FMO

Entrepreneurial Development Bank

Implementing FMO's Sustainability Policy – Considerations for FMO

In 2016, FMO launched its revised Sustainability Policy to help FMO to position itself as the leading impact investor that contributes to a world where in 2050 a projected nine billion people can live well and within the boundaries of our planet. The Sustainability Policy is firmly embedded in a larger system of guidance documents and position statements showing the broad approach FMO takes to sustainable development. Nevertheless, where this framework may seem straightforward, the reality in which FMO works poses serious and practical challenges or dilemmas. These practical challenges and dilemma's show that the straightforwardness of the policy is not always matched with a straightforward route to implementation. This document therefore describes how FMO navigates in reality when implementing the policy.

1. Prioritization

Ensuring impact in achieving sustainability is first achieved by focusing on what is important and urgent. FMO has, as part of its team and through its network, access to significant ESG resources. These resources are allocated across FMO's new deals and portfolio, amongst others to stimulate compliance with minimum standards and to deal with high risk clients[1]. FMO is amongst its peers one of the best-resourced institutions in the area of sustainability and ESG risk management. Naturally FMO faces limitations to engage extensively with all of its clients. FMO thus allocates most of its ESG resources to the transactions and clients that pose the highest risks from an ESG impact and credit point of view. By focusing its resources on these issues, FMO ensures that it tackles the most pressing issues first.

2. Contextual Risks

Emerging markets pose relatively high contextual ESG risks not directly linked to FMO's clients but to broader national or regional dynamics. Key sources of contextual risks relate to poverty and inequality, (latent) conflict, a weak rule of law and public governance, legacy issues and the relatively high dependence by local populations on locally available natural and environmental resources, including notably land, water and forests. FMO confronts this challenge by addressing sustainability from FMO's very early engagement with potential clients and also by careful client selection and monitoring. FMO further contractually agrees with and supports FMO's clients to achieve measurable improvement towards standards laid down in the Sustainability Policy over time.

[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.

3. Market Imperfections

If in a direct relationship with the client, the implementation of our standards could have adverse effects on the clients' market position due to lack of a "level playing field", FMO will look for other routes to effectuate its sustainability ambitions.

One of the best examples of ESG challenges posed by imperfect markets are FMO's investments in financial institutions. FMO's ambition is for all medium and high ESG risk sub-clients to comply with our policies and standards, but the business imperative to enhance ESG requirements to our standards can be challenging for local financial institution clients. FMO has responded to this in selected countries by collaborating with financial institutions, the local banking associations and the central bank to promote sector-wide minimum ESG risk management standards. These sector-wide ESG initiatives aim to create a level playing field, while elevating ESG standards across the financial sector. This is in line with FMO's ambition to use its convening power.

4. FMO's Accountability

Confronting the challenges described above and meeting FMO's ambition as written in its Sustainability Policy, FMO is committed to remain one of the best-resourced banks on in-house ESG expertise. This extends to its internal accountability mechanisms. Ensuring that FMO's specialists work well with the Sustainability Policy, FMO has implemented a unique four-eye principle that assures that the work of FMO's deal teams is adequately challenged in FMO's Credit department that employs its own set of specialists. Also FMO's Investment Committee considers ESG in each of its investment decisions and upholds a high standard of ESG scrutiny throughout the organization.

FMO's risk-based approach enables it to pick and prioritize the management of the highest ESG risks and monitor these closely. With its sector initiatives and capacity development program FMO aims to gradually increase ESG requirements for clients in a particular sector. Future clients then consequently need to abide by these.

Finally, FMO sets ambitious strategic targets to increasingly grow the share of green and inclusive investments in its portfolio. This is another important part of FMO's strategy to achieve long term, sustainable impact.

FMO has an Evaluation unit which operates independently from production-orientated departments and periodically evaluates projects and sectors for purposes of accountability and internal lessons learned. ESG performance is included in the scope of the evaluation program. These evaluations are published also for external transparency.

Accountability is further extended by the implementation of a complaints mechanism through which external Stakeholders can hold FMO accountable on its sustainability ambitions.

FMO strives to continuously improve its policies and procedures. It aims to do this in close partnership with its key-stakeholders. In this way FMO creates shared value, remains transparent and accountable, and achieves sustainable impact in the societies where it operates.