INVESTMENT FUND FOR DEVELOPING COUNTRIES

IFU'S CLIMATE POLICY (APRIL 2022)

1. Background

IFU, the Danish state-owned Development Finance Institution (DFI), provides equity, loans and guarantees on commercial terms to private sector investments in developing countries.

The objective of IFU is to promote investments, which support sustainable development in developing countries and contribute to the realisation of the Sustainable Development Goals[1]. With due consideration being given to the interests of developing countries and the special conditions applying to investments in these countries, IFU will operate according to business principles and in close cooperation with the private business sector. IFU will apply relevant international standards for sustainable and socially responsible investments based on intergovernmental agreements, including UN Guiding Principles for Business and Human Rights and work continuously to implement such standards in its investments and procedures.

IFU's overarching ambition is to become **a best-in-class impact investor** that delivers value and impact by mobilizing private and public capital, developing sustainable companies, and supporting development in alignment with Danish foreign policy, Danish development cooperation and Danish strategies for sustainable development[2].

IFU wants to invest to create a world where growing populations live well and achieve their fullest potential within the boundaries of the planet. IFU's investment strategy supports this vision by only making investments, which contribute to building green, just and inclusive economies and provide risk adjusted market returns.

Contributing to building green economies, including climate change mitigation and adaptation, is key to the global green transition and will have a very important role to play in assisting developing countries prosper, increase their resilience, improve local livelihoods and reduce climate-related migration. Common for such investments is that they must be consistent with existing human rights agreements, obligations, standards and principles to ensure equity.

IFU believes that a climate policy must support the Paris Agreement and its goal of holding the increase in global average temperature to 1.5 degrees Celsius[3]. This requires global peak of greenhouse gas (GHG) emissions as soon as possible and rapid reductions thereafter in accordance with best available science, to achieve a balance between emissions and removals in the second half of the century. The current policy is furthermore guided by the UNSGs Roadmap for Clean Energy for All by 2030 (SDG7), while also contributing to achieving global net zero emissions by 2050[4].

2. Objectives and scope of the climate policy

This climate policy is part of IFU's sustainability policy framework, which defines IFU's commitments and how IFU will meet its investment strategy and impact priorities by steering investments towards building green, just and inclusive economies.

IFU's climate policy applies to all new IFU investments. The policy will support the already implemented investment strategy and ensure that IFU substantially contributes to the stabilization of GHG concentrations in the atmosphere at a level, which prevents dangerous anthropogenic interference with the climate system, by financing projects that avoid or reduce GHG emissions or increase sequestration. IFU will continue to invest in climate adaptation to build resilience and reduce vulnerability for countries and populations in areas of operation.

[1] https://www.ifu.dk/wp-content/uploads/2020/07/IFU-vedt%C3%A6gt-30-marts-2020.pdf
[2] https://um.dk/da/danida/strategi%20og%20prioriteter/
[3] https://www.un.org/en/climatechange/paris-agreement
[4] UNSGs Roadmap for Clean Energy for All by 2030 (SDG7)

IFU is also committed to making climate-related financial disclosures in 2024 in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and embed climate risk management at every level of its institution.

IFU has already signed up to industry commitments[5] that call for aligning all new financing with the objectives of the Paris Agreement by 2022 and to transition investment portfolios to net-zero GHG emissions by 2050 at the latest. In addition, this policy requires all new investments to ensure no significant harm to climate change, set a significant volume target for climate finance and deliver a net-zero portfolio sooner than the UNFCC advocates. IFU's specific commitments translate into the following targets:

IFU climate policy targets:

1. achieving net-zero portfolio emissions by 2040 at the latest: IFU will continuously report on the current greenhouse gas emissions in the portfolio and present an outlook for the future, with a road-map towards its target of net-zero by 2040.
2. decreasing 3-year rolling average of carbon intensity measured at sector level
3. having minimum 50% of all new direct investment volume contracted between 2022-2024 qualifying as climate finance
4. screening of all new investment opportunities against do no significant harm on climate impact (mitigation) and risk (adaptation)

3. Operationalising the climate policy

In order to reach the ambitious targets for decarbonisation - including not least achieving net zero emissions of its portfolio by 2040 – IFU will develop scenarios to establish decarbonization pathways for IFU's investment sectors. To ensure a progressive reduction in IFU's portfolio footprint over time, IFU will regularly update its exclusion list and climate finance target as well as invest in carbon sequestration and removal (Carbon Capture, Utilisation and Storage Solutions) to generate negative emissions. As most investments are expected to generate actual emissions, although at a decreasing intensity, IFU will require all high emitting investments to also deliver emissions avoided.

3.1. Direct investments

For IFU to achieve a net-zero emissions portfolio by 2040 and to successfully operationalize its sustainability policy, including this climate policy, IFU screens all its new direct investments in terms of their strategic fit. Their alignment with this policy will be determined as either (i) misaligned, (ii) aligned or (iii) conditionally aligned, where misaligned means covered by the exclusion list, aligned means investments in climate finance or projects outside high GHG-emissive systems, and conditionally aligned means satisfying do no significant harm principles and other requirements as specified.

i) Misaligned:

IFU's exclusion list extends beyond the EDFI harmonised exclusion list[6] on fossil fuels and commitments[7] made by the Danish Government to end both public finance and export promotion for fossil fuels in the energy sector abroad by 1 January 2022. In addition, a few exclusions are drawn from the EIB Group Climate Bank Roadmap 2021-2025. In summary, IFU will not engage in new investments within the following activities:

- Standalone fossil fueled power plants
- Drilling, exploration, extraction, refining and sale of crude oil, natural gas and thermal coal
- Storage, supporting infrastructure (pipelines etc.), transportation and logistics, and services primarily related to fossil fuels.
- Any business using captive coal for power and/or heat generation
- Electricity generation from peat and activities leading to deforestation

[5] https://edfi-website-v1.s3.fr-par.scw.cloud/uploads/2020/11/1.-EDFI-Statement-on-Climate-and-Energy-Finance-Final.pdf
[6] https://edfi-website-v1.s3.fr-par.scw.cloud/uploads/2021/02/EDFI-Fossil-Fuel-Exclusion-List-October-2020.pdf
[7] https://en.kefm.dk/news/news-archive/2021/nov/denmark-ends-public-financing-for-fossil-energy-abroad

- Investments and/or other projects that aim to produce or make use of agricultural or forestry products associated with unsustainable expansion of agricultural activity into land that had the status of high carbon stock and high biodiversity areas
- Biomaterials and biofuel production that make use of feedstock that could otherwise meaningfully serve as food or compromise food security.
- Export-oriented agribusiness models that focus on long-haul air cargo[8] for commercialisation
- Meat and dairy industries based on production systems that involve unsustainable animal rearing and/or lead to increased GHG emissions as compared to best industry, low-carbon standards/benchmarks[9]

ii) Aligned:
All direct investments satisfying the below requirements will be aligned with this policy and qualify as climate finance. Requirements include aligning with established green/climate finance frameworks as the EU Taxonomy[10] and the Common Principles for Climate Mitigation Finance[11] developed by the International Development Finance Club (IDFC) and Multilateral Development Banks (MDBs). Common to both these frameworks is the intention to ensure significant contribution to climate mitigation and/or adaptation, while ensuring no significant harm to other environmental priorities.

IFU's climate policy recognises that a significant contribution to climate change mitigation and/or adaptation can involve the following categories of climate finance:

1. All adaptation projects, i.e. investments that reduce vulnerability to climate impacts and build resilience towards the effects of global warming (e.g. extreme weather, droughts, raising sea levels etc.).
2. Negative or very-low-emission activities, which result in negative, zero or very low GHG emissions, e.g. carbon sequestration in biomass and soils, and most forms of renewable energy.
3. Enabling activities, which are instrumental in enabling other activities to make a substantial contribution to climate change mitigation, e.g. manufacture of very-low emission technologies.
4. Transitional activities, which are still part of GHG-emissive systems, but are important for and contribute to the transition to a climate-neutral economy, e.g. energy efficiency improvements in manufacturing or climate-smart agriculture. Transitional activities will count as climate finance if the solution:
   - Can accelerate the green transition and does not lead to hydrocarbon lock-in AND
   - Does not have an economically and technical feasible lower emitting alternative AND
   - Meets the EU taxonomy technical screening criteria OR
   - If not covered by the EU taxonomy, is at least 20 per cent lower emitting than the most likely alternative (greenfield) or what is being replaced or upgraded (brownfield) AND has an emissions intensity significantly lower than the sector average or performs in the top quartile compared to the rest of the sector.

Projects outside high GHG-emissive systems and not qualifying as climate finance as per the above can still be aligned, but must deliver on IFU's social impact priorities of building a just and inclusive economy or non-climate related green priorities (e.g. biodiversity conservation). These investments must demonstrate no significant harm, follow the IFC performance standards and be consistent with pathways towards lower GHG emissions.

iii) Conditionally aligned
In a developing country context, it is recognised that the transition to a low carbon economy must be fair and just, and that country transitions will vary[12]. This implies that some investments in the poorest developing

[8] Following Eurocontrol's definition, long-haul is taken to be longer than 4 000 kilometres (The EIB Group Climate Bank Roadmap 2021-2025)
[9] For agrifood value chain projects in countries with vulnerable food supply systems, benchmarking of GHG emissions of agro-industry projects on local instead of international best standards is possible on a case-by-case basis. This would apply in particular to smallholder and agriculture microfinance schemes or agrifood industries that target local demand and may involve derogation of general carbon footprint thresholds related to power and heat generation established in this bioeconomy section and under the industry and energy tables above (The EIB Group Climate Bank Roadmap 2021-2025)
[10] https://ec.europa.eu/sustainable-finance-taxonomy/
[11] https://www.eib.org/attachments/documents/mdb_idfc_mitigation_common_principles_en.pdf
[12] dac-declaration-climate-change-cop26.pdf (oecd.org)

countries (LDC and LIC) will not qualify as climate finance, but nevertheless be necessary. IFU will consider such investments conditionally aligned with this policy, if all of the following conditions are met:

- The investment supports National Determined Contributions (NDCs) and long-term low GHG emission development strategies (LTSs)
- The investment does not delay the transition to renewable energy, and the risk of lock-in to emission intensive production is low
- Alternative zero/low emission solutions have been thoroughly examined and are found to be technically and economically unfeasible
- The project is not at risk of becoming a stranded asset
- The project will use best available technology and follow best environmental and social standards and practices[13], including precautionary measures to minimise emissions, and demonstrate clear additionality in the form of pushing the technology frontier beyond what would be the case without IFU's investment

3.2 Indirect finance:
For new indirect investments, IFU will work with its financial institutions and funds to make their finance flows consistent with the SDGs and the Paris Agreement.

Specifically, IFU will require new indirect investments to:
- apply IFU's exclusion list to all new transactions
- be committed to supporting the goals of the Paris Agreement

In addition, IFU will in support of systemic change work with its financial institutions and funds to:
- develop a corporate climate governance matrix as laid out by the TCFD
- develop a plan for portfolio Paris alignment

4. Emissions accounting
During preparation of a new investment, IFU will - with the support of a third-party independent service provider - assess both the project's absolute emissions and the expected avoided or sequestered emissions, when relevant. These assessments build on international recognised frameworks and accounting practices[14]. A detailed GHG accounting methodology paper is publicly available on IFU website.

For practical reasons, IFU will only assess absolute emissions from individual investments, if the project is above DKK 25 million and has an expected emission level above 10,000 tCO2e per year during the lifetime of the project.

Calculated emissions are related to the Scope 1, 2 and 3 emissions of companies and projects in which IFU is investing. The financed emissions are defined in alignment with the "follow the money" principle, meaning that the money from loans and investments should be followed as far as possible, to understand and account for the climate impact in the real economy. Furthermore, to avoid double-counting, the footprint results account for attribution, in accordance with the GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard. The attribution factor is defined so that GHG emissions from loans and investments are allocated to the reporting financial institutions, based on the proportional share of the total financing in the borrower or investee. The attribution factor is then multiplied with the emissions of the company or project.

IFU also annually collects data from its investments on energy consumed and for renewable energy projects capacity installed and actual power generation.

IFU is working towards comprehensively assessing the climate change risks to its investments, both physical and transition risks.

[13] Is interpreted to include IFC Performance Standards, UN Guiding Principles on Business and Human Rights, and OECD Guiding Principles for Multinational Enterprises.
[14] For example, the GHG Protocol, PCAF (Partnership for Carbon Accounting Financials), IFI TWG methodology

This is done with a view to lowering possible short, medium and long-term risks to the investments, as well as identifying climate change resilient technologies and adaptation measures to be put in place as part of the investment.

The physical risk is considered as part of the preparation of the investment, based on local consequences of global warming. The assessment of transition risk is work in progress but will most likely include a shadow price on carbon in IFU’s financial model.

IFU recognises the need for climate mitigation projects to reduce absolute emissions, which is why carbon credits from renewable energy or avoided emissions from REDD+[15] purchased by the project cannot be used to offset emission directly generated by the activity.

5. Reporting on climate

IFU will account and publicly report on climate change in line with international reporting standards and procedures as described in IFU's sustainability policy and operating procedures.

In 2021, IFU assessed for the first time the GHG footprint of its active portfolio, attributed to IFU’s investment share. IFU will repeat this assessment annually to track the emissions financed through IFU investments and relate the result back to the overall commitment of achieving a net-zero portfolio by 2040 at the latest. As the portfolio composition changes over time, annual variations, and even increases in the total footprint, may be observed, yet sector specific average emission intensities should always decline.

IFU is committed to making climate-related financial disclosures in 2024. To deliver on these TCFD requirements, IFU will develop the tools and procedures needed (in 2022) to financially assess (in 2023) and disclose (in 2024).

6. Approval and revisions

The climate policy takes effect on 7 April 2022. The policy will be reviewed by IFU’s Board of Directors on an annual basis in accordance with IFU’s Rules of Procedure.

[15] Reduced Emissions from Deforestation and Forest Degradation