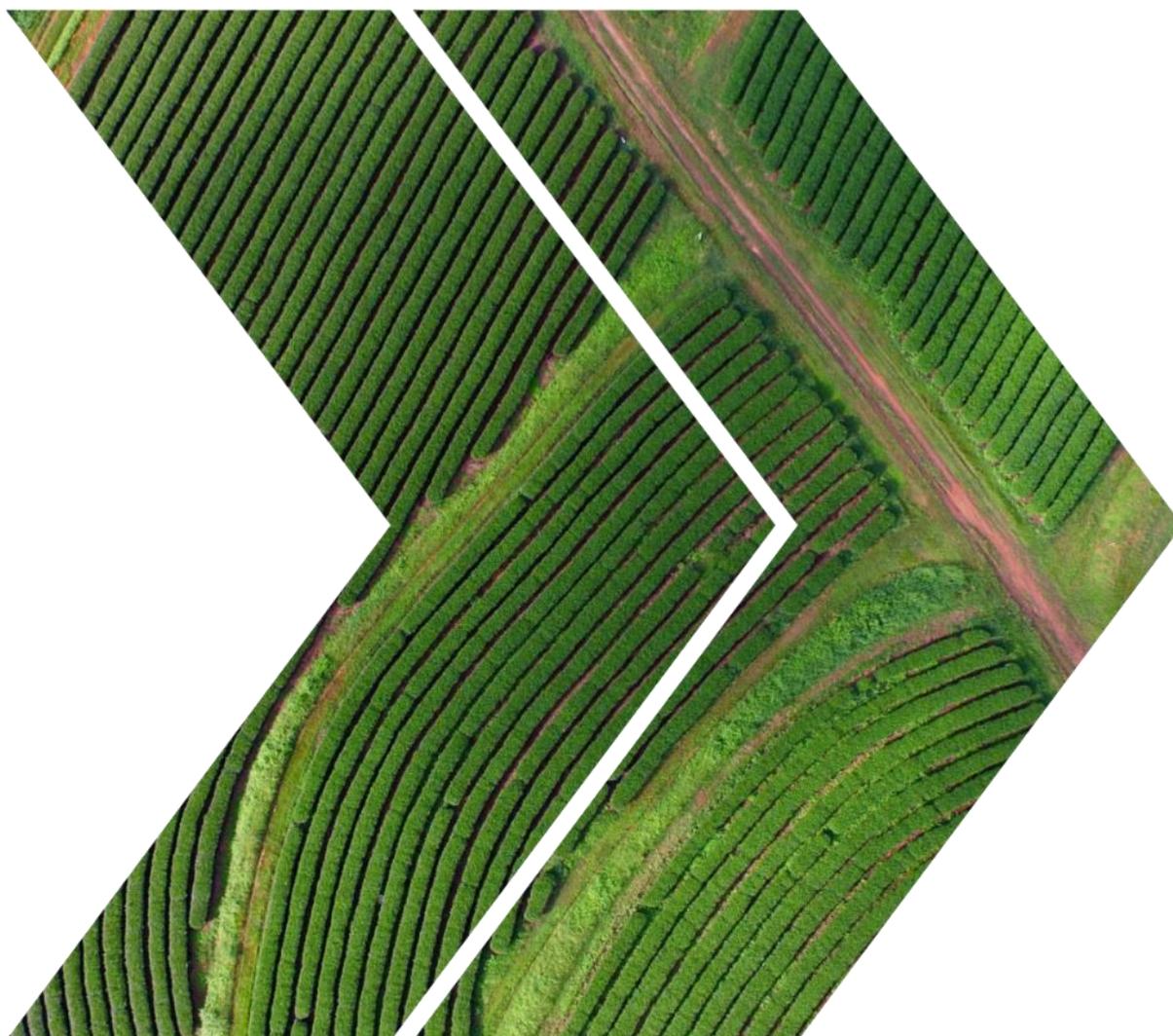


Our fossil fuel policy

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1.1 Context – energy access and economic development in the context of a net zero emissions future to limit global warming to the 1.5°C temperature goal

Climate change is the most important challenge facing our generation. The scale of this challenge is vast. In 2018, a special report from the Intergovernmental Panel on Climate Change (IPCC) underscored the importance of limiting a global average temperature increase to 1.5°C for sustainable development and poverty eradication. The 1.5°C goal creates a clear pathway for global action – it means cutting greenhouse gas emissions (GHG) emissions by 45 per cent by 2030, and reaching net zero by 2050. The Paris Agreement explicitly recognises the role of finance in Article 2.1c, where it sets out that finance flows should be consistent with a pathway towards low GHG emissions and climate-resilient development.

Investment decisions should, therefore, consider how to contribute towards the 1.5°C temperature goal. Decisions should also ensure transition risks, as set out in the recommendations of the Taskforce for Climate-related Financial Disclosures (TCFD), are effectively managed. In order to guide investment decision-making, the emerging Paris Alignment paradigm seeks to define economic activities as either aligned, conditionally aligned or mis-aligned with the Paris objectives relating to temperature goals and resilient development. In the energy sector, for example, renewable energy (such as wind and solar) would be a clearly aligned activity, whereas coal-fired power generation would clearly be a misaligned activity.

In relation to the power sector, the IPCC states a “robust feature of 1.5°C consistent pathways” is “virtually full decarbonisation of the power sector around mid-century”. This is also a feature of 2°C consistent pathways – indicating that GHG emissions must be virtually eliminated from the global electricity system by 2050, regardless of the precise level of sub-2°C warming targeted.

The Paris Agreement recognises that developing countries are still to go through their peak in GHG emissions. We know that a lack of reliable, affordable and sustainable energy services is a key constraint to economic growth and to improving the standard of living in the markets in which we operate. Meeting these energy needs whilst ensuring investments are consistent with Least Developed Countries’ (LDCs) vision for delivering net zero emissions by 2050, and ensuring climate resilience, is a key challenge for CDC. Addressing these multiple challenges together by building sustainable energy systems that support the major energy needs to create economic opportunities, improve energy access and living standards, whilst laying the foundations for net zero and resilient development pathways is core to CDC’s approach to the power sector.

1.2 Our approach to climate change – the three building blocks of Paris alignment

We recognise we must operate within the remaining global carbon budget to limit the global rise in temperature to 1.5°C. The change required to address the climate emergency is not incremental. Without a fundamental shift in how economies and sectors work, the 1.5°C target will be breached 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 also recognise the need to ‘future-proof’ our operations, given the threat that climate change poses for our dual mandate of development impact and financial return.

These objectives underpin our Climate Change Strategy¹, which sets out three building blocks that align our activities with the Paris Climate Change Agreement.

- **Net zero by 2050** – we recognise the need for global anthropogenic CO₂ emissions to be reduced over the coming decades to reach ‘net zero’ by 2050, in line with the Paris Agreement’s 1.5°C temperature goal.² Support for net zero development pathways is what our markets demand. We will take a combined approach to achieve net zero. First, we will look at overall emissions of our entire portfolio, including through direct investments and intermediaries, so that we can make future decisions based on the target to achieve net zero emissions at the portfolio level by 2050. Second, we will consider how each investment aligns to the individual country’s pathway to net zero emissions by 2050.
- **Just transition** – the fundamental transition towards a new green and resilient economy provides an opportunity to build a fairer and more inclusive economy. The ‘just transition’ agenda promotes change that seizes the opportunity to be socially inclusive of workers’ rights, women and communities, while managing the impact on those workers 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 benefits of the new green economy by focusing on job creation along with reskilling and upskilling for roles in green and resilient sectors in the new economy. We will integrate the just transition agenda into our existing programme of work to address skills and leadership, gender and job quality. Just transition issues are not addressed within this guidance note, but are considered separately as part of our wider investment appraisal process.
- **Adaptation and resilience** – CDC’s 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.

1.3 Our position on fossil fuels

As part of our 2050 net zero commitment, we recognise the need to act now to lay the foundations for our portfolio to have net zero emissions by 2050, and to avoid investments that risk countries locking-in high carbon pathways that are inconsistent with their own pathways to a net zero future.

Direct investments (equity or debt), new commitments to funds, co-investments and directed lending

For these reasons, we will not make any new commitments (equity and debt) directly or through new commitments to funds and co-investments, as well as new directed lending³ through financial institutions in the following sub-sectors – based on the these definitions: upstream activities (exploration and production of fossil fuels); midstream (transportation and storage of raw fossil fuels); downstream (refining and distribution of refined fossil fuels); and power generation (defined as grid-connected rather than in captive capacity).

¹ <https://www.cdcgroup.com/en/climate-change-strategy/>

² Net zero emissions will be achieved when anthropogenic GHG emissions to the atmosphere are balanced by anthropogenic removals over the same period.

³ Directed lending is defined as “term financing extended to a financial intermediary with a defined use of proceeds”.

Coal

- + Coal-fired power plants, including dual-power plants.
- + Refurbishment, retrofitting and rehabilitation of existing coal power facilities, including dual-power plants.
- + Coal prospection, exploration, mining, processing and trading.

Oil

- + Upstream oil exploration and production.
- + Midstream oil, including pipelines.
- + Downstream oil, including refineries and petrol stations.
- + Heavy fuel oil (HFO) or diesel-only, dual-fuel HFO or diesel/gas and HFO or diesel/renewable hybrid power plants.
- + Refurbishment, retrofitting and rehabilitation of existing⁴ HFO or diesel-only, dual-fuel HFO or diesel/gas and HFO or diesel/renewable power plants leading to an increase of absolute GHG emissions (i.e. where energy efficiency measures do not compensate for any capacity or load factor increase) and/or where the lifetime of an asset that would be otherwise retired would be substantially increased.
- + Diesel-only mini grids.

Gas

- + Upstream gas exploration and production.
- + Midstream/downstream gas (including gas import/export infrastructure and processing facilities) except gas transport, storage and distribution infrastructure where the primary purpose is power generation consistent with a country's pathway to net zero emissions by 2050 or liquid petroleum gas (LPG) and associated facilities for sourcing, transport, storage, bottling and distribution.

Transport

- + Transport (road/rail/port) infrastructure where the primary use is fossil fuel transport.⁵

The above exclusions also apply to:

- + Financing an allowed activity that exclusively serves an excluded fossil fuel activity (such as a solar plant for a coal terminal, a wastewater plant for an oil refinery).
- + Financing companies or projects that exclusively provide services (including advisory), equipment, or other outputs to excluded fossil fuel activities. (such as a company that exclusively provides construction services for oil exploration activities).
- + Financing companies or projects that exclusively produce goods for and/or provide goods to excluded fossil fuel activities (such as a company that exclusively manufactures machine parts for use in coal-fired power plants).

Financial institutions and trade finance

For investments in financial institutions, we will apply these exclusions to the use of proceeds for any directed lending lines where we can reasonably ringfence and have line of sight on what our funds are used for. We will generally strive to require a whole portfolio exclusion for coal mining and grid-connected coal power.

⁴ Existing refers to HFO plants already in our portfolio.

⁵ Primary use means more than 50 per cent of the infrastructure's handled tonnage.

Where we cannot specify where funds will be ultimately deployed, or how profits will be reinvested (such as with new equity or non-directed lending or general purpose loan commitments), we will seek credible evidence that the recipients of the investments are working towards aligning future activities and portfolios with the Paris Agreement. We will also generally strive to require a whole portfolio exclusion for coal mining and grid-connected coal power.

Where applicable, support should be restricted to circumstances where the investee can credibly demonstrate that the funds requested are conducive to the transition process and the future growth of their 'clean growth' capability, and will be used to that end.

Regarding trade finance in particular, we will not support trade activities related to coal and crude oil.

Other fungible funds

Where we cannot specify where funds will be ultimately deployed, or how profits will be reinvested (for example, new equity or corporate loans to diversified companies), we will seek credible evidence that the recipients of the investments are working towards aligning future activities and portfolios with the Paris Agreement.

Where applicable, support should be restricted to circumstances where the investee can credibly demonstrate the funds requested are conducive to the transition process and the future growth of their 'clean growth' capability, and will be used to that end.

Notwithstanding anything in the above exclusions, the following areas are considered eligible for investment:

Diesel/renewable hybrid mini grids and standalone diesel generators

- + Diesel/renewable hybrid mini grids where:
 - (i) a renewable-only grid has been proven as not offering sufficient reliability or cost feasibility in the context of the proposed application,
 - (ii) the cleanest feasible fossil fuel options have been used; and
 - (iii) the risk of ramping up the use of the non-renewable part to respond to increased demand is being managed.
- + Stand-alone diesel generators, where demonstrated that the option of a renewable generator is technically or commercially not feasible.

Gas power, associated infrastructure and liquid petroleum gas

- + Gas power plants consistent with a country's pathway to net zero by 2050, subject to gas guidance as per section 1.5.
- + Gas transport, storage and distribution infrastructure where the primary purpose is gas power generation consistent with the country's pathway to net zero emissions by 2050, subject to gas guidance as per section 1.5.

LPG for cooking and heating, including associated facilities for sourcing, transport, storage, bottling and distribution.

Decommissioning

- + Support for physical decommissioning of oil and gas assets, or conversion into non-fossil fuel infrastructure.

Carbon Capture and Storage, or Carbon Capture Use and Storage

- + Support to Carbon Capture and Storage (CCS), or Carbon Capture Use and Storage (CCUS) projects, but only allowed for gas power and only where projects will significantly abate emissions and not significantly extend the life of existing fossil fuel assets. CCUS with enhanced oil recovery (EOR) is not allowed.

Transmission and distribution networks

- + Electricity (power) or heat (hot air or water) transmission and distribution networks, regardless of the fuel used for their generation.

Transport sector

- + Including rail, ship, vehicle and aircraft manufacturing, fleets and supporting infrastructure; and transportation infrastructure assets (including road, ports, rail), including those whose primary scope is non-fossil fuel transport, but where it may not be physically, legally or economically possible or viable to exclude any fossil fuel transportation using that infrastructure.
- + Support for blending of ethanol and biofuels in petroleum products

Industry

- + Industries that need high temperatures that can only be achieved through burning fossil fuels (such as cement, ceramics, glass and paper).
- + Industries that use fossil fuels as feedstock but that do not produce fuels (such as steel, detergents and paint).
- + Investments in economic activities outside heavy industries (for example, commercial activities or farms) that use fossil fuels as source of energy (captive fossil fuel energy), while ensuring that they are encouraged to transition to renewables. Where the investment is associated with an increase in energy use, that additional use should be met by renewables, unless it is shown this would be technically or commercially unviable.
- + For industrial use of fossil fuels, we will consider whether the cleanest and most efficient technology is being used, and that provisions for technological switching to lower-emission options (including CCUS) are considered in future.
- + For captive coal, the approach outlined in section 1.4. applies.

Improvement of efficiency and environmental standards

- + Improving efficiency, health and safety and environmental standards of existing assets in our portfolio if they continue to perform an excluded activity, on the condition that the investments do not substantially increase the lifetime of an asset that would be otherwise retired.

Conversion of excluded activities into allowed activities

- + Investment in an existing asset which performs an excluded oil or gas activity, and which may or may not be in our portfolio already, but where we have a high degree of confidence that the asset will be converted into an activity which will not be excluded after our investment entry. This could include, for example, retrofitting CCS on existing gas plants which may not otherwise be Paris-aligned (only where it significantly abates emissions and does not significantly extend the life of existing fossil fuel assets); conversion of existing liquid fuel production facilities into chemical production; and conversion of excluded existing gas midstream infrastructure into hydrogen infrastructure)

Financial institutions and trade finance

- + Financial institutions with fossil fuel exposure – subject to us seeking credible evidence that the recipients of the investments are working towards aligning future activities and portfolios with the Paris Agreement.

- + Trade finance activities for refined energy products

‘Just transition’ of workers and fossil fuel-dependent communities

- + Support to fossil fuel sectors to enable a just transition of workers and fossil fuel-dependent communities, limited to the just transition element of the investment only (for example, social dialogue, skills and retraining, and bridging loans).

Technical assistance

- + Technical or regulatory assistance that supports energy efficiency, health and safety, or environmental and social safeguard improvements.
- + Technical assistance on energy market reform to countries.

Other

- + Methane capture.
- + Methane detection.
- + HSE training.

1.4 Our approach to captive coal

Where captive coal (for electricity generation, heat) already exists in a business, we can only invest if the production of energy is in an eligible (International Development Association) country and where the following additional considerations have been met:

- (i) Long-term financial viability
- (ii) Best available technology (including compliance with International Finance Corporation Performance Standards)
- (iii) Alternatives considered
- (iv) Compelling development impact
- (v) Best efforts have been made to increase energy efficiency and reduce GHG emissions
- (vi) A commitment has been made to work with us on transitioning to alternatives

We will not finance expansions⁶ of existing captive coal or new captive coal operations which means either:

- (1) We will not invest in a business with planned coal-related expansions or new captive coal

OR

- (2) The business has agreed to not expand existing captive coal or add new captive coal operations

This policy will not apply to coal used to initiate chemical reactions (e.g. metallurgical coal mixed with iron ore to produce iron and steel) or as an ingredient mixed with other materials, given the lack of feasible and commercially viable alternatives.

⁶ ‘Expansions’ refers to adding new captive coal infrastructure and, for the avoidance of doubt, does not refer to situations where captive coal operations which have been running only at partial capacity are extended towards higher or full capacity.

1.5 Our approach to gas power and infrastructure investments

Existing grids in Africa and parts of South Asia are fundamentally different to more advanced developed markets, where existing capacity and grids can absorb significant intermittent power. Considering this, the baseload power still required in many of our markets can be delivered through hydro and gas technology. The commercial equation for storage solutions is not yet competitive with grid power market prices in our markets, but we will look ambitiously at ways to integrate this technology into our investments in the coming years. Drought conditions experienced in many African countries mean that a reliable baseload remains important. Gas power can, therefore, play a role in providing base load power, but this role has to be considered in light of the country's transition towards a net zero future. The goal is to ensure it helps – rather than delays or diminishes – the transition to renewables, and that the risk of it becoming a stranded asset due to climate change factors remains low.

As we are committed to working towards Paris alignment and implementing TCFD recommendations, we recognise this means a shift from a short-term horizon of relative emissions (with a focus on financing lower-carbon alternatives) to a long-term horizon (with a focus on aligning investments with the remaining global carbon budget).

Therefore, we will only pursue investments in gas-fired power stations and gas transport, storage and distribution infrastructure where the primary purpose is power generation when the investments clearly fulfil our guidance requirements on alignment with countries' development pathways to net zero emissions by 2050, and which we have assessed as being truly transitional to a net zero future.⁷

This approach will allow us to deliver on our development and climate change objectives in a coherent way. It will also support the economic transformation in our markets to achieve net zero emissions by 2050 in a socially just manner that delivers on both the United Nations Sustainable Development Goals and people's needs for prosperity and improved living standards.

⁷ https://assets.cdcgroup.com/wp-content/uploads/2020/12/12145227/CDC_GasGuidance_December2020.pdf