More detailed information on the targets and limitations is provided in VER's Principles for Responsible Investing.

**Graph 1. Weighted average carbon intensity of VER's listed equities portfolio 2019–2022**

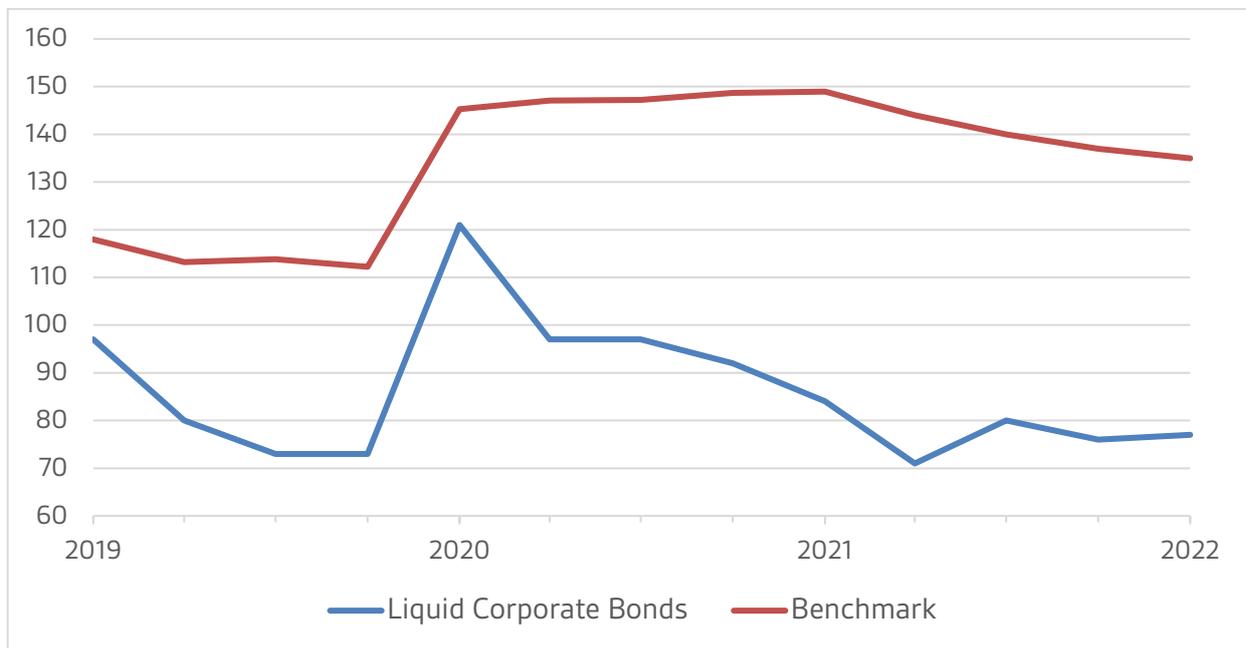


Carbon Intensity	2019	2020	2021	2022	Δ (2022 - 2019)
Listed Equities	223	194	158	145	-35,0 %
Benchmark	231	187	164	161	-30,3 %

VER's short-term objective is to reduce the carbon intensity of its listed equity portfolio by 30% by the end of 2025 relative to the 2019 level, while the medium-term objective is to reduce it by 50% by the end of 2030. From 2019 to 2022, the weighted average carbon intensity of VER's listed equities decreased by 35.0% and it remained approximately 10% below the benchmark index.

The emission reduction target for 2023 was met, and the 2025 target was reached three years ahead of schedule. However, it is important to note that in the short term, carbon intensity is particularly sensitive to changes in sector weights, so if carbon-intensive sectors perform well, the carbon intensity of the portfolio may increase relative to the benchmark index.

**Graph 2. Weighted average carbon intensity of VER's corporate bond portfolio 2019–2022**



Carbon Intensity	2019	2020	2021	2022	Δ (2022 - 2019)
Liquid Corporate Bonds	97	121	84	77	-20,6 %
Benchmark	118	145	149	135	14,4 %

With regard to liquid corporate bonds, VER's goal is to keep the overall carbon intensity below the benchmark index. The carbon intensity of corporate bonds fell by 20.6%. The weighted average carbon intensity of the liquid corporate bond portfolio is almost 43% less than the benchmark index, so the emission reduction target for corporate bonds was also met in 2022.

As weighted average carbon intensity fails to capture all the climate risks of an investment portfolio, VER also looks at other climate indicators. Table 1 shows the absolute emissions and carbon footprints of VER's listed equities and liquid corporate bonds, along with carbon intensities. The figures include Scope 1 and 2 emissions.

For the past few years, emissions coverage in listed equities has exceeded 95 per cent, whereas the coverage in corporate bonds is still undermined by the low level of reporting by the issuers of high-yield loans.

**Table 1. Climate indicators of VER's portfolio**

Indicator	Listed Equities	Liquid Corporate Bonds
Absolute Emissions, tCO <sub>2</sub> e	768 507	64 358
Carbon Footprint, tCO <sub>2</sub> e / Invested MEUR (EVIC)	90	33
Carbon Intensity, tCO <sub>2</sub> e / Revenue MUSD	145	77
Market Capitalization, MEUR	8 612	1 983
% of VER's Total Assets	39,9 %	9,2 %
Emissions Coverage (Absolute Emissions), %	97,1 %	51,8 %
Emissions Coverage (Carbon Intensity), %	98,4 %	71,1 %

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