ILMASTO-
RAHASTO

Updated 15 January 2024

INVESTMENT POLICY OF THE CLIMATE FUND

1. Introduction

1.1. Objectives and content of the Climate Fund's investment policy

The Climate Fund (Ilmastorahasto Oy) is a wholly state-owned special-assignment company, the operations of which focus on capital investments and other financing activities, and the purpose of which is to tackle climate change, boost low-carbon industry and promote related digitalisation in Finland.

The Climate Fund's investment policy defines and sums up the company's approach to investment, operative investment principles and objectives, funding criteria and categories, instrumentation and investment process, and the principles and objectives of the company's liquid asset management. The Climate Fund's Board of Directors confirms the company's investment policy on an annual basis.

1.2. Regulatory and guidance framework

The Climate Fund's operations are guided by the Act on the Fully State-owned Limited Liability Company the Climate Fund (173/2023), the Limited Liability Companies Act (624/2006), Securities Markets Act (746/2012) and State Shareholdings and Ownership Steering Act (1368/2007). The company also follows the government resolution on state ownership policy as well as other industrial and ownership policy objectives laid down by the State. Where applicable, the company's operations are also guided by national and international treaty obligations as well as national and EU regulations on State aid, the Fund's Articles of Association and the principles of good governance.

The Ministry of Economic Affairs and Employment is responsible for the company's ownership steering and has issued the Climate Fund's operational guidelines. The company's decision-making and oversight mechanisms are described in the Governance Report.

1.3. Framework for determining the investment policy

As a special-assignment company, the Climate Fund aims at fulfilling its mission as efficiently as possible and creating societal impact instead of seeking to maximise its own revenue. However, the company's investments and funding must be self-sustainable in the long term when assessed as a whole.

The Climate Fund's operational guidelines require the Fund to primarily operate on the yield of its capital, such as the return on investments and funding.

1.4. Sustainability in the company's investments

Financial, environmental and societal impact and sustainability are key elements of the criteria guiding the Climate Fund's financing activities. The reporting obligations of investment targets, including with regard to impact criteria, are agreed on in the financing agreements, which lay the foundations for the company's annual reporting, for example. Sustainability in the Climate Fund's operations is described in more detail in both the company's sustainability programme and annual reports.

The environmental sustainability of investment targets is assessed against several criteria, both by the company's own analytics and by third-party experts. One of the three preconditions in the Climate Fund's funding criteria is compliance with the "do no significant harm" (DNSH) principle. The principle is used to identify the essential environmental objectives with regard to the investment targets and ensure compliance with the EU's environmental and climate regulations relevant to those objectives. Each investment target is also assessed according to its emissions reduction potential. The Climate Fund also monitors compliance with the EU's sustainable investment framework, i.e. the taxonomy, even though this is not a precondition for funding. The monitoring of other aspects, such as biodiversity, can also be relevant depending on the investment target.

The company follows anti-money laundering and terrorist financing practices in its investment process by applying customer due diligence analyses of investment targets. If necessary, the company reports any suspicious transactions to the Financial Intelligence Unit.

The Climate Fund requires its client companies to follow applicable tax regulations and best practices in tax matters. In the role of a public funding provider, the Fund seeks to identify cases in which various structures have been used inappropriately to eliminate or reduce tax liabilities.

The Climate Fund's approach to responsibility is described in more detail in the company's Code of Conduct. It obliges the company's contract partners to also follow the principles of responsibility, for example with regard to employee rights and compliance with labour legislation, data security and privacy, and the prevention of bribery and corruption.

When investing the company's liquid assets, the principles of responsible investment are also taken into account.

1.5. Responsibilities, authorities and reporting in investment activities

The Climate Fund's AGM, Board of Directors and CEO are responsible for the company's governance. The company has an executive team tasked with assisting the CEO. The company also has an investment council to ensure a cross-administrative perspective on the company's operations. The Investment Council is not an organ of the company as described in the Limited Liability Companies Act, but a special body that reports to the Ministry of Economic Affairs and Employment on the company's activities and changes in its operating environment.

Each year, the Climate Fund's Board of Directors confirms the guiding principles of the company's investment policy prepared by the Fund's operative management. The Climate Fund's CEO and executive team are responsible both for implementing these guiding principles in the company's operating models and processes, as well as reporting on the company's operations to the Board. The Board is regularly informed of the progress of investment activities and the company's financial standing in order to ensure that policies are appropriate and implemented at the correct time.

The Climate Fund's Board of Directors discusses projects several times as part of dealflow overviews and reviews of the preparation of investment decisions. According to the operational guidelines, the Board makes investment decisions. The Ministry of Economic Affairs and Employment also brings decisions on investments in excess of EUR 20 million to the Ministerial Committee on Economic Policy for approval.

The Climate Fund reports regularly on its finances and activities to the Ministry of Economic Affairs and Employment in accordance with the operational guidelines. The Climate Fund also reports, through the Investment Council, to the Prime Minister's Office, the Ministry of Finance, the Ministry of the Environment, the Ministry of Transport and Communications and the Ministry of Agriculture and Forestry. As with other state-owned companies, the Fund also submits a quarterly report to the Ownership Steering Department of the Prime Minister's Office on the basis of its instructions. The Ministry of Economic Affairs and Employment reports on the Fund's operations to the Ministerial Committee on Economic Pol- icy.

The meetings of the Investment Council primarily address current issues related to the company's investment activities and overall business environment. The Investment Council does not discuss or participate in the making of individual investment or financing decisions.

2. Operative investments

2.1. Funding principles and objectives

The company aims to achieve a full return on invested capital over time and across the portfolio. However, the Climate Fund's operations involve significant risks concerning the return of capital in the case of individual investment decisions, and the time span for the return of capital is long.

The target volume of investment operations was EUR 50 million in 2021 and EUR 80 million in 2022. As demand for financing has stabilised at a level of more than EUR 1 billion, it was decided to increase the target volume of financing decisions to EUR 130 million for the year 2023. However, the operational guidelines have been modified in line with the arrangement concerning state-owned capital investment companies outlined in the programme of Prime Minister Petteri Orpo's Government so that the Climate Fund continues its financing operations during the transition period in 2023–2024 to the extent of the available funds.

2.2. Funding criteria

The company's operational guidelines specify investment criteria and a three-stage assessment model for the Climate Fund, consisting of financial and other preconditions, cross-cutting impact goals and more detailed, investment-proposal-specific impact goals. Funding will only be granted if the investment proposal meets all of these preconditions. The final comparison and choice between investment proposals that meet the preconditions is made on the basis of the Fund's impact goals.

The Climate Fund's Board has approved the following three-step criteria for assessing investment targets.

1. Preconditions
2. Climate Fund impact criteria
3. Investment proposal specific analysis

PRECONDITIONS

Each investment proposal has to meet the Fund's preconditions:

1. Each investment target must have a credible plan with regard to, e.g. the competencies and other financing in terms of its ability to repay the financing pro- vided by the Climate Fund. The Climate Fund's analysis period for profitability may be longer than usual.
2. The Climate Fund's investment is either necessary for the project to be realised in the first place or enables the project's realisation earlier or on a larger scale than it would have been without the investment from the Climate Fund.
3. Compliance with the "Do no significant harm" (DNSH) principle: if implemented, the investment must not cause significant harm to any of the six environmental objectives of the EU's sustainable investment framework:
    - climate change mitigation;

* climate change adaptation;
* the sustainable use and protection of water and marine resources;
* the transition to a circular economy;
* pollution prevention and control; and
* the protection and restoration of biodiversity and ecosystems.

CLIMATE FUND IMPACT CRITERIA

Each investment decision is assessed against the Climate Fund's general impact criteria. An individual mechanism for monitoring and verifying the intended impact is also created before each investment decision.

The Climate Fund's general impact criteria are:

* Emissions reduction potential in Finland and globally.
* Productivity and business potential that the investment package enables, directly or indirectly, for actors registered in Finland. The potential can be assessed with the investment target's business plan, as well as with indicators such as the growth of national RDI inputs, high-value employment impact, or increases in intellectual capital (e.g. patents).

The Climate Fund's assessment process also examines projects' compliance with the EU taxonomy of sustainable investments. The purpose of the EU taxonomy is to channel funding to support more climate- and environment-friendly investments by setting measure-specific criteria for what types of activities can be classified as sustainable. Since the taxonomy mainly covers the sectors that are responsible for the most significant amounts of greenhouse gas emissions and the most common measures, compliance with the taxonomy is not a criterion for the Climate Fund's funding, but the Fund monitors and reports what proportion of its funding complies with the taxonomy.

INVESTMENT PROPOSAL SPECIFIC ANALYSIS

The key aspects for assessing impact and risks can vary widely between investment targets. A proposal-specific analysis can provide more in-depth information about, for example, biodiversity impact, circular economy or the use of natural resources, export potential, social justice issues or potential for leveraging EU funding.

2.3. Investment categories

The operational guidelines state that the Climate Fund's activities focus on combating climate change, boosting low-carbon industry and promoting digitalisation. The Climate Fund's objective is to reduce the carbon footprint and boost the carbon handprint, as well as to promote innovative climate and digital solutions with the aim of reducing greenhouse gas emissions, enhancing the use of natural resources and promoting biodiversity. The Climate Fund may also finance other digitalisation projects, provided that they are at least neutral in terms of their environmental impact and that they can achieve other significant societal benefits.

The operational guidelines require approximately 65% of the Climate Fund's investments to relate to climate change and about 35% to digitalisation. The focus of the Fund's investment activities must be on combating climate change and accelerating the transition to low-carbon industry. The percentage allocation (65%/35%) is an ap- proximate figure and will be considered over the long term. The allocation can be made either in euros or in volume, depending on the future project flow and the sup- ply of financing, for example.

The operational guidelines state that the Climate Fund's primary investment targets are industrial scale-ups of, for example, new technology demonstration projects. The Fund can invest in both private and public projects. The Climate Fund can also participate in various public platforms for enhancing the use of data, and in public-private joint projects.

Within the framework of the operational guidelines, the Climate Fund's Board of Di- rectors has decided to focus the Fund's operations on three investment categories:

1. Facility investments and other climate infrastructure;
2. Scaling up the deployment of climate solutions;
3. Digital climate solutions

Facility investments and other climate infrastructure

The projects in this investment category concern the scaling up of climate solutions to an industrial scale, the commercialisation and scaling up of climate solutions or infra- structure that otherwise enables emissions reductions. Typically, the investment is for capital expenditures (CAPEX).

Facility investment targets are typically companies aiming at a significant expansion of their commercial operations, whose project meets the preconditions of the Climate Fund's funding criteria and produces significant impacts in accordance with the Fund's funding criteria – such as emissions reductions in Finland and globally, as well as high-value business operations and productivity benefits. Infrastructure targets may directly reduce emissions significantly or enable emissions reductions as a test or piloting infrastructure for climate solutions, for example.

Scaling up the deployment of climate solutions

Projects in this investment category involve the scaling up of a technology and/or business model that has been shown to be commercially viable on a small scale to a significant, commercial scale. The investment is typically used as working capital to accelerate sales and entry to the market.

Digital climate solutions

Projects in this investment category concern the development and commercialisation of new digital climate solutions, emissions-reducing features or data platforms.

Projects to be funded must meet the preconditions of the Climate Fund's funding criteria, including a credible plan for revenue streams that will create business that is at least self-sustaining. Projects must also produce clear impact in accordance with the Climate Fund's funding criteria, for example by removing a significant bottleneck in the realisation of emissions reductions by actors using the platform.

2.4. Instrumentation and ticket size

In order to fulfil the purpose of its operations, the company's duty is to allocate equity and debt financing, mezzanine financing, to establish funds and invest in funds, and to purchase, sell, own and manage shares, partner's shares and corresponding interests as well as securities and fixed assets. Leveraging EU funding is also one of the Climate Fund's duties.

So far, the Climate Fund has not offered EU instruments defined as State aid, Therefore, all investment decisions must be determined on a market-base. The market-based nature of each investment by the Climate Fund is ensured by applying existing methods. These can typically include setting a minimum price using the reference interest rate table published by the EU, or financing on the same terms as a private investor. In principle, the Climate Fund also requires a significant amount of other market- based funding (approximately 30%) to be available for projects, but exceptions may be considered if the market-based nature of the funding can otherwise be sufficiently established.

The Climate Fund's risk management policy limits its investment to a maximum of 50% of the total investment and requires a yield to be agreed upon and linked to the funding for each investment target. The yield can consist of an interest rate premium exceeding the minimum rate, a convertible and/or a profit sharing. Furthermore, the amount of the Climate Fund's individual investments is limited so that the Fund can spread its risk over several investment decisions within its annual investment volume. As of 2023, the Climate Fund's investments will, as a rule, be between EUR 4 and 40 million. The lower end of the range is more suitable for digital targets in particular and the upper end for facility investments.

Considering the objectives of the operations, the Climate Fund's Board of Directors has decided to focus, for the time being, on capital loans as the company's primary financing instruments. Investments in funds may also be considered in certain circumstances as well as debt instruments. If necessary, the company may also use other instruments permitted by the Act on the Climate Fund and the operational guidelines.

Capital loans

The interest and principal of capital loans are subordinate to all other debts in case of liquidation or bankruptcy of the company. Principal is repaid and interest paid only to the extent by which the aggregate amount of the company's unrestricted equity and all subordinated loans at the time of payment exceeds the losses recognised on the balance sheet in the company's latest financial statements. In the debtor's accounting, a capital loan does not increase the company's equity but can be added to equity for the purpose of calculating solvency in certain cases.

Debt instruments

The Climate Fund may consider hybrid bonds and junior or senior loans for targets in which the client's financing needs and the limited financing available to the client are specifically related to debt financing and when a capital loan is not the appropriate instrument for the client.

Investments in funds

When investing in funds, the Climate Fund does not invest directly in companies and projects that produce climate solutions but makes its investment through an intermediary that manages the Climate Fund's stake by virtue of a fund agreement or other management agreement. Investing in funds is not the focus of the Climate Fund's operations, and the Climate Fund does not invest in funds co-financed by Tesi or Busi- ness Finland VC. The Climate Fund may act as an anchor investor and/or be involved in setting up funds in cases in which a fund is justifiably the most productive and efficient way to produce impacts in accordance with the Fund's funding criteria. Operating through a fund may help to extend the Climate Fund's financing to a larger number of targets, including targets that are smaller than the focus of the Fund's direct investment operations.

2.5. Target companies

The investment targets consist of private companies, state-owned enterprises and public-private partnerships. The financed projects must meet the preconditions set in the Climate Fund's funding criteria and generate clear impact in line with the criteria.

The focus of the Climate Fund's investment operations is on companies registered in Finland. According to the Climate Fund's funding criteria, each investment target is assessed according to its business potential, productivity benefits and added value that the investment package enables for other registered actors operating in Finland.

2.6. Funding process

The funding process is the Climate Fund's core process. Dealflow management has a pronounced role in its early phases, for example in generating project flow and providing customer service to potential investment targets. Dealflow management and analysis provides an overview of the field of potential investment targets. It also identifies promising investment targets that are in an appropriate stage of development in light of the Climate Fund's funding criteria and picks them out for more detailed analysis.

The investment analysis includes analysing individual investment targets, preparing the investment decision, and managing and monitoring the investment for the project's entire lifespan. The analysis of investment targets is based on the Climate Fund's funding criteria in all stages of the decision-making process. The Fund's operational guide- lines stipulate that every investment must meet the preconditions set in the funding criteria. The final comparison and choice between investment proposals that meet the preconditions is made based on the Fund's impact goals.

The Climate Fund makes significant investments in a wide variety of different solutions. The careful and credible preparation of investment decisions requires bringing in external subject matter expertise to support the investment decisions on individual investment proposals. The validation and assessment of the sought-after impact also frequently requires special expertise in the investment target's field, which the Climate Fund also acquires from outside experts.

The Climate Fund's investment process does not end with the investment decision. Monitoring and reporting on the societal impact sought by the Climate Fund begins immediately after the investment decision has been made. Impact monitoring is carried out as part of the long-term cooperation with investment targets. The actual terms of the investment are also often tied to the realisation or verification of the sought- after impact. In certain cases, the Climate Fund can even take the role of owner for the duration of the investment. The funding process is described below in Finnish (Figure 1).

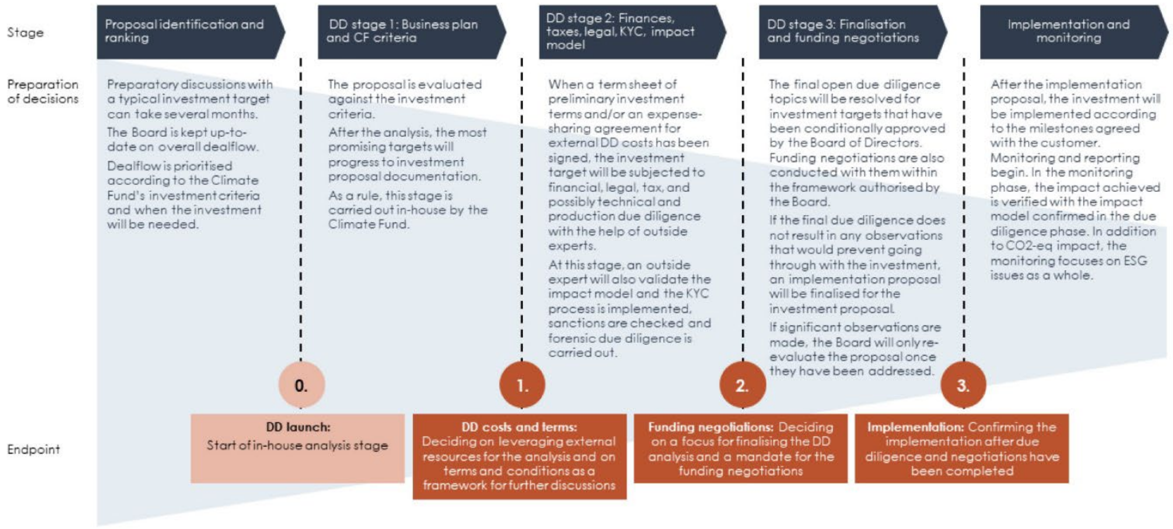

Figure 1Funding process

2.7. Risks and risk management

The company's key risk categories are risks in investment operations, financial risks, strategic risks, administrative risks, and reputational and sustainability risks. The greatest financial risks are related to the financial foundation of the operations during the transition period of the ownership arrangement and to the success of risk management in the company's operative financing activities. It is the task of financial risk management to ensure the continuity and profitability of operations, secure the company's assets and property, and provide the true and fair view of the company's finances and operations required by regulations. The company's risk management approach, processes and reporting are discussed in more detail in its Internal Auditing and Risk Management Guidelines and in the annual report.

2.8. State aid

The Act on the Fully State-owned Limited Liability Company the Climate Fund (173/2023) entered into force on 16 February 2023. The Act allows for the use of state aid in the Climate Fund's financing instruments, but the Climate Fund is not obligated to use state aid under the Act. So far, the Climate Fund has not used instruments that include state aid.

3. Liquid assets

The company shall have sufficient liquid assets available to cover its open investment commitments and operative expenses. At least the amount of funds required to ensure the company's day-to-day operations is always kept on the company's bank account.

Other liquid assets are invested in either bank accounts, fixed-term deposits or low-risk and liquid bond funds, taking into account the company's investment commitments and the liquidity requirements of its investment activities. The goal of these investments is to yield a moderate return.

The liquid assets are distributed over several investment targets to reduce risk. Factors such as the fund's investment policy, counter-party risk, size, liquidity, risk profile, past performance, time span and cost structure are taken into account in selecting investment targets for the Climate Fund's liquid assets.

The principles of responsible investment are taken into consideration when investing assets, and the Climate Fund prefers to invest in funds with a confirmed climate or low-carbon policy or which otherwise seek to minimise the negative climate impact of their investment activities.

The company's management ensures sufficient liquidity, invests the company's liquid assets and realises liquid assets from the investment targets within the investment authorisations issued by the Board of Directors.