FMO
Entrepreneurial Development Bank

SUSTAINABILITY POLICY

1. Purpose of this Policy

FMO's mission is to empower entrepreneurs in emerging markets to build a better world through a firm commitment to sustainable development. This Sustainability Policy sets out FMO's commitment to sustainable development. This Policy document starts with introducing its Purpose and Scope and is followed by Section 3 which presents FMO's Sustainability Vision and Strategy. Section 4 describes FMO's Principles that determine its commitment and approach. Consistent with FMO's commitment, FMO implements thorough environmental, social and corporate governance due diligence, monitoring and engagement procedures as described in Section 5 of this Policy.

By following this Policy, FMO intends to protect people and the environment impacted by its own operations and its investments and to help clients[1] manage their environmental and social impact and improve their corporate governance. FMO further seeks to advance a greener and more inclusive economy and to improve the transparency and accountability of FMO's actions and decision-making. FMO believes that adhering to this Policy makes good business sense as it protects FMO's assets and reputation, helps identify new business opportunities and improves the overall value of FMO's investments.

This Sustainability Policy is the leading part of a broader sustainability policy universe that also encompasses position statements and (internal) guidance documents that jointly give further depth and content to the choices FMO makes. Sustainability within FMO is part of an ongoing discussion where dilemma's and issues are frequently faced and resolved. The abovementioned universe of Policy and associated position statements, as well as a document describing how FMO navigates dilemma's and issues[2], are all published on FMO's website and should be read in conjunction.

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[1] FMO refers to "Clients" when it provides debt to companies and to "Investee companies", "Portfolio Companies" and "Relationships" when investing equity. For the sake of readability, this Policy applies the term "Client" to refer to all these different partners.
[2] For more information, see the 'Implementing this Policy' document on the FMO website.

This Policy is the foundation of FMO's Sustainability Management System and provides guidance to FMO's internal processes. FMO considers this Policy a living document. Therefore, it will be updated based on lessons learned and input from FMO's stakeholders.

2. Scope

The scope of this Policy extends to FMO's entire footprint. This includes FMO's activities at the organizational level, energy use, resource use, travel and new investments with respect to all products provided by FMO[3]. The nature of the services FMO delivers can in some situations limit FMO's level of influence[4]. FMO will then apply this policy to the greatest extent possible.

3. FMO's Sustainability Vision and Strategy

FMO's vision is to contribute to a world where, in 2050, a projected nine billion people can live well and within the boundaries of our planet. FMO's vision and activities are well aligned with the global sustainable development agenda as formulated in the Global Goals for Sustainable Development[5] and the Addis Ababa Action Agenda. FMO sets strategic goals on its development impact and footprint with the intention to realize its vision[6]. To that end, FMO has set itself the goal to *'become the leading impact investor by doubling our impact and halving our footprint by doubling jobs supported and avoided GHG emissions by 2020*'.

Impact

FMO supports private sector development in emerging markets, aiming for job creation and overall sustainable development. Furthermore, FMO actively seeks to achieve inclusive development[7].

[3] In some cases, grants by the Capacity Development Program of FMO may be excluded.
[4] For more information, see the 'Implementing this Policy' document on the FMO website.
[5] Also known as the SDGs. For more information see the UN Sustainable Development Goals website.
[6] For the current goal see the FMO website.
[7] A statement on FMO's position on inclusive development is expected to be published in 2017.

FMO aims to reach the economically excluded, including those at the Base of the Pyramid, through supporting valuable and quality jobs, inclusive finance, and finance of innovative products and services.

FMO actively strives to achieve gender equality. This is not only reflected in FMO's own Position Statement on Gender[8] but also in its work to close the gender gap through the empowerment of women and girls and in reaching those at the Base of the Pyramid.

Footprint

FMO aims to contribute to financing the transition in the economy, in line with the Paris UNFCCC COP 21[9] goal, to keep global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius[10]. Genuine improvements towards sustainable use of natural resources, such as water, is another element in FMO's footprint. FMO recognizes the value of ecosystems, that form the natural capital for the world economy. FMO aims to prevent their degradation, which directly poses a risk for FMO's clients and the societies in which they operate. Notwithstanding the direct relationship of biodiversity in the form of Natural Capital, FMO also aims to conserve biodiversity in the broadest sense[11].

How do we work

FMO selects clients who are willing to work with FMO on improving their environmental, social and human rights impacts, as well as improving their governance. FMO contractually agrees performance improvements related to most important Environmental, Social and Governance (ESG) risks with its clients. By improving its performance, the client's potential adverse impact on

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[8] A statement on FMO's position on Gender is expected to be published before mid-2017.
[9] United Nations Framework Convention on Climate Change 21st annual Conference of the Parties in Paris in November 2015.
[10] A statement on FMO's position on climate change is expected to be published in 2017.
[11] A statement on FMO's position on natural resources and water is expected to be published in 2017.

environmental and social issues is significantly reduced. FMO also works in this manner with clients to improve their governance.

In line with the United Nations Guiding Principles on Business and Human Rights, FMO recognizes the responsibility of businesses to respect human rights, wherever they operate. FMO respects internationally recognized human rights standards and takes measures to avoid supporting activities that may cause or contribute to human rights violations and acknowledges the responsibility of its clients to do the same. This means to avoid infringing the human rights of others and to address adverse impact these businesses may cause or contribute to[12]. FMO values freedom of expression, the added value of civil society, and recognizes the need to protect dissenting voices. FMO does not condone violations of human rights by its clients, including oppression of, or violence towards, those who voice their dissenting opinion in relation to FMO activities and the activities of FMO's clients. Meeting this responsibility also means creating access to an effective grievance mechanism that can facilitate early indication, and prompt remediation, of various project-related grievances.

FMO requests from its (temporary) staff, clients and counterparties to adhere to the letter and spirit of the laws and regulations they are subject to and maintain the highest ethical standards. FMO requires clients to comply with all tax regulations in their home and host countries and show responsible tax behavior[13].

FMO believes that the development of its vision, strategy and policies needs to be done in close consultation with FMO's stakeholder community, consisting of, amongst others, the Dutch government, clients, partner-institutions, affected communities and Civil Society Organizations. Integrating stakeholder considerations and information, based on a meaningful consultation with stakeholders (including affected communities, in line with the IFC Performance Standards), in investment and monitoring decisions will further contribute to the quality and positive impact of FMO's investments, as well as ensure community support.

[12] A statement on FMO's position on Human Rights is expected to be published before mid-2017.
[13] As defined in the FMO Position Statement on Responsible Tax.

4. Principles

FMO requires, that all clients comply with applicable environmental, social and human rights laws in their home and host countries[14]. In addition, FMO upholds the following (inter)national standards[15], including in its own operations, as applicable:

- IFC Performance Standards/ World Bank Group Environmental Health and Safety Guidelines/ Equator Principles
- OECD Guidelines on Multinational Enterprises
- UN Guiding Principles on Business and Human Rights
- ILO Declaration on Fundamental Principles and Rights at Work
- UN Principles for Responsible Investment
- EDFI Principles for Responsible Financing
- G20/OECD Principles of Corporate Governance/ Dutch Corporate Governance Code
- SMART Campaign Client Protection Principles

With respect to the management of environmental and social impact, the primary standards that guide FMO's relationship with clients are the IFC Environmental and Social Performance Standards and the associated World Bank Group Environmental Health and Safety Guidelines. They cover the larger part of the ESG requirements in the OECD Guidelines on Multinational Enterprises, which also reference the UN Guiding Principles on Business and Human Rights. Subject to its applicability criteria, FMO also applies the Equator Principles which are based on the IFC Performance Standards.

The IFC Performance Standards guide FMO's human rights due diligence with respect to clients. FMO requires clients to assess the likelihood and severity of impact on human rights as part of their

[14] Applicable environmental, social and human rights laws are both applicable national and international law to which the client is subject.
[15] Version currently in force.

assessment of social and environmental impact, and to implement mitigation measures in line with the IFC Performance Standards[16].

In case environmental, social or human rights impacts are identified that the IFC Performance Standards do not sufficiently address, FMO will identify and agree on mitigants by referring to the other standards above as relevant.

FMO's Corporate Governance (CG) approach focuses on the rights and responsibilities of its investee companies' shareowners, (supervisory) board of directors, and management. FMO's approach towards improving the corporate governance practices within its portfolio is based on (inter)national benchmarks such as the G20/OECD Guidelines on Corporate Governance and the Dutch Corporate Governance Code. The Corporate Governance Development Framework, signed by FMO (2011) and 33 other Development Finance Institutions, further defines FMO's approach and the methodology and tools FMO uses. Moreover, FMO requires clients to comply with all tax regulations in their home and host countries and show responsible tax behavior in line with what is being aimed for with the OECD/G20 BEPS action plan[17].

Pursuant to Dutch law and regulations, FMO 's investee companies – including their owners, directors, managers, and other key staff – need to comply with FMO's policies on business integrity and anti-money laundering. Guided by the OECD Convention on Combating Bribery and the UN Convention against Corruption, FMO maintains a zero tolerance policy regarding bribery and corruption. FMO's Know Your Customer ('KYC') Policy describes these policies.

Finally, FMO's responsible finance approach defines the exclusion of certain consumer finance activities, and the adoption of the Client Protection Principles (CPPs) which provide a risk-based approach similar to the ESG processes. The CPPs aim to facilitate a risk-based assessment of financial institutions, non-banking financial institutions and corporates providing finance to natural

[16] A statement on FMO's position on Human Rights is expected to be published before mid-2017.
[17] BEPS – Base Erosion and Profit Sharing

persons. CPPs define the minimum standards that end-clients should expect to receive when doing business with an entity providing financing to natural persons[18].

To uphold the above principles, FMO has embedded ESG risk management as an integral part of its organizational structure and investment process. Project approvals and contracts include both financial and ESG considerations. FMO has built up a large and experienced team of ESG specialists who work with its clients on the identification and management of ESG risks, adding value to its clients' businesses and identifying further business opportunities. FMO provides technical assistance funds to assist clients to build capacity for managing ESG performance. FMO recognizes the need for level playing fields for its clients who are introducing ESG risk management to their market. To this end, FMO promotes a sector-wide approach as a strategic tool for promoting locally owned change.

5. Operational implementation

How Does FMO Manage Sustainability in its Investment Process?

In the initial assessment of potential investments FMO checks that the transaction does not breach FMO's Exclusion List, which defines the type of activities in which FMO does not invest.

FMO then screens all transactions on ESG risk. FMO categorizes its investments in different levels of Environmental and Social (E&S) risk, similar to IFC's approach to E&S risk categorization, which is also used by all European Development Finance Institutions (DFIs). For direct investments, risk categorization is based on the client's activity, IFC Performance Standards triggered transactions and prevailing country specific ESG challenges. With regard to financial institutions[19] the risk categorization is made on the basis of the banks existing or proposed portfolio, IFC Performance

[18] A statement on FMO's position on Client Protection will be published in 2017.
[19] A statement on FMO's position on Indirect Investments will be published in 2017.

Standards triggered transactions[20] and prevailing country-specific sensitive issues[21]. The risk-categories as distinguished by FMO are found in Annex I.

With regards to ESG in particular, FMO requires all direct investments of medium and high E&S risk (category B, B+, A, see Annex 1 for the categorization) to fully adhere to the ESG standards referred to in Section 4. Low risk (category C) investments are required to adhere to applicable law[22]. For investments in financial institutions (FI), FMO requires FI-A and FI-B clients to apply the IFC Performance Standards framework to IFC PS-triggered transactions. Transactions with country-specific sensitive issues will be addressed through the IFC Performance Standards or an approach through which we strive to align with the international standards listed in Section 4. The rest of the portfolio needs to adhere to applicable law and, when relevant, the client protection principles. FMO requires Private Equity Funds to implement an ESG risk management system which is compliant with the IFC Performance Standards. The system should require its high risk investee companies to adhere to the standards mentioned in Section 4.

During due diligence FMO executes a thorough ESG assessment on its potential clients. This enables FMO to identify the main ESG risks and strengths that a client is exposed to and to assess the quality of its risk management and mitigation measures. The findings during due diligence are important input for monitoring and engagement throughout the investment, or could lead to modification of the transaction (including cancellation).

Dedicated ESG specialists within FMO engage actively with all category A, B+, and where warranted, category B clients. The level and exact focus of engagement depend on the type and severity of impact and/or the extent to which they pose a risk to the client and FMO. ESG risk management is fully integrated in the approval process: this judgement call lies with FMO's commercial teams while FMO's credit team independently subjects it to critical scrutiny for

[20] Project finance and corporate loans related to project finance (total project size USD ≥ 10m / ≥36 months tenor)
[21] E.g. Indigenous people / Land rights / Water / Deforestation
[22] Applicable law means national and international law to which the client is subject.

verification. Both deal and credit teams have dedicated ESG specialists that are involved in the assessment. FMO applies heightened scrutiny to any investment causing complex resettlement or affecting Indigenous Peoples, critical habitat or critical cultural heritage[23].

With regard to corporate governance, FMO classifies all its clients as either high risk (1), moderate risk (2) or low risk (3). FMO considers a transaction 'high risk' if three out of five risk areas, namely the commitment to good corporate governance, board structure and functioning, the control environment, transparency and disclosure, as well as protecting shareholder rights are considered high risk. In such an event, FMO's governance specialists are involved in due diligence and action plans are part of FMO's investment contract.

FMO contractually agrees ESG conditions and reporting requirements with its clients. In many cases, these ESG conditions include implementation of an Environmental and Social Action Plan (ESAP) and/or Corporate Governance Action Plan (CGAP) and/or Consumer Protection Principles Action Plan (CAP) that are agreed with the client prior to contracting. In line with the IFC Performance Standards, clients are also required to have a grievance mechanism in place. The objective of these action plans is to ensure that within a reasonable time-period, and at a minimum within the period of the investment[24], investments supported by FMO comply with FMO's ESG policies and standards.

FMO maintains frequent and intensive contact on ESG with its clients and, when applicable, requires annual ESG performance reports to assess the client's performance and progress on the action plans. Depending on the transaction's risk and impact profile, FMO determines the required intensity of the engagement and monitoring and may also conduct monitoring visits and/or commission independent external monitoring. FMO sees monitoring as an important opportunity to support clients in achieving their sustainability goals. FMO also commissions evaluations to assess the development impact of its investments.

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[23] A statement on FMO's position on Indirect Investments will be published before in 2017.
[24] EDFI Principles for Responsible Finance.

Finally, FMO proactively seeks investment opportunities that contribute to a greener and more resource efficient economy. To stimulate "Green investments", FMO has set internal annually increasing targets. To determine if a transaction contributes to FMO's green targets and goals, an independent internal panel screens transactions. The panel determines whether the environmental benefits made through the transaction are genuine and sufficient (as defined in FMO's Green criteria) to qualify for its green targets and goals.

Working with Partner Institutions

In line and spirit with the Equator Principles, FMO is committed to work constructively with other DFIs and banks. This includes exchanging information, collaborating in developing a mutual understanding of ESG risks, impacts and mitigation strategies, co-financing and engaging with clients. FMO may partially or fully rely on trusted Partner institutions to operationalize the intentions of FMO's Sustainability Policy during due diligence, contracting and monitoring. For instance, FMO is a member of EDFI, the Association of European Development Finance Institutions and has a Friendship Facility agreement with DEG[25] and Proparco under which FMO relies on the Partner's investment due diligence and may rely on their client monitoring. Similarly, FMO has a Master Cooperation Agreement with IFC[26].

Disclosure

FMO believes that transparency and accountability in its financing and investments are fundamental to fulfilling its development mandate. It allows our stakeholders to assess if FMO is achieving what it intends to do: empowering entrepreneurs in emerging markets to build a better world. To facilitate this, FMO adopted a Disclosure Policy, outlining the scope and type of information that it makes available to the public. In addition to the disclosure of its annual reports, press releases and corporate- and policy- related disclosure, FMO also discloses selected relevant information about

[25] Deutsche Investitions- und Entwicklungsgesellschaft mbH.
[26] International Finance Corporation.

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its investments and financing both prior to (explicitly inviting comments from the stakeholder community), and after contracting.

FMO's Complaints Procedure

As outlined in this Policy, FMO strives to achieve positive sustainable development outcomes through its investments and has high standards when it comes to good provision of services. FMO welcomes feedback on its projects. FMO also offers a platform for conflict resolution via its complaints procedure.

FMO makes a distinction between project-related complaints and general complaints. General complaints can be communicated in two ways: either in writing or via the internet. For project-related complaints, FMO has implemented an Independent Complaints Mechanism (Mechanism) and accompanying procedures. The Mechanism describes the structure and governance of the complaints procedure, which allows affected external parties to file a complaint concerning a project financed by FMO. FMO will not condone reprisals against individuals or organizations that raise issues with its Independent Complaints Mechanism. In this way FMO strives to implement a robust and independent procedure and to transparently communicate to stakeholders.

Managing FMO's own operations

FMO also integrates ESG in its own operations. FMO complies with applicable Dutch law and regulations, the Dutch Banking Code and the Dutch Corporate Governance Code. FMO adheres to the Covenant Dutch Tax Authority. FMO believes in diversity and embraces and promotes it in recruitment, career management and management development within FMO.

FMO will remain climate neutral in all of its operational activities, through energy efficiency, compensation and sustainable energy production. In its supply chain, FMO pays particular attention to the terms and conditions of employment of the contractors working in its facilities and to minimizing the environmental impact of the food supplied in FMO's facilities. FMO provides healthy and organic food to FMO's staff. FMO informs staff regularly on external and internal results from ESG and sustainability efforts and provides regular staff training on its Sustainability Policy and on specific ESG issues and processes.

Approved by FMO's Management Board on 23 December 2016

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Annex 1

FMO distinguishes the following E&S risk-categories (following the IFC's Environmental and Social Risk Categorization Framework):

Direct investments	
Category A	Business activities with potential significant adverse environmental or social risks and/or impacts that are diverse, irreversible, or unprecedented.
Category B+	Business activities with potential adverse environmental or social risks and/or impacts that are generally beyond the site boundaries, largely irreversible and can be addressed through relevant mitigation measures.
Category B	Business activities with potential limited adverse environmental or social risks and/or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures.
Category C	Business activities with minimal or no adverse environmental or social risks and/or impacts.

Financial Intermediaries	
Category FI-A	FIs with an existing or proposed portfolio that includes, or is expected to include, substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
Category FI-B	FIs with an existing or proposed portfolio that includes, or is expected to include, business activities that have potential limited adverse environmental or social risks or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures; or includes a very limited number of business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible, or unprecedented.
Category FI-C	FIs with an existing or proposed portfolio that includes and is expected to include business activities that predominantly have minimal or no adverse environmental or social impacts.

Private Equity Funds	
Category A	Private Equity Funds which (intend to) invest >15% of its portfolio in high risk (e.g. Category A or B+ as defined above for Direct Investments).
Category B	Private Equity Funds which (intend to) invest <=15% of its portfolio in high risk (e.g. Category A or B+ as defined above for Direct Investments).