TCFD Disclosure 2021

16/03/2022

FMO
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TCFD DISCLOSURE

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Introduction

Climate action remains one of the key pillars of our overall strategy. FMO acknowledges the need to demonstrate its responsibility and foresight in considering climate issues. This goes beyond assessing the impact of our activities on the environment as climate change may affect customers vulnerable to the material consequences of the transition to a low-carbon economy. We strongly believe that improving the management of climate-related risks and opportunities is a journey and we continuously improve our practices.

Following our 2020 TCFD disclosure, in 2021, we have set up a project structure to implement the expectations of the ECB guide on climate-related and environmental risks. The implementation of ECB expectations will also be in line with TCFD's recommendations as we see a significant overlap between the two. A project structure helps us to coordinate between the several departments involved in the topic of climate risk. Although the scope of the project is limited to implementing the ECB expectations, due to the many and strong relations to other climate-related topics, the project's deliverables are aligned with other activities and initiatives within the bank. This not only includes the development of a climate-risk framework to assess FMO's portfolio and new transactions, but also covers areas such as creating awareness and building knowledge, aligning with other projects and initiatives like developing FMO's climate targets and action plan, assessing steps for increased alignment with the EU taxonomy, setting-up governance, embedding climate-risk in FMO's strategy, updating the risk framework and risk documentation, developing new reports, adjusting existing reports, and developing scenarios and stress-tests. While we aim to fully finalize the ECB expectations by 2022, this year's disclosure provides an overview of the activities and 'distance traveled' so far in relation to the four main pillars of the TCFD recommendations.

Governance

Organizationally, we plan to assign climate-related risk to be part of the roles and responsibilities of the Chief Risk and Finance (CRFO), despite its many relations and overlaps with other climate-related activities within FMO. Oversight will be performed by the CFRO making predominant use of the already existing risk committees since climate-related risk is considered a driver for already existing risk types including credit risk, operational risk, liquidity risks, and others.

In our three Lines of Defense (LoD) model, climate-related risk activities are currently inventoried and described, so that in a later phase, when the climate risk assessment framework has been implemented, they can be assigned to different roles and responsibilities in the 1st, 2nd, and 3rd lines of defense. At the same time, we are also in the process of defining Key Performance Indicators (KPIs), Key Risk Indicators (KRIs), and implementing dedicated climate risk reports as well as changes to existing reports, that will enable effective oversight and management at all levels on climate risk.

Strategy

In our current strategy, climate action has been identified as one of the three top-line Sustainable Development Goals (SDGs) to which FMO can contribute. In practice, this means pursuing a portfolio that delivers positive outcomes on climate mitigation and adaptation. This is aligned with our Sustainability Policy, published in 2017, which states FMO aims to contribute to financing the transition to a green economy in line with the Paris Agreement.

We contribute to SDG 13 (Climate Action) and steer our portfolio toward this objective in three main ways: steering the portfolio toward more climate and environmentally aligned objectives through FMO's Green Label (as described below), measuring, and reporting on our portfolio's GHG emissions, and through the use of exclusions and position statements. In June 2021, FMO issued its Position Statement on Phasing out Fossil Fuels in Direct Investments, where we commit to no longer investing in fossil fuel direct investments with the exceptions of gas-fired power plants and certain distributed power investments for a transition period and under strict criteria. This Position Statement strongly contributes to FMO's climate commitment and toward reducing the risk of stranded assets in the portfolio in the years to come. FMO also signed the Statement on International Support for the Clean Energy Transition at the occasion of the COP26, re-stating its commitment to phase out fossil fuel financing in direct investments. Statement on International Public Support for the Clean Energy Transition – UN Climate Change Conference (COP26) at the SEC – Glasgow 2021 (ukcop26.org).
In 2022, we will publish our climate targets and action plan, as committed to under the Dutch Climate Agreement which will set out our climate targets and action plan for 2030.

Climate-related risks

We define climate-related risks as risks posed by direct exposure to climate change, or indirect exposure through counterparties that may potentially be affected by or contribute to climate change. These include two strongly interlinked perspectives:

1. *An inside-out perspective*, defined as the impact BY FMO and its clients on climate
2. *An outside-in perspective*, defined as the impact ON FMO due to transition and physical risks. *Physical risks* are the risks arising from the impact of climate change, such as extreme weather events and gradual shifts of the climate. As such physical risks are either chronic or acute. *Transition risks* are the risks arising from the uncertainty related to the timing and speed of the process of adjustment to an environmentally sustainable economy; this can materialize through policy and regulation, technology, market, or behavioral changes.

At a transactional level, for all our investments, we identify, assess, and monitor environmental, social and governance (ESG) risks through our risk, compliance, and operational processes. As climate-related risks are becoming more prominent, we are constantly discussing how to improve mitigation and resilience with our customers.
FMO's ESG standards are anchored in our Sustainability Policy, which guides our contribution to sustainable development concerning both development impact and ESG. This is supplemented by our position statements on topics such as human rights, land governance, and coal. We have adopted the IFC Performance Standards as our operating standard. They cover the Assessment and Management of Environmental and Social Risks and Impacts, Labor and Working Conditions, Resource Efficiency and Pollution Prevention, Community Health, Safety and Security, Land Acquisition and Involuntary Resettlement, Biodiversity Conservation, and Sustainable Management of Living Natural Resources, Indigenous Peoples, and Cultural Heritage. Furthermore, we are also guided by the United Nations Guiding Principles for Business and Human Rights (UNGPs), the OECD Guidelines on Multinational Enterprises, the Equator Principles, the International Labor Organization Declaration on Fundamental Principles and Rights at Work, and the CFI Client Protection Principles.

Currently, we already conduct ad-hoc in-depth risk assessments on specific transactions that are exposed to high climate-related risk. However, we are working on a new framework to implement such assessments for our entire portfolio by formally integrating climate-related risk considerations at contracting and monitoring stages of our investment process. This will be done by introducing how climate-related risks affect other existing risk categories in our Risk Appetite Framework (RAF). Moreover, to better understand the short-, medium- and long-term climate-related risks on the organization, especially those generated due to our investments at a portfolio level, we are in the process of undergoing a structured portfolio scan starting with our Energy portfolio. This scan is expected to inform us regarding the different types of physical and transitional risks we are exposed to (in line with TCFD's recommended risk categories). This exercise is expected to be completed during the first quarter of 2022 followed by the portfolio scan of the entire investment portfolio.

Climate-related opportunities

Climate change poses risks to the economies and markets in which we operate. Our customers' performance can be impacted by physical risks, such as acute or chronic weather events, or policy, legal, technology, market, and transition risks arising from the shift to a low-carbon and climate-resilient economy. While this may present investment and business risks for FMO, it also creates opportunities to help customers become more resource and energy-efficient, reduce GHG emissions, transition to low-carbon solutions, and increase resilience to physical climate risk. We continuously assess how this may affect our business over the short, medium, and long term.

We target and track investments that promote our climate and other environmental objectives using FMO's Green Label, which provides guidance and concrete criteria for what qualifies for the standards we have set. To qualify, investments must meet specific criteria which aim to reduce greenhouse gas emissions, increase resource efficiency, preserve, and grow natural capital, and/ support climate adaptation and resilience. Examples of Green labeled investments include climate mitigation and adaptation projects in the energy and agricultural sectors, green credit lines to financial institutions, contributing to the financing of green funds, and supporting the issuance and financing of green bonds.

We also manage public funds on behalf of the Dutch government and together with the UK government that are focused on climate adaptation. These funds - Dutch Fund for Climate and Development (DFCD) and Mobilizing Finance for Forests (MFF) respectively - enable private sector investments in projects aimed at climate adaptation, enhancing climate resilience in developing countries, combating deforestation and other environmentally unsustainable land practices, and targeting climate mitigation activities in the forestry and agricultural sector. The total fund sizes for DFCD and MFF are €160 million and £150 million respectively. The programs' investees are also supported with technical assistance post-investment.

Risk Management

Climate-related risks can be further divided into:

1. Physical Risks, which arise from the physical effects of climate change, either chronic or acute
2. Transition Risks, which arise from the uncertainty related to the timing and speed of the process of adjustment to an environmentally sustainable economy; can materialize through Policy & Legal, Market, Reputation, and Technological changes

Physical and transition risk drivers impact economic activities, which in turn impact the financial system. This impact can occur directly, through for example lower corporate profitability, operational risks, or regulation, or indirectly, through macro-financial changes and via client's defaults. An initial mapping of how physical and transition risks can drive these existing risk categories has already been performed. Some of the examples of the impact on our business are mentioned below:

- Climate-related natural disasters may cause damage to the property and assets of our clients, which can increase our capital or operating costs. This may further increase the underperformance of our clients and is thus a Credit Risk.
- Due to an increase in climate-related natural disasters, insurance premiums are increasing while the availability is coming under pressure. This could lead to both Credit risk and Business Model Risk, as some investment opportunities may not be viable without proper insurance.
- New regulations such as carbon pricing may cause some of our clients to have financial consequences, leading to additional credit risk.
- Some risks can impact us directly. For example, we must now also comply with new disclosure and supervisory regulation. If we do not comply, this can lead to Regulatory Compliance Risk.

To determine the materiality of physical and transition climate risks in our portfolio, we have started to also analyze our exposure across the sectors in which we lend and invest. For physical risks, we are assessing country-level hazards and sector exposures to these hazards. For transitional risks, on the other hand, sector-based analysis has been made looking at our portfolio exposures based on the TCFD recommended risk categories. The results from these assessments will allow us to have a first top-down portfolio level scan, to then be used as a starting point for a more in-depth bottom-up assessment. This approach is also currently being tested and will be further refined in 2022.

We are also embedding tasks and responsibilities in the framework of the existing risk types in the risk management system. Part of the project's scope will be to ensure that existing processes and procedures are updated to factor in climate risk assessment to ensure an adequate risk identification, assessment, management, and reporting in line with the three LoD model. While these risks might already be assessed in the investment cycle, the project aims to improve harmonization, consistency, and integration with the already existing processes.

Metrics and Targets

As mentioned earlier, this year's disclosure is focused on the 'distance traveled' in terms of embedding climate-related risks within the organization. This also applies to the metrics recommended by TCFD. This section contains disclosure on certain metrics like GHG emissions, climate related opportunities, capital deployment, and our thought process on the remaining metrics. As far as the overall target setting is concerned, we will only be able to further identify these once the overall implementation of climate-related risks within the organization reaches completion.

GHG emissions

Measuring and reporting the greenhouse gas (GHG) emissions linked to FMO's activities and investments provides insights into our positive and negative climate-related impact and how to steer our investments towards a more positive impact in the future.

We report on:

- *Absolute GHG emissions from FMO's own operations* associated with heating and electricity used in our office buildings as well as personnel travel. These are naturally much smaller than our financed absolute emissions but show what steps we are taking to reduce our operational footprint.
- *Financed absolute GHG emissions* generated through our investments. These emissions give an understanding of our portfolio's overall climate impact and the opportunity to reduce such emissions.

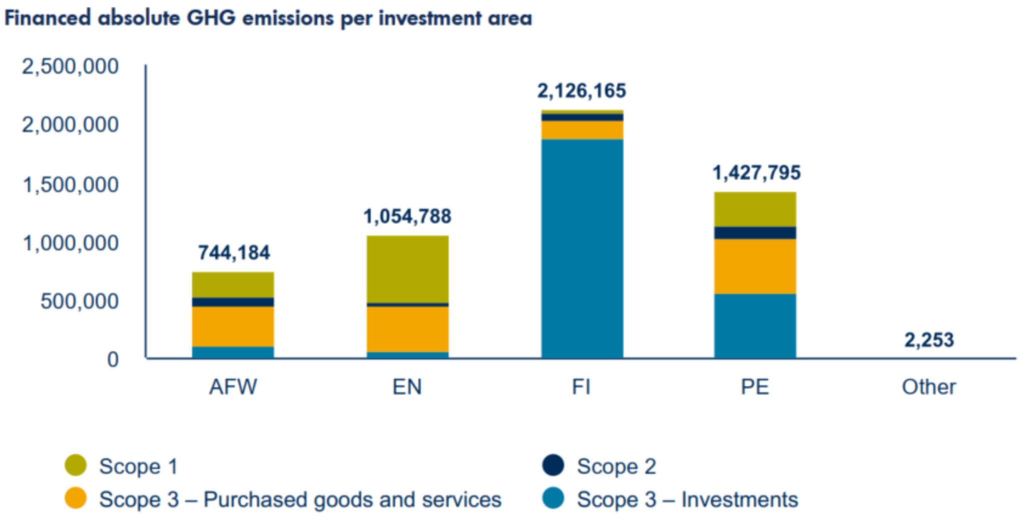
We report on absolute emissions scopes 1, 2, and 3 in line with the GHG Protocol. Scope 1 relates to direct emissions resulting from the activities of an organization or under their control (e.g., a power plant burning gas); scope 2 relates to indirect emissions from energy (electricity, heat, and steam) used by an organization: scope 3 relates to all other indirect emissions in the value chain related to, for instance, business travel or purchased goods and services. The financed absolute GHG emissions are reported in line with the Global GHG Accounting and Reporting Standard for the Financial Industry published by the Partnership for Carbon Accounting Financials (PCAF).

Absolute GHG emissions from FMO's own operations
The carbon footprint of FMO's own operations amounted to 420 tCO2e (2020: 1,309 tCO2e). Scope 1 emissions amounted to 96 tCO2e, which came from cars leased for use by FMO employees. Scope 2 emissions amounted to 30 tCO2e connected to district heating that FMO obtains for its head office. Scope 2 emissions related to the use of electricity were equal to zero since FMO purchases electricity from renewable sources. Scope 3 emissions amounted to 294 tCO2e, mainly from staff travel. As we serve customers around the world, 63% of our own emissions resulted from air travel. The impact of COVID-19 and KYC led to reduced staff travel and office use, which has significantly lowered our carbon footprint compared to pre-COVID years.[1] We made further progress to lower the emissions from our own operations through the renovation of our office in The Hague. FMO offsets the remaining emissions by investing in VCS REDD+[2] certified forestry credits.

Financed absolute GHG emissions
In 2021, FMO's outstanding portfolio resulted in an estimated 5,355,185 tCO2e absolute GHG emissions (2020:4,962,939 tCO2e), of which 1,407,841 tCO2e (2020: 1,612,610 tCO2e) were scope 1 and 2 combined and 3,947,344 tCO2e (2020: 3,350,329 tCO2e) were scope 3. The scope 3 emissions consist of two main GHG Protocol categories: purchased goods and services (1,337,844 tCO2e) related to the production and transportation of purchased products and services, and investments (2,609,500 tCO2e) related to emissions in the portfolios of our customers, which are particularly relevant for FIs. Overall, 91% of emissions were attributed to FMO's own balance sheet, while 9% were attributed to funding from public funds that we manage on behalf of the Dutch government.

The majority of FMO's financed absolute GHG emissions are still estimated through economic modeling via the Joint Impact Model (JIM). While we continue to improve our GHG emission data collection, in many of our markets, such data is not yet readily available. The JIM allows us to have a view of our portfolio and sources of emissions in the interim.

1 The absolute GHG emissions from FMO's own operations do not include any (additional) emissions as a result of employees working from home, such as (increased) electricity use and heating in home offices.
2 VCS is the Verified Carbon Standard, a standard for certifying carbon emissions reductions. REDD+ refers to the focus on Reducing Emissions from Deforestation and forest Degradation, including sustainable management of forests.



In our energy (EN) portfolio, most scope 1 emissions come from the remaining investments FMO has in fossil fuel-fired power plants. When direct emissions data is unavailable, the emissions estimates based on economic models cannot distinguish between different types of energy investments. In particular, this means that scope 3 emissions are likely overestimated for certain investments such as transmission & distribution and renewable energy.

The agribusiness, food, and water (AFW) portfolio is diverse, giving rise to different sources of GHG emissions. Manufacturing and processing of food products lead to CO_2 emissions from energy usage. Primary agricultural production can have significant non-CO_2 emissions such as methane emissions from livestock and nitrous oxide emissions from fertilizers. The AFW portfolio also includes a few financial institutions focused on providing loans to SME agribusinesses, which have scope 3 emissions related to their investments. Emission removals from forestry projects and other activities have not been included.

In the financial institutions (FI) portfolio scopes 1 and 2 emissions are limited as these mainly pertain to the energy use by their office buildings. Most emissions stem from their loan portfolios in sectors such as agriculture, manufacturing, and energy. Within their portfolios, 62% come from their customers' scope 1 and 2 emissions and 38% come from emissions related to their customers' scope 3 emissions from purchased goods and services. Specific use of proceeds (e.g., green credit lines) cannot yet be taken into account in emission estimations due to a lack of data.

The private equity (PE) portfolio contains equity investments in corporates and projects as well as fund investments. One main driver of emissions are the remaining equity investments in fossil fuel-fired power plants. For equity investments in financial institutions and funds, the majority of emissions come from underlying portfolio companies in the energy, manufacturing, and agriculture sectors.

Other climate-related metrics recommended by TCFD

Metric Category	Explanation
Transition Risks	We are currently in the process of conducting a transition risk scan starting with our Energy portfolio to determine the exposure of different energy generation technologies to various transition risk categories as defined by TCFD.
Physical Climate Risks	We are currently in the process of conducting a physical risk scan, based on the categories recommended by TCFD, to consider the portfolio's exposure to physical climate risk in the short-, medium-, and long term.
Climate-Related Opportunities	In 2021, we invested a total capital of €544 million (2020: €466 million), representing 28% of the total investment volume (2020: 25%) towards Green Labelled investments. Of this total, €268 million was invested from FMO A (our own books), €155 million from public funds that we manage, and €121 million from mobilized funds[3].
Capital Deployment	In 2021, a total of €500k operational expenditure was incurred towards the project activities for embedding climate-related risks into the organization.
Internal Carbon Prices	We will further analyze this metric during 2022 and assess if and how to further take this metric into account.
Remuneration	FMO's remuneration structure is not currently defined as such given climate is the core part of our strategy and business model. We don't foresee disclosing or reporting on this metric also in the future.

Climate-related financial impact metrics recommended by TCFD

Metric Category	Explanation
Impact of any material climate-related risks or opportunities on financial performance (e.g., cost, profitability, operating cash flow, impairment)	We are currently in the process of assessing the impact of any material climate-related risks or opportunities on our financial performance. We will be able to disclose information on this metric once climate-related risks are fully embedded into all the pillars of the organization as per TCFD recommendations.
Impact of any material climate-related risks or opportunities on financial position (e.g., assets and liabilities)	We are currently in the process of assessing the impact of any material climate-related risks or opportunities on our financial position. We will be able to disclose information on this metric once climate-related risks are fully embedded into all the pillars of the organization as per TCFD recommendations.

[3] mobilized funds are amounts committed by third parties that are demonstrably mobilized by FMO as well as guarantees provided by third parties on investments on FMO's existing portfolio