

Sustainable Investment Framework

Municipality Finance Plc



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1 Introduction

MuniFin is one of the largest financial institutions in Finland with a mission to build a better and more sustainable future together with its customers. MuniFin's customers include Finnish municipalities, joint municipal authorities, municipally controlled entities and non-profit housing organisations. In general, MuniFin grants financing for environmentally and socially responsible investments such as public transportation, sustainable buildings, hospitals and healthcare centres, schools and day care centres, and homes for people with special needs.

As MuniFin was established to develop the Finnish welfare state, sustainability is involved in all of MuniFin's decisions and actions. This is in the interest of MuniFin, its customers, shareholders, investors, and the Finnish society. MuniFin is committed to support the UN Sustainable Development Goals in its everyday work.

MuniFin has defined its key principles and goals of corporate responsibility already in 2017. These are disclosed in the Sustainability Policy, which is approved by the Board of Directors (BoD). The concrete meaning of these principles in the practical work of everyone at MuniFin has been illustrated specifically for each business unit. MuniFin has created its own sustainability virtual team that coordinates and promotes sustainability practices across business units.

Likewise, MuniFin Treasury has had sustainability practices in place for several years. This document summarizes the framework for sustainable investing, which is a natural part of Treasury's business and evolving constantly, as new insights and data frequently become available.

2 Overview of investments

MuniFin is a systemically important financial institution (O-SIIs) and directly supervised by the European Central Bank (ECB). MuniFin is by regulation obligated to hold an adequate liquidity buffer to secure efficient business continuity. This buffer consists of the company's liquidity investments and is subject to active portfolio management by the Treasury.

Primary objective in liquidity portfolio management is to preserve liquidity and invested capital, while generating sufficient income from the Net Interest Income ("NII") perspective. In order to achieve this, the portfolio is constructed of fixed income assets issued by Financial Institutions, Sovereigns, as well as Sovereign Agencies and Supranationals. In practice there are no investments in corporate issuers or equities.

MuniFin has chosen to invest only in issuers domiciled in OECD countries, and this rule also applies to the issuer's ultimate parent. This principle defines the base standards for social, economic, and environmental issues of all portfolio investments, and significantly reduces sustainability risks in the portfolio.

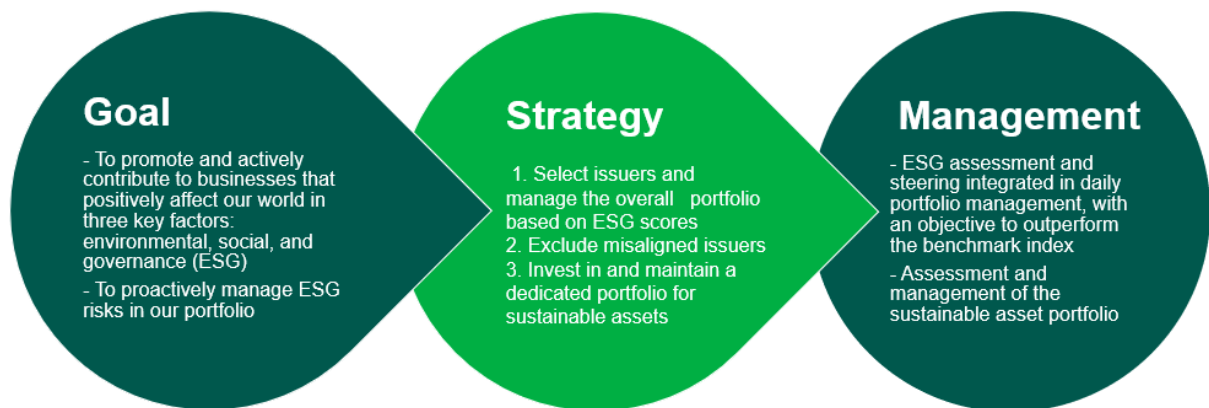
MuniFin has a long-standing commitment to sustainable thematic investing, which is related to the company's tradition of being an active issuer of sustainable bonds already since 2016. Since then, Treasury has actively invested in Green and Social bonds as part of its liquidity portfolio management.

3 Approach to sustainable investing




MuniFin's investment policy approves only fixed income investments that are principally issued by financial institutions, sovereigns and sovereign agencies from OECD countries. This, in our opinion, reduces major sustainability risks in the portfolio, as the OECD supports the United Nations in ensuring the success of the 2030 Agenda for Sustainable Development.

Since MuniFin's ultimate objective is to embed sustainability across all its business areas, Treasury has further set concrete sustainability targets for its liquidity portfolio management. The approach is two-fold; In-depth fundamental analysis and active mitigation of Environmental, Social and Governance ("ESG") risks improve risk-adjusted portfolio performance in the long run. On the other hand, MuniFin aims to encourage issuers and market participants to engage in more sustainable practices. MuniFin has since 2016 been a member of Finland's Sustainable Investment Forum (Finsif), which promotes sustainable investing among Finnish institutions.

Figure 1: MuniFin's approach to sustainable investments



MuniFin promotes its objectives in sustainable investing by applying the following three operational principles:

-  1 Investment /Issuer selection, exclusion and controversy monitoring.
-  2 Applying issuer-level ESG management to the portfolio management process covering the entire portfolio.
-  3 Thematic Investing in sustainable assets that generate direct environmental and social impacts globally.

Munifin believes that each of these principles adds its value and the combination of them constitutes a holistic approach, which helps us to meet our sustainability goals.

3.1 Exclusions and controversy monitoring

An essential part of sustainability management in the portfolio management process is the exclusion of such issuers/investments that violate MuniFin's ethical standards, or operate in controversial fields of business. As explained earlier, MuniFin limits its investments in certain issuer classes from only OECD countries to reduce major sustainability and economic risks. In order to fully assure that all portfolio assets are constantly aligned with the sustainability objectives, Treasury has set the following pre-defined exclusion criteria, according to which misaligned issuers are excluded from portfolio.

Figure 2: Pre-defined exclusion criteria for all issuers in the portfolio

Controversial business practices (principals of the UN Global Compact)	
▪ Violation of ILO labor standards, including child labor and forced labor	✓
▪ Violation of human rights, environmental protection rules, anti-corruption laws	✓
Controversial fields of business	
▪ Outlawed and controversial weapons (ABC weapons, land mines and cluster bombs)	✓
▪ Coal extraction, coal-fired power generation	✓
▪ Arms	✓
▪ Tobacco	✓
▪ Pornography	✓
▪ Controversial gene technology	✓
▪ High risk of addiction (gambling, alcohol)	✓
▪ Animal experimentation for nonmedical purposes	✓
▪ Fracking and tar sands	✓
Countries	
▪ Illiberal states (e.g., restrictions on religious and press freedom)	✓
▪ High level of corruption	✓
▪ Non-OECD countries (applies to all issuers by their domicile)	✓

Treasury manager is responsible for assessing the issuer vs. Exclusion Criteria at the time of applying for a new investment credit line and at the time of investing.

Liquidity portfolio is screened semi-annually with the above filters in order to ensure that investments are continually aligned with MuniFin's values. Misaligned issuers are reviewed in the Capital Markets and Sustainability Management Team where they are either rejected from future investments (soft exclusion) or sold from the portfolio (hard exclusion).

3.2 ESG management

MuniFin's Sustainability Policy states that Environmental, Social and Governance factors ("ESG") must be integrated in the investment process. This policy is adopted by using a benchmark approach, where the ESG score for each issuer is compared against a sustainability benchmark based on a quarterly assessment. The sustainability benchmark is explained in the next chapter.

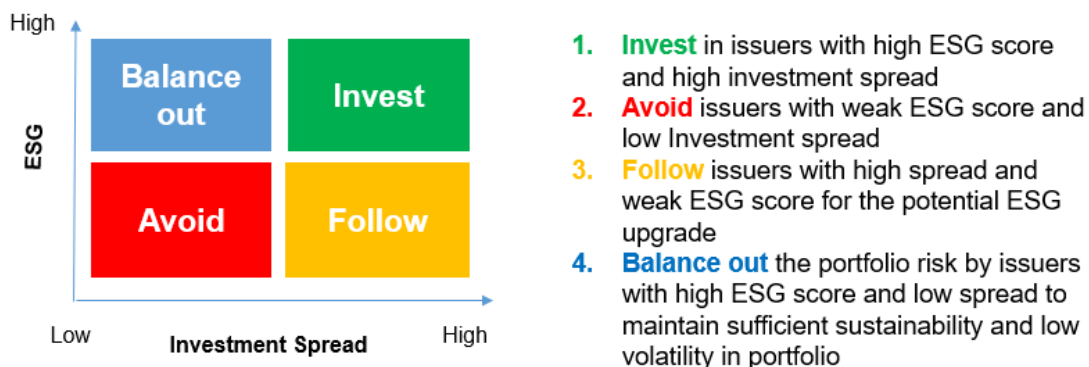
MuniFin has established a material risk indicator for the average ESG score of the portfolio in its Risk Appetite Framework (RAF). The RAF indicator suggests that the average ESG score of the portfolio should be above the sustainability benchmark. This reinforces investing in instruments with an ESG score higher than the benchmark, and ultimately drives towards a best-in-class ESG portfolio.



The portfolio ESG is a material risk measure (RAF) with the following condition:
Portfolio ESG \geq Sustainability Benchmark

Figure 3: ESG assessment as part of investment process

ESG assesment is part of investment process



Treasury manager is responsible for assessing the issuer ESG score at the time of applying for a new credit line and at the time of investing. Furthermore, the portfolio ESG is constantly managed at aggregate level vs. the sustainability benchmark, with the objective to outperform the sustainability benchmark. ESG management is part of the overall risk management process of the portfolio, as it is acknowledged that potential for an upgrade in the ESG score creates more investment value in the future.

3.2.1 Sustainability benchmark and reporting

Sustainability benchmark is composed of relevant market indices replicating the actual portfolio weights in each asset class. The second line of defence (Risk Management) is in charge of overseeing the sustainability benchmark and reporting the portfolio ESG performance vs. benchmark.

Portfolio ESG vs. sustainability benchmark is reported on material risks' dashboard within the RAF risk indicators (governed by the BoD). The results are published on MuniFin's website on a quarterly report.

3.2.2 ESG dimensions

MuniFin receives an ESG score for each issuer quarterly from an external service provider, who has long-standing market expertise in sustainable investing. An external service provider is believed to enable more reliable and comprehensive results than what would be achieved internally. The ESG Scores used in MuniFin measure sustainability holistically in five dimensions:

- ESG management quality: How well are E, S & G aspects managed in companies
- Business Model: To what extent are business areas sustainable in terms of supplying product solutions that foster sustainability and contribute to the achievement of the UN Sustainable Development Goals
- Controversies: To what extent are companies involved in significant controversies
- Consideration of financial materiality by means of putting a stronger weight on those ESG aspects that have a material impact on corporate financial performance

Figure 4: Sustainability dimensions in ESG score calculation



3.3 Sustainable thematic investing

MuniFin wants to promote and support Green and Social projects in its lending operations as well as in liquidity investments. Hence MuniFin has set a minimum size requirement for the sustainable thematic assets at 10 % of the total outstanding amount of MuniFin's sustainable bond funding.

Furthermore, MuniFin seeks to actively address climate change and social controversies, and has therefore set a target for the share of sustainable investments in its liquidity portfolio versus the market index. The share of eligible sustainable assets in the liquidity portfolio shall be significantly above the market rate, which is the share of sustainable assets in a weighted composition of relevant market indices.

Eligible assets may include green bonds, social bonds, or other bonds that provide environmental and social benefits. An additional due diligence is conducted for the sustainable investment selection process to meet internal eligibility criteria. The basic requirement is that eligible assets must be issued in accordance with the ICMA principles and carry a second opinion. The internal criteria for sustainable thematic assets is subject to constant evolution in accordance with changes in market standards and regulation.

MuniFin publishes a quarterly report on the development of sustainable thematic assets vs. benchmark.

4 Governance, roles and responsibilities

The key governing documents of sustainability in investment activities include MuniFin’s Sustainability Policy and the Sustainable Investment Framework. These two documents contain the requirements relating to the principles and practices in MuniFin’s sustainable investing.

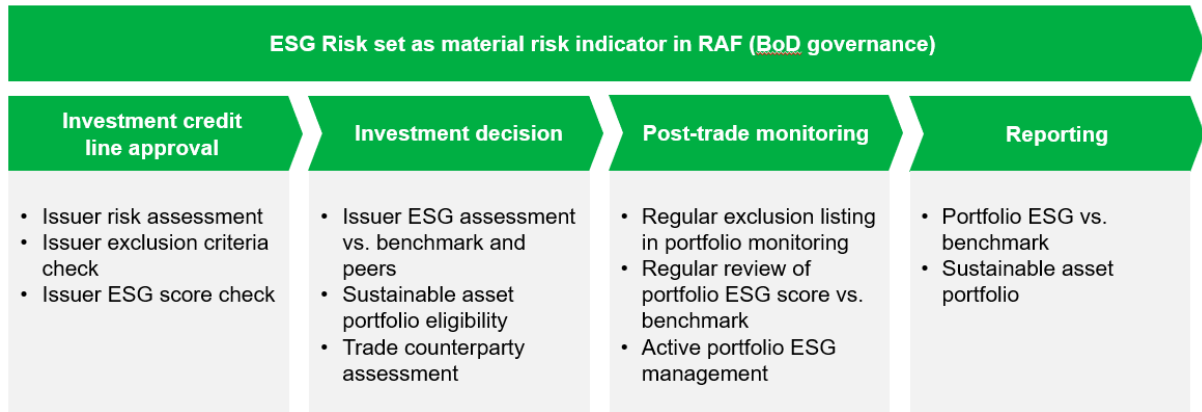
Treasury is responsible for liquidity portfolio management in the first-line of defense, including sustainability analysis and consideration. It considers ESG factors when making investment decisions in the same way it would consider other traditional variables, such as credit- or market risk factors. Treasury assesses ESG factors during each investment decision and manages the aggregate ESG-score on a portfolio level vs. the sustainability benchmark.

Risk Management & Compliance monitor the liquidity portfolio’s ESG score (in relation to the benchmark) and the portfolio exclusion listing, as the second-line of defense. They also ensure that sustainable investment management practices comply with regulation and internal requirements.

Figure 5: Sustainability governance model in MuniFin

	Purpose and key contents	Approval
Sustainability Policy	<ul style="list-style-type: none"> • Defines and governs sustainability throughout the whole company • Sets out requirements for ESG considerations in investing and for the direct sustainable assets • Sets first-level criteria for approved counterparties 	The Board of Directors
Sustainable Investment Framework	<ul style="list-style-type: none"> • Sets out the responsibility and sustainability practices for liquidity investing 	The Capital Markets Management Team
Sustainability Team across business units <ul style="list-style-type: none"> • Coordinates and guides sustainability development • Gives opinion on sustainability issues 	Treasury <ul style="list-style-type: none"> • Responsible for the strategy and operational execution of portfolio management according to the governing policies and guidelines • Responsible for operating according to the Sustainable Investments Framework 	
	Risk Management & Compliance <ul style="list-style-type: none"> • Responsible for monitoring portfolio ESG and the sustainability benchmark for ESG management • Exclusion screening • Compliance monitoring for tasks & processes 	

Figure 6: Sustainability as part of portfolio management process



When setting internal guidelines, roles and responsibilities, MuniFin pays close attention to the EBA guidance on the management of Environmental, Social and Governance (ESG) risks for credit institutions and to the ECB guide on climate-related and environmental risks (November 2020).

MuniFin strives to meet supervisory expectations by fully incorporating the ESG risks in the existing portfolio- and risk management process. Furthermore, the portfolio ESG risk has been established as a material risk indicator in MuniFin Risk Appetite Framework (governed by the BoD).

Environmental risks are the risks posed by liquidity portfolio exposures to counterparties or invested assets that may potentially be affected by or contribute to the negative impacts of environmental factors, such as climate change and other forms of environmental degradation. Part of these risks are mitigated by holding a growing amount of green bonds that provide environmental benefits in the thematic sustainable asset portfolio. MuniFin also monitors the CO2 intensity of all issuers in its liquidity portfolio and references the results against a relevant market index.