Climate change:
At a tipping point

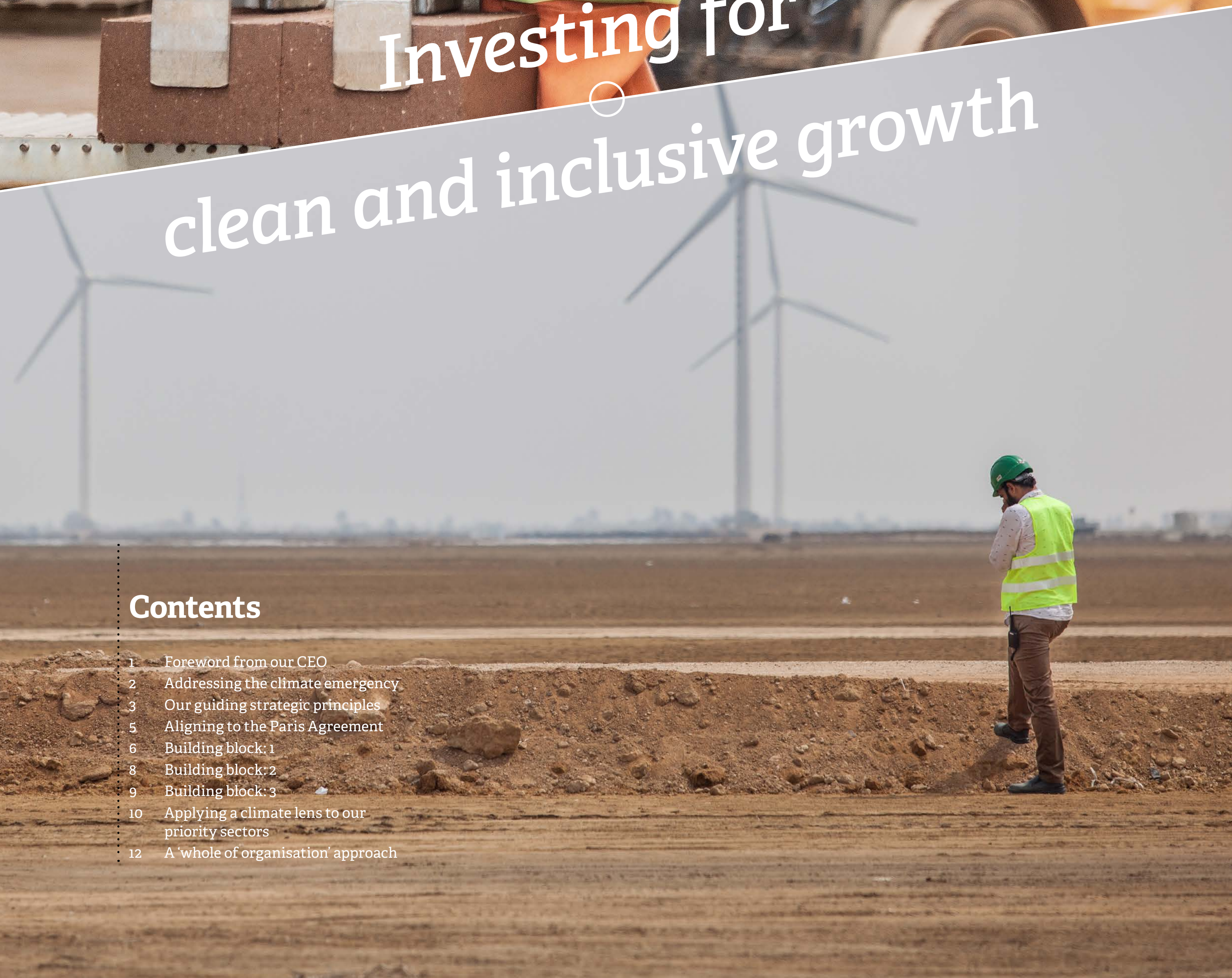
Investing for clean and inclusive growth

Climate Change Strategy

Executive Summary

CDC
Investment works

Investing for clean and inclusive growth



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Nick O'Donohoe

Foreword from our Chief Executive Officer

In the midst of the COVID-19 pandemic, it would be easy not to look beyond the next grim statistic or horrifying headline.

At CDC we are swinging the weight of the whole organisation behind supporting our investee companies and financial partners to fight the economic fallout of the pandemic.

But we must not lose sight of our longer-term commitments and the opportunity. As governments, multinational institutions and private investors plan the global economic comeback from COVID-19, there exists a once in a generation opportunity to build back better for an inclusive, green and resilient recovery. Since 2017, CDC has provided over $1 billion in climate finance. Climate change remains the single largest challenge faced by the planet and is the defining issue for our generation and for those who will follow.

That is why we have launched this ground-breaking Climate Change Strategy that will shape every single investment decision we make moving forward.

As a development finance institution, one of the most important questions this strategy has to answer is: how do we support economic transformation and poverty reduction in a socially just manner that not only delivers on people's needs for prosperity and improved living standards, but also builds the foundations for net zero emissions by 2050 and increased resilience?

This strategy articulates how we will rise to the challenge to deliver coherently on the climate and development challenges by aligning to the goals of the Paris Agreement and deliver on all of the SDGs. In short, how we will support clean, inclusive and resilient growth in Africa and Asia.

So what does that mean in practice? Like any investor, we need to operate within the remaining global carbon budget to limit global warming to 1.5˚C.

This strategy sets out a two-pronged approach to achieve this.

Firstly, we will transform our investment portfolio so that it will reach net zero emissions by 2050. Secondly, we will make an investment only if it supports a country's unique plan to meet its ambition to become a net zero economy by 2050 – a pre-requisite to limit global temperature rises to 1.5˚C.

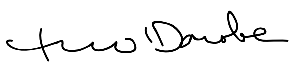
Alongside this, we will invest more of our capital in sectors that deliver on global climate and development goals such as renewable energy and forestry. To kick-start our approach, we have set an ambitious target to invest 30 per cent of our total annual commitments in 2021 in climate finance.

Crucially, we will not make new investments – either directly or through a fund – in fossil fuel sub-sectors that we have classified as misaligned with the Paris Agreement. In the rare cases where we would consider making a fossil fuel-related investment beyond these sub-sectors, it would only be to support a country in its transition to a net zero carbon future.

We will also apply our expertise to create high-value, decent jobs in green sectors to support a transition to net zero in a way that embraces wider development goals.

Staying within 1.5˚C does not mean there will be no negative impacts from climate change, so the final important focus of our strategy is on adaptation and resilience. We will increase our investment in those businesses that increase an economy's ability to adapt to and become resilient to the impacts of climate change. And we'll take a systematic approach to assessing physical climate risk across our investments to help our investees to adapt.

As we recover from this crisis, there could be no better way of putting our investments to work than to create a greener, more inclusive and resilient future for everyone.



Nick O'Donohoe
Chief Executive Officer

Addressing the climate emergency

Climate change is a unique global challenge in terms of scale, urgency, magnitude and complexity of action. From increased flooding and droughts to poor air quality, the effects are complex, severe and are happening now. Without decisive action, it will be particularly devastating for those living in Africa and South Asia.

Put simply, climate change undermines development and affects everything we aim to achieve through our mandate. The development, economic and business cases for climate action are clear. According to the World Bank, climate change has the power to push 100 million people back into poverty in just over ten years. And it will hit communities in Africa and South Asia the hardest. Overall, countries in Africa and South Asia are the most vulnerable to, and the least prepared for, climate change. However, those countries also offer significant opportunities for green economic transformation using new net zero and resilient approaches. From food to energy and manufacturing to construction, right across the economy there are opportunities to make changes that will both meet the challenge of climate change and deliver prosperity within a new, green economy.

These are challenges that must both be met. Countries in Africa and South Asia are tackling the climate emergency alongside other urgent needs, notably the need for economic growth, increased energy access and improved living standards to meet the needs of their citizens and to meet the UN Sustainable Development Goals (SDGs).

Therefore, the key question for CDC as a development finance institution has been: how do we support economic transformation and poverty reduction in a socially just manner that not only delivers on people's needs for prosperity and improved living standards, but also builds the foundations for net zero emissions by 2050 and increased resilience?

Since 2017 we have already taken significant steps towards addressing the climate emergency by committing over $1 billion of climate finance to Africa and South Asia and focusing on renewable energy and resource efficiency across a wide range of investments. However, we want to do more. Through this strategy we will ensure that our activities and portfolio are aligned with the Paris Agreement.

Our goal is to play a meaningful role in tackling climate change, and supporting countries and communities in a successful and just transition to net zero and resilient economies. Our strategy addresses each of these areas.

This Executive Summary describes our key commitments and should be read in conjunction with our full strategy document *'Investing for clean and inclusive growth'.*

The Paris Agreement

This landmark global agreement, reached in 2015 by all 197 parties of the United Nations Framework Convention on Climate Change, has three equally important objectives:

1. to keep global average temperature rise this century well below 2˚C, and to pursue efforts to limit it to 1.5˚C;
2. to adapt to climate change and reduce countries' vulnerabilities to climate impacts; and
3. to align finance flows with countries' pathways to low greenhouse gas (GHG) emissions and resilient development.

It was the first agreement of its kind and succeeded because it allowed each country to set its own emission reduction targets and adopt its own strategies for achieving them. The Agreement puts in place several frameworks to assist developing nations – and the most vulnerable nations – to meet the target.

Read more about how we're aligning with the Paris Agreement on page 4.

Our guiding strategic principles

In developing our strategy, we ensured that it was underpinned by the following key principles.

We will adopt international standards of best practice as a framework

The Task Force on Climate-related Financial Disclosures (TCFD) is recognised as the main international framework for integrating climate change opportunities and risks into the management systems of financial institutions and businesses. We have therefore organised our strategy using TCFD's four pillars: Strategy, Governance, Risk management, and Metrics (see the chart on page 4).

We will operate within the remaining carbon budget

We will operate within the remaining global carbon budget to limit global warming to 1.5˚C. This is line with Article 2.1a of the Paris Agreement which requires all financial flows to be consistent with the goals of the Agreement, including the need for investments that support climate resilience.

We will support economic transformation

The change required to address the climate emergency is not incremental. If we do not make a fundamental shift in how economies and sectors work, we will exceed a 1.5˚C increase in global warming as early as 2030. Therefore, through our activities we will support economic transformation in each country to meet the challenge to be climate resilient and consistent with net zero emissions by 2050. As the UK's development finance institution, we have a specific responsibility to ensure the transformation is socially just for workers and communities, and delivers on the need for economic growth and improved living standards.

We will apply the strategy to the whole organisation

Our strategy is a 'whole of organisation' approach. This is because we recognise the threat that climate change poses to the delivery of our mandate – and our dual objectives of achieving development impact and a financial return. Climate change is the biggest global development challenge we will face over the coming decades, therefore it influences all of our development impact. We must also make financially sound investment decisions to avoid holding stranded assets. To meet these dual objectives, we will implement our strategy across our governance structure, and through our investments across all product lines and all sectors.

About the Task Force on Climate-related Financial Disclosures

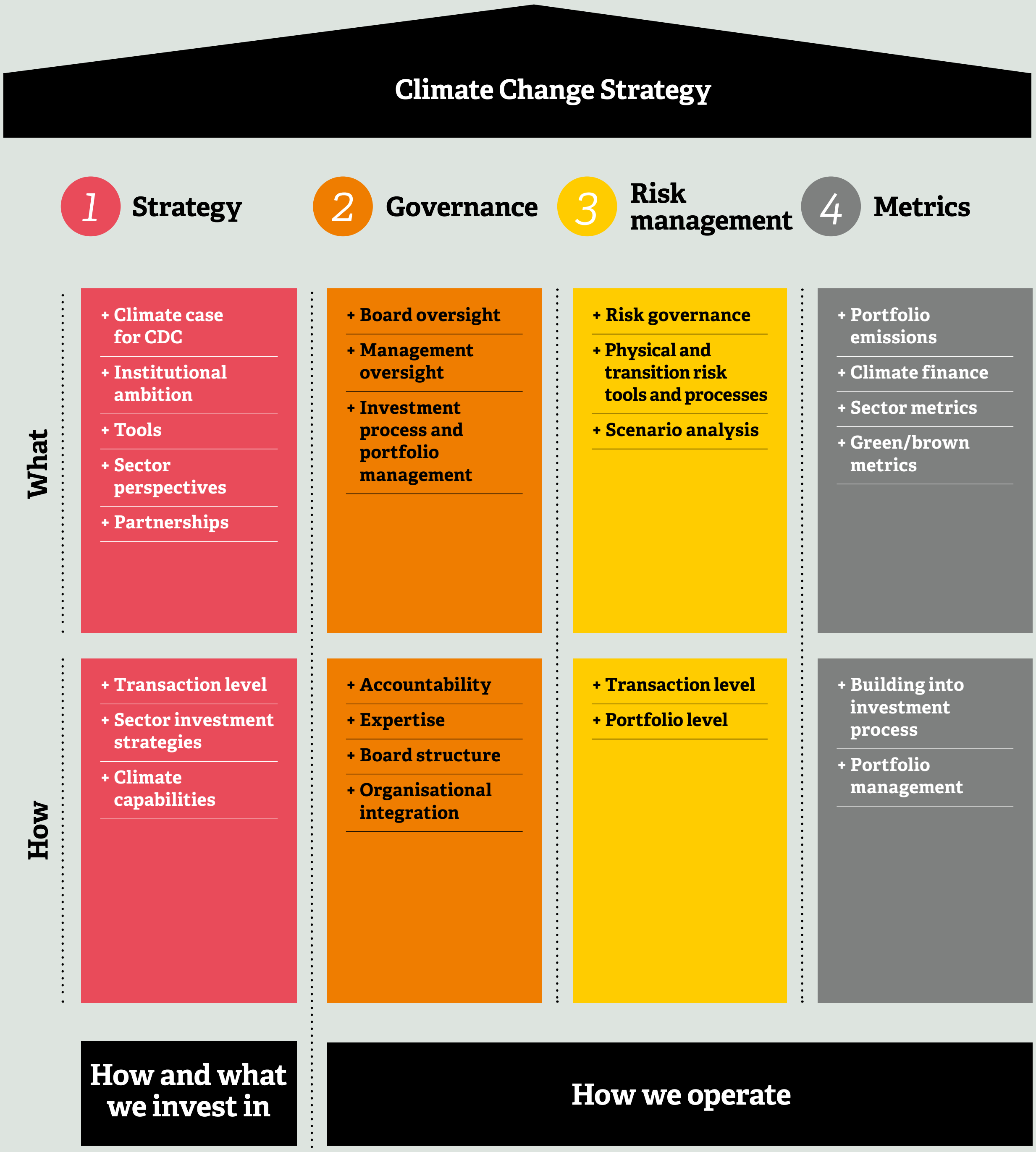
The TCFD is a private sector initiative launched by the Financial Stability Board under Mark Carney's leadership. Chaired by Michael Bloomberg, its membership included a range of industry representatives such as BNP Paribas, JPMorgan, UBS, BlackRock, Moody's, Deloitte, KPMG, Unilever and Tata. The TCFD framework and recommendations published in 2017 provide guidance for financial sector organisations, including asset owners, asset managers, banks and insurance companies, to understand their financial exposure to climate risk and help companies disclose this information in a clear and consistent way. As of February 2020, support for the TCFD has grown to over 1,027 organisations, representing a market capitalisation of over $12 trillion.

We have structured our climate strategy against the four pillars recommended by the TCFD.

This Executive Summary largely focuses on the first pillar, 'Strategy', and covers what we invest in, and how pages 5–11.

There is a brief summary of the remaining three pillars on pages 12–13. You can read further information in our *full strategy.*

Our approach to climate change: using the four pillars of the TCFD

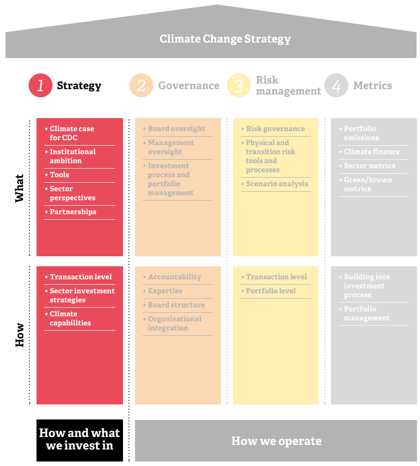


Read more about this on pages 5–11

Read more about this on pages 12–13

Aligning to the Paris Agreement

What we invest in, and how.



African and South Asian countries played a critical role in securing the goal in the Paris Agreement to limit global warming to 1.5˚C, which requires action from all countries. The Paris Agreement also recognises that in developing countries, including those within Africa and South Asia, the current low level of emissions driven by lower economic and public sector activity and lower energy access, for example, means that emissions in these regions will continue to rise in the coming years before they peak and start to fall.

Even so, investment today needs to lay the foundations for reaching net zero emissions by 2050. This is recognised in the Least Developed Countries' 2050 Vision for a climate-resilient future, which seeks to create net zero carbon emissions and prosperous economies "with sustainable growth within ecological limits". It's critical that CDC supports economic transformation in these regions in a way that delivers sustainable, inclusive and resilient long-term growth, and this strategy will guide how we will do this through all our investments.

Our strategy is made up of three building blocks which align our activities and investments with the goals of the Paris Agreement:

1. **Net zero by 2050:** investing for a net zero world, because investment decisions today affect emissions tomorrow.
2. **Just transition:** supporting a 'just transition' to a net zero economy by keeping the creation of decent jobs and skills development at the forefront of the change.
3. **Adaptation and resilience:** strengthening adaptation and resilience of sectors, communities, businesses and people to the effects of climate change.

Our approach to Paris alignment

Paris alignment

Building block: 1

Net zero by 2050

Building block: 2

Just transition

Building block: 3

Adaptation and resilience

Across all sectors

Portfolio with net zero emissions by 2050	Investments consistent with countries' pathways to net zero by 2050	Focus on job creation, re- and upskilling in new low carbon/resilient sectors, aligned with approaches on skills and leadership, gender, and job quality	Increase resilience in our portfolio companies, including a gender lens	Invest in sectors targeted for resilience

Building block: 1

Net zero 2050: investing for a net zero world.

Investing in line with the 1.5˚C temperature goal is the way we can contribute to a net zero world. Our strategy is to decarbonise by not pursuing new investments in some highly-emitting sub-sectors; reducing emissions intensities across sectors, and actively supporting the new technologies and business models needed for economic transformation.

There are two main approaches that investors use to achieve net zero by 2050. Commercial investment firms often take a portfolio approach, while multilateral development banks often take a country pathway approach. We see benefits in both. Therefore, we will be taking a combined approach to achieve net zero. Firstly, we will look at the overall emissions of our entire portfolio, including through direct investments and intermediaries, so that we can make future decisions in the context of our ambition to achieve net zero emissions at portfolio level by 2050. Secondly, for each investment we will consider how it aligns to an individual country's pathway to net zero emissions by 2050.

Decarbonising our portfolio

We will decarbonise our portfolio by employing a 'carbon budget' approach. We will produce a baseline of our portfolio emissions and then develop a methodology to invest towards net zero by 2050. Significantly, we will not offset the emissions of our investment portfolio by buying carbon credits from the market. Instead, we have chosen to reduce emissions across our portfolio and only balance any residual emissions from harder-to-decarbonise sectors by proactively investing in solutions that produce negative emissions, such as forestry.

We believe it is important to contribute to the decarbonisation of the real economy. This means that we will not transfer assets, and consequently emissions, from our portfolio to someone else's. Instead, we will actively support companies to adapt and transform to reduce their carbon footprints.

Supporting individual country pathways

Alongside the portfolio approach, we will ensure that individual investments are aligned with each country's pathway to net zero emissions by 2050. A portfolio carbon budget, on its own, does not sufficiently consider the individual decarbonisation circumstances of each country, and this approach obliges us to consider both the impact on a country as well as the impact on our portfolio.

Supporting individual country pathways *continued*

In Africa and South Asia, country pathways to net zero by 2050 will be different to those in developed economies. While developed economies are focusing on reducing emissions immediately, in many African and South Asian countries, we will see a later peak in emissions as governments tackle important human development needs such as increasing energy access, reducing poverty and improving living standards to meet the SDGs.

What does this mean in practice?

- We are currently baselining our portfolio emissions this year and will use this to develop a carbon budget and roadmap to net zero emissions by 2050. This work will cover each sector in which we invest and will support each country's pathway towards a net zero economy.

- **We will accelerate our investment activity in sectors aligned with the Paris Agreement.** For 2021, we have set a climate finance target of 30 per cent of annual commitments.

- **We will not make any new commitments, whether directly or indirectly, through funds and co-investments in sub-sectors that we have classified[1] as misaligned with the Paris Agreement.** This covers the following sub-sectors: coal-fired power plants (including dual-power plants), retrofitting and rehabilitation of existing coal power facilities, coal mining, processing and trading, upstream oil exploration and production, midstream oil (including refineries), Heavy Fuel Oil (HFO)-only-fired power plants and mini-grids, standalone upstream gas exploration and production as well as transport infrastructure for exclusive crude oil or coal transportation for power generation.

- **We are developing guidance on how to assess alignment with the Paris Agreement and country net zero pathways for sub-sectors that are 'in between' or 'conditional'.** This will cover sub-sectors that can play a role towards net zero economies in certain, but not all, circumstances. As we are committed to working towards alignment with the Paris Agreement, we recognise that this means shifting from a short-term horizon of relative emissions (i.e. a focus on financing lower-carbon alternatives) towards a long-term horizon (i.e. a focus on aligning investments with the remaining global carbon budget). This will establish new parameters for investment decision-making.

That is why we will only pursue investments in gas-fired power stations and gas midstream projects if they fulfil the requirements of our emerging guidance tool to demonstrate alignment with countries' pathways to net zero emissions by 2050 and therefore can be considered transitionary investments to net zero economies by 2050. This approach will allow us to deliver on our development and climate change objectives in a coherent way.

This position will be reviewed as the UK Government's broader approach to Official Development Assistance (ODA) funding for fossil fuels is updated.

For 2021, we have set a climate finance target of 30 per cent of annual commitments.

1 We have used World Resources Institute data/ research to guide our classification of sector alignment with the *Paris Agreement.*

Building block: 2

Supporting a 'just transition': making sure the change to net zero and climate resilient economies is socially inclusive.

The fundamental change to a new green and resilient economy provides an opportunity to build a fairer and more inclusive economy. The just transition agenda champions a transition that seizes the opportunity to be socially inclusive of workers' rights, women and communities, while managing the impact on those workers who will be negatively affected by the move away from particular sectors.

Our focus on a just transition will be to help as many companies and communities to reap the opportunities of the new green economy by focusing on job creation, and reskilling and upskilling for roles in green and resilient sectors in the new economy. We will integrate the just transition agenda into our existing programmes of work that address skills and leadership, gender and job quality.

Addressing the negative effects of job losses in highly-polluting sectors is an important element of the just transition approach, and while this is often best served by national government policy, we will work with other institutions on appropriate research and thought leadership in this topic.

What does this mean in practice?

- We have started to identify green skills needs across our priority sectors in order to develop targeted initiatives. For example, in the food and agriculture sector our investments support agricultural workers to gain adaptation and resilience skills against extreme weather events.
- We will build on the green skills pilot programme developed with Ayana, the renewable energy company we established in India in 2017. Through the pilot programme we supported widespread training of infrastructure workers for the new roles that are being created within the renewable energy sector.
- We are integrating gender considerations into the design of our skills programmes as an important way of securing an inclusive transition.

Building block: *3*

Adaptation and resilience: addressing vulnerability to climate shocks.

Climate change adaptation approaches are those that aim to reduce the risks or vulnerabilities posed by climate change. Climate shocks can be acute (e.g. extreme weather events such as heatwaves, extreme droughts, landslides, hurricanes, cyclones, floods, wildfire, hail) or chronic (e.g. increasing temperatures, sea-level rise, ocean salinisation, glacier retreat, desertification, loss in biodiversity, land and forest degradation). Resilience measures are those that aim to increase the capacity of businesses, communities and people to absorb and adapt to the stress imposed by climate change.

Our approach to this challenge will work on two levels. We will work with our portfolio companies to help identify risks and opportunities, and then implement strategies for those businesses to adapt and be resilient to the changing climate. Alongside this, we will increase our investment into solutions that deliver adaptation and resilience of sectors, businesses, communities and people.

What does this mean in practice?

+ We will develop a more systematic tool for assessing climate risk within individual investments and across our portfolio. We will begin by assessing food and agriculture, construction and real estate, and infrastructure as those sectors are especially exposed to acute and chronic climate risks.

+ We are exploring how to increase our investment into activities and tools that are needed to support adaptation and resilience, including in key sectors such as water infrastructure.

+ Our adaptation and resilience interventions will consider gender implications as women commonly suffer disproportionately from the impacts of climate change and, at the same time, can be critical agents of adaptation and resilience responses.

+ We will start tracking adaptation finance and identify metrics that can assess progress towards resilience to climate impacts.

Applying a climate lens to our priority sectors

The climate emergency, and the three building blocks of our Paris alignment approach, require actions across all sectors and financial products. This presents a clear opportunity to invest for clean and inclusive growth that delivers on the SDGs across all sectors.

We have conducted preliminary assessments of the climate change-related opportunities across each of our priority sectors and products. *The full strategy* identifies climate and development objectives by sector and outlines both our current approach and our future approach in light of the three building blocks. We have also identified potential transition and physical climate risks for each sector (in line with the TCFD).

As well as investing directly (using equity and debt) across all these priority areas, we will also seek to invest in climate-focused investment funds in these areas and, where possible, we will encourage each fund manager to adopt the TCFD as a risk management framework for climate change. Further information about our approach to sectors can be found in our *full strategy*.

In summary, we have so far identified the following priorities for investment:

We will:
- support the development of utility-scale renewables generation capacity;
- strengthen transmission and distribution, and improve grid networks to drive maximum efficiency across the network;
- support decentralised renewable energy solutions such as solar home systems, mini grids, commercial and industrial;
- catalyse technology solutions for climate action e.g. energy storage; and
- ensure that energy efficiency is a cross-cutting theme for all relevant sectors.

We will:
- support urban mobility by moving passengers to more efficient modes of travel;
- consider electric transport infrastructure; and
- consider demand management and logistics efficiency.

We will:
- focus on adaptation and resilience and the circular economy; and
- ensure water efficiency is a cross-cutting theme for all relevant sectors.

Food and agriculture

We will:
- support agroforestry (silvopasture, tropical tree crops, intercropping);
- support food and agriculture infrastructure that reduces losses, such as anaerobic digesters that create biogas; better storage for composting; improved processing and transport; and
- increase our focus within each investment on climate-smart practices and resource efficiency.

Forestry

We will:
- target investments in forestry to generate negative emissions and increase development impact as part of our commitment to decarbonise our portfolio.

Manufacturing

We will:
- invest in clean technology and more sustainable building materials;
- nurture emerging areas, such as the circular economy and distributed manufacturing; and
- support our investees to progressively reduce their carbon footprints as better technologies become more feasible to adopt.

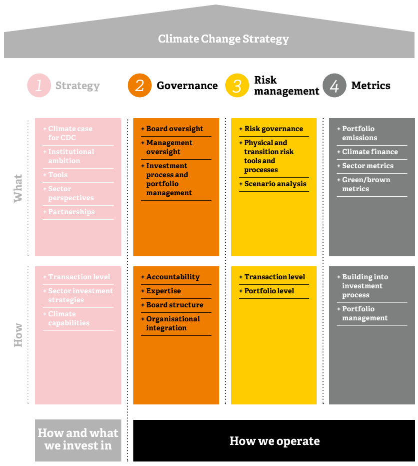
Construction and real estate

We will:
- continue to encourage the adoption of International Finance Corporation Excellence in Design for Greater Efficiencies (IFC EDGE) standards across our investments in buildings; and
- work with developers, portfolio companies and other partners to increase resource efficiency and increase resilience within buildings.

Financial institutions and trade finance

We will:
- explore the development of green products strategies to help local financial institutions support net zero and resilient economies;
- promote the TCFD as a management framework for climate change among our investees (and the wider industry);
- engage our current trade finance partners to enhance existing facilities or provide new support for green technology trades; and
- explore incentive schemes under our existing Master Risk Participation Agreement structures to support trade that has a climate benefit.

A 'whole of organisation' approach



How we operate
Climate change is the biggest global development challenge we will face in the coming decades. In recognition of the scale of the challenge and the threat climate change poses to the delivery of our mandate, we have adopted a strategy that covers the whole of our organisation, covering our investment activity across all product lines and all sectors. It also reaches into our governance structure, risk management and reporting metrics, in line with the remaining three TCFD pillars.

2 – Governance: accountability at the Board and executive management

To make climate change part of the long-term stewardship of a company, it is vital to ensure climate accountability and competence are present at all levels within the Board structure, including the broader Board committee structures.

We have, therefore, made formal changes to our own Board structure so that climate change is considered at Board level, as well as at the relevant sub-committees, including:

+ the Development Committee, which considers and discusses our climate impact; and
+ the Risk Committee, which takes a view of our climate risk at the portfolio level.

At an executive management level, we are introducing further steps to ensure that our Climate Change Strategy both informs strategic investment planning and is embedded within portfolio management processes.

3 – Risk management: enabling informed decision-making

We will follow the financial risk concepts laid out in the TCFD as we believe that understanding climate risk in more detail will help us to make more informed decisions about our future investments and overall portfolio.

We will look at both physical risk and transition risk at a portfolio and investment level.

And we will move from considering climate risk purely as an environmental and social risk at an individual investment level, to a financial risk at an overall portfolio level. This will involve:

+ integrating the TCFD framework of physical and transition risks into our investment and portfolio management processes;
+ embedding TCFD recommendations into our overall risk framework and governance; and
+ over time, taking the first steps towards stress-testing our portfolio in different climate scenarios.

4– Metrics: driving a successful shift

We will measure our progress against the three building blocks of our climate strategy by tracking several portfolio metrics. In future, many of these will be reported in our Annual Reviews and TCFD disclosures.

Net zero 2050: investing for a net zero world

We will:

- measure our financial contribution to climate mitigation by recording our commitments to climate finance (US$ committed per year). We will do this in line with the joint multilateral development bank methodology on mitigation finance;
- measure the amount of capital mobilised into climate mitigation investments; and
- baseline and track the carbon footprint of our portfolio and measure the reduction of greenhouse gas emissions over time, in line with our ambition to achieve net zero emissions at a portfolio level and align with the net zero pathways of individual countries.

Supporting a just transition: making sure the change to net zero and climate resilient economies is socially inclusive

We will measure our contribution to a just transition through the results of our investment-specific pilot projects. From 2021 onwards, we will measure the number of jobs created in green sectors and the number of skills development projects we run.

Adaptation and resilience: addressing vulnerability to climate shocks

We will measure our financial contribution to climate adaptation and resilience through the amount we commit to adaptation finance (US$ committed per year).

You can read more about our approach in these three areas in our *full strategy*.

Physical and transition risks

Physical risks

Physical risks resulting from climate change can be event driven (acute) or longer-term shifts (chronic) in climate patterns. Physical risks may have financial implications for organisations, such as direct damage to assets and indirect impacts from supply chain disruption. Financial performance may also be affected by changes in water (availability, sourcing and quality); food security; and extreme temperature changes that affect premises, operations, supply chains, transport needs and employee safety.

Transition risks

Transitioning to a net zero economy may entail extensive policy, legal, technology and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organisations.

Climate change:
At a tipping point

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