

**SIFEM's Approach to Responsible Investment**  
*Policy Document*

December 2017

SIFEM seeks risk-adjusted returns on its long-term investments in emerging and frontier markets, while generating sustainable, positive impacts. Responsible investing involves integrating environmental, social, and corporate governance (including business integrity) (ESG) matters into investment decision-making and portfolio management. SIFEM asserts that proper ESG risk management not only reduce risks to workers, the environment, local communities and other affected stakeholders, but it can also serve to reduce reputational and financial risks. Proper ESG risk management can also serve to generate a range of sustainable, positive financial, environmental and societal impacts. Examples include: accessing new markets, reducing costs through energy and resource efficiency measures, reducing emissions and waste, creating better, safer jobs, and enhancing community relationships.

Underpinning SIFEM's fiduciary responsibility is its commitment to invest responsibly. SIFEM commits to:

- Integrating ESG matters into its investment practices across entire investment cycles-- from deal sourcing, analyses, decision-making, investment management to exits;
- Requiring investees<sup>1</sup> to minimize their adverse impacts and enhance positive effects on the environment and all stakeholders (including employees and any affected communities);
- Requiring investees to comply with the legal and regulatory requirements in the jurisdictions where they operate, at a minimum, and work over defined time frames towards relevant international E&S norms and standards<sup>2</sup>;
- Requiring investees to observe high standards of business integrity and governance<sup>3</sup>;
- Requiring investees to ensure a preventive and precautionary approach with respect to their environmental and social impacts. If negative environmental or social impacts are unavoidable, they must be appropriately mitigated or compensated for;
- Encouraging investees to establish open dialogues with their stakeholders on the environmental and social impacts of their activities;
- Encouraging investees to consider the potential for positive impacts and opportunities from business activities (e.g., certifications to enter new markets, strengthening of supply chain structures/management, and employee training); and
- Seeking continuous improvement in its own ESG management, where the aim is to always enhance positive effects in relation to the environment, workers, communities, and other affected stakeholders.

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<sup>1</sup> SIFEM invests in companies directly, and indirectly via financial intermediaries (private equity funds, financial institutions, and other investment vehicles).

<sup>2</sup> Our benchmarks include the UN Guiding Principles for Business and Human Rights (see: <https://www.unglobalcompact.org/library/2>), the ILO Fundamental Conventions (ILO Core Labor Conventions) (see: [http://www.ilo.org/wcmsp5/groups/public/@ed\\_norm/@declaration/documents/publication/wcms\\_095895.pdf](http://www.ilo.org/wcmsp5/groups/public/@ed_norm/@declaration/documents/publication/wcms_095895.pdf)), and the IFC Performance Standards on Social and Environmental Sustainability (see: [http://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/sustainability-at-ifc/policies-standards/performance-standards](http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/policies-standards/performance-standards)) and the associated Environmental, Health and Safety (EHS) Guidelines.

<sup>3</sup> Our benchmark is the Corporate Governance Development Framework (SIFEM is a signatory to this Framework) (see <http://cgdevelopmentframework.com/>)

### ***Policy Statement***

SIFEM's Approach to Responsible Investment, or its Responsible Investment Policy, stipulates SIFEM's ESG-related investment requirements. It has been based on international accepted, best practice standards which include the UN Guiding Principles for Business and Human Rights, ILO Core Labor Standards, International Finance Corporation's (IFC's) Standards on Social and Environmental Sustainability (2012) and the associated Environmental, Health and Safety (EHS) Guidelines, the Corporate Governance Development Framework, and the Client Protection Principles<sup>4</sup>.

SIFEM's Approach to Responsible Investment is aligned with, or materially similar to, the approaches used by other European Development Finance Institutions (EDFIs).

### ***Scope and Application***

This Policy applies to SIFEM, SIFEM's Investment Advisor<sup>5</sup>, its Fund Managers and their underlying portfolio companies, as well as its Financial Institutions and their clients.

SIFEM is cognizant that its direct and indirect investments may not be compliant with this policy at the time of investment. In such cases, SIFEM's Investment Advisor works with Fund Managers and Financial Institutions to develop Environmental and Social Action Plans (ESAPs) and achieve compliance within defined time frames. SIFEM requires that Fund Managers and Financial Institutions take the same steps to ensure that their portfolio companies and clients achieve compliance. SIFEM's Investment Advisor actively assists SIFEM's Fund Managers and Financial Institutions to reach compliance and/or support Fund Managers' and Financial Institutions' efforts to ensure that their Portfolio Companies' and Clients' compliance.

SIFEM only invests in companies, and it requires that its Fund Managers and Financial Institutions only provide financing to companies and clients, which are expected to reach compliance with this Responsible Investment Policy within defined time frames. Failure to reach compliance within established deadlines, and other material breaches in this Policy, may trigger remedial actions or divestment.

SIFEM's Investment Advisor's CEO may under extraordinary circumstances grant and revoke waivers of this Policy.

### ***Structure***

SIFEM's Responsible Investment Policy is structured as follows:

- Section 1:** SIFEM's Responsible Investment Requirements
- Section 2:** SIFEM's E&S Requirements for Funds and Fund Managers
- Section 3:** SIFEM's E&S Requirements for Financial Institutions
- Section 4:** Exclusion List

### ***Policy Authority and Revision***

SIFEM's Investment Advisor's Chief Executive Officer (CEO) is the owner of SIFEM's Responsible Investment Policy and its Head of Environmental, Social and Governance (ESG) is responsible for the Policy's implementation.

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<sup>4</sup> See <http://www.smartcampaign.org/index.php>

<sup>5</sup> Obviam is SIFEM's Investment Advisor.

This Policy will be reviewed and revised, as necessary, to reflect changes in ESG practices and standards and lessons learned. At a minimum, it will be reviewed biennially. The next scheduled review will be in December 2019.

### ***Related Policies/Procedures***

SIFEM's legal building blocks, as they pertain to ESG matters  
SIFEM's Investment Advisor's Procedure Manual (under revision)

## **1. SIFEM's Investment Advisor's Responsible Investment Requirements**

SIFEM's Investment Advisor shall:

- Ensure that SIFEM's Approach to Responsible Investment is integrated into investment-decision making process and portfolio management.
- Maintain a management system which supports:
  - Not directly, or indirectly financing companies in engaged in excluded activities found in Section 4;
  - Identifying and assessing potential investees' ESG risks (including possible integrity and reputational risks) and Impacts;
  - Assisting SIFEM's Fund Managers and Financial Institutions to develop, maintain, and if necessary, enhance their ESG management systems through the delivery or facilitation of training or guidance;
  - Actively monitoring (including engagement with) and tracking its Funds' and Financial Institutions' adherence to SIFEM's Responsible Investment Policy as set out in Sections 2, and 3;
  - Tracking and following up on Environmental and Social Action Plans (ESAPs);
  - Ensuring that material breaches of SIFEM's Responsible Investment Policy by a Fund, Portfolio Company, Financial Institution, or Client are investigated and resolved in a timely manner; and
  - Identifying and assessing areas in which its Fund Managers, and their underlying Portfolio Companies, and Financial Institutions can generate sustainable, positive impacts, and where possible, support efforts to generate such impacts.
- Ensure that it has adequate in-house ESG capacity to fulfill these requirements and has access to commercial tools and 3<sup>rd</sup> party resources to support and supplement this capacity.

When SIFEM co-invests with other development finance institutions, its Investment Advisor may apply some, or all of these co-investors' (aligned) requirements to achieve a harmonized set of requirements.

## 2. SIFEM's E&S Requirements for Funds and Fund Managers

Fund managers must commit to providing reasonable labor and working conditions to their employees by ensuring that their own operations meet the requirements of IFC Performance Standard 2- Labor and Working Conditions<sup>6</sup>.

Fund managers must develop and implement Social and Environmental Management Systems (SEMS) before they make their first investment. These SEMS should support the identification, assessment, remediation, and management of E&S issues in their pipelines and portfolio companies, and their sophistication should be commensurate with the E&S risks and impacts associated with the Funds' investment strategies.

Fund managers' SEMS should, at a minimum, contain the following elements:

<b>E&amp;S Policy and Processes:</b>	A policy describing how the Fund Manager will identify, assess, mitigate, and monitor its portfolio companies' compliance with the Exclusion List, Local legislation, and International Standards. The policy should also include a description of the ways in which it develops Environmental and Social Action Plans to address its portfolio companies' non-compliance.
<b>Exclusion List:</b>	Apply the list of excluded activities found in Section 4 when assessing potential investee companies and monitoring portfolio companies.
<b>Local Legislation:</b>	Ensure that all portfolio companies uphold all applicable local laws and regulations, including environmental, health & safety and labor laws, corporate governance regulations, and laws intended to prevent extortion, bribery and financial crime.
<b>International E&amp;S Standards:</b>	Ensure that all portfolio companies work over defined time frames to comply with relevant international standards, including the UN Guiding Principles for Business and Human Rights, ILO Core Conventions, and the IFC Performance Standards and associated EHS Guidelines.
<b>Roles and Responsibilities:</b>	Assign E&S responsibilities to ensure effective oversight of the SEMS by senior management and implementation by suitably qualified staff or consultants.
<b>E&amp;S Risk Categorization:</b>	Categorize potential investee companies as having high, medium or low E&S risk using adequate instruments to determine the appropriate level of management and monitoring <sup>7</sup> .
<b>Assessment:</b>	Assess E&S issues of all new investments, as an integral part of the investment appraisal process, against the Exclusion List, Local legislation, and International Standards.
	For high risk companies, use a suitably qualified expert to evaluate compliance with the Exclusion List, Local legislation and International E&S Standards and carry out a gap analysis by applying the relevant IFC Performance Standards and EHS Guidelines. An evaluation shall include an adequate Environmental

<sup>6</sup> See: [http://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/sustainability-at-ifc/policies-standards/performance-standards/ps2](http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/policies-standards/performance-standards/ps2)

<sup>7</sup> For assessing risks and categorization FMO Toolkit for Private Equity Funds ([http://www.fmo.nl/FMO/documents/ESG/FMO\\_PEF-EandS\\_Toolkit.zip](http://www.fmo.nl/FMO/documents/ESG/FMO_PEF-EandS_Toolkit.zip)) or an equivalent tool or consultant report must be used.

and Social Impact Assessment (ESIA) or adequate Environmental and Social Audit<sup>8</sup>.

**Monitoring:**

- Monitor investee companies' performance and continued compliance with the Exclusion List, Local Legislation and International Standards, and progress on agreed ESAPs on E&S matters including their progress towards action plans, using technical expertise where necessary. For high risk investees, external monitoring is recommended, and in some cases, it may be required.
- Identify and record any serious incidents involving portfolio companies and material breaches of the Exclusion List, Local Legislation and International E&S Standards.
- Work with portfolio companies to continually improve their E&S performance.

**Reporting of Serious Incidents:**

Report any serious incidents, including all fatalities, and any other material breach of law to governing bodies and investors, in any portfolio company immediately to SIFEM's Investment Advisor. Reporting shall include a description of the incident, its impacts, and measures being taken to address them and prevent any future similar event. SIFEM's Investment Advisor shall be informed of the on-going implementation of those measures.

**Annual E&S Reporting:**

Submit regular reporting on E&S Performance (not less than annually) in a format acceptable to SIFEM's Investment Advisor.

Any serious incidents, including all fatalities, and any other material breach of law to governing bodies and investors, associated with the Fund Manager's own operations must be immediately reported to SIFEM's Investment Advisor. Reporting shall include a description of the incident, its impacts, and measures being taken to address them and prevent any future similar event. SIFEM's Investment Advisor shall be informed of the on-going implementation of those measures.

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<sup>8</sup> For greenfield operations and major expansion of existing facilities, risks and impacts should be evaluated through an adequate Environmental and Social Impact Assessment (ESIA). ESIA requirements can be found in IFC Performance Standard 1, Assessment and Management Systems, Guidance Notes (Annex A). For existing operations, the evaluation of risks and impacts shall be assessed through an adequate Environmental and Social Audit. Audit requirements can be found in IFC Performance Standard 1, Assessment and Management Systems, Guidance Notes (Annex B). See [https://www.ifc.org/wps/wcm/connect/b29a4600498009cfa7fcf7336b93d75f/Updated\\_GN1-2012.pdf?MOD=AJPERES](https://www.ifc.org/wps/wcm/connect/b29a4600498009cfa7fcf7336b93d75f/Updated_GN1-2012.pdf?MOD=AJPERES)

### 3. SIFEM's E&S Requirements for Financial Institutions

Financial Institutions must commit to providing reasonable labor and working conditions to their employees by ensuring that their own operations meet the requirements of IFC Performance Standard 2- Labor and Working Conditions.

Financial Institutions must develop and implement Social and Environmental Management Systems (SEMSs) before SIFEM's investment.

The SEMS should support the identification, assessment, remediation, and management of E&S issues in their underlying loan portfolio, and its sophistication should be commensurate with the E&S risks in that portfolio.

Financial Institutions' SEMSs should, at a minimum, contain the following elements:

<b>E&amp;S Policy and Processes:</b>	A policy describing how the Financial Institution will identify, assess, mitigate, and monitor its clients' compliance with the Exclusion List, Local legislation, and International Standards. The policy should also include a description of the ways in which it develops Environmental and Social Action Plans to address certain of its clients' non-compliance.
<b>Exclusion List:</b>	Apply the list of excluded activities found in Section 4 when assessing potential clients and monitoring clients.
<b>Local Legislation:</b>	Ensure that all clients uphold all applicable local laws and regulations, including environmental, health & safety and labor laws, corporate governance regulations, and laws intended to prevent extortion, bribery and financial crime.
<b>International E&amp;S Standards:</b>	Ensure that all clients comply with relevant international standards, including the UN Guiding Principles for Business and Human Rights, and ILO Core Conventions.
<b>Client Protection Principles</b>	Financial Institutions having clients, or are likely to have client, which could potentially have significant adverse social or environmental impacts must also apply the IFC Performance Standards and associated EHS Guidelines.
<b>Roles and Responsibilities:</b>	For Microfinance Institutions: Seek to endorse The Smart Campaign
<b>E&amp;S Risk Categorization:</b>	Assign E&S responsibilities to ensure effective oversight of the SEMS by senior management and implementation by suitably qualified staff or consultants.
<b>Assessment:</b>	Categorize potential clients as having high, medium or low E&S risk using adequate instruments to determine the appropriate level of management and monitoring.
	Assess E&S issues of all new clients, as an integral part of the investment appraisal process, against the Exclusion List, Local Legislation, and relevant international standards, including the UN Guiding Principles for Business and Human Rights, and ILO Core Conventions.
	In the assessment of high risk clients, or clients with high risk activities, the IFC Performance Standards and associated EHS Guidelines shall also be applied.

**Monitoring:**

- Monitor clients' performance, and continued compliance with the Exclusion List, Local Legislation, and relevant international standards, including the UN Guiding Principles for Business and Human Rights, ILO Core Conventions, and in the cases of high risk clients, or clients with high risk activities, the IFC Performance Standards and associated EHS Guidelines.
- Monitor progress on agreed ESAPs on E&S matters, including progress towards action plans, using technical expertise where necessary. For high risk clients or clients with high risk activities, external monitoring is recommended, and in some cases, it may be required.
- Identify and record any serious incidents involving portfolio companies and material breaches in the Requirements
- Seek to work with clients to continually improve their E&S performance

**Annual E&S Reporting:**

Submit regular reporting on E&S Performance (not less than annually) in a format acceptable to SIFEM's Investment Advisor.

Any serious incidents, including all fatalities, and any other material breach of law to governing bodies and investors, associated with the Financial Institution's own operations must be immediately reported to SIFEM's Investment Advisor. Reporting shall include a description of the incident, its impacts, and measures being taken to address them and prevent any future similar event. SIFEM's Investment Advisor shall be informed of the on-going implementation of those measures.



#### 4. Exclusion List

Any activity, production, use of, trade in, distribution of or involving:

1. Forced labor<sup>9</sup> or child labor<sup>10</sup>
2. Activities or materials deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international phase-outs or bans, such as:
  - a) Ozone depleting substances, PCB's (Polychlorinated Biphenyl's) and other specific, hazardous pharmaceuticals, pesticides/herbicides or chemicals;
  - b) Wildlife or products regulated under the Convention on International Trade in Endangered Species or Wild Fauna and Flora (CITES); or
  - c) Unsustainable fishing methods (e.g. blast fishing and drift net fishing in the marine environment using nets in excess of 2.5 km in length)
3. Cross-border trade in waste and waste products, unless compliant to the Basel Convention and the underlying regulations
4. Destruction<sup>11</sup> of High Conservation Value areas<sup>12</sup>
5. Radioactive materials<sup>13</sup> and unbounded asbestos fibres
6. Construction of new and extension of any existing coal fired thermal power plants
7. Pornography and/or prostitution.
8. Racist and/or anti-democratic media
9. Weapons and munitions<sup>14</sup>
10. In the event that any of these following products form a substantial part of a project's primary financed business activities:<sup>15</sup>
  - a) Alcohol beverages (except beer and wine);
  - b) Tobacco; or
  - c) Gambling, casinos and equivalent enterprises

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<sup>9</sup> Forced labor means all work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty as defined by ILO conventions.

<sup>10</sup> Persons may only be employed if they are at least 15 years old, as defined in the ILO Fundamental Human Rights Conventions (Minimum Age Convention C138, Art.2), unless local legislation specifies compulsory school attendances or the minimum age for working. In such cases the higher age shall apply.

<sup>11</sup> Destruction means the (1) elimination or severe diminution of the integrity of an area caused by a major, long-term change in land or water use or (2) modification of a habitat in such a way that the area's ability to maintain its role is lost.

<sup>12</sup> High Conservation Value (HCV) areas are defined as natural habitats where these values are considered to be of outstanding significance or critical importance (see <http://www.hcvnetwork.org>).

<sup>13</sup> This does not apply to the purchase of medical equipment, quality control (measurement) equipment or any other equipment where the radioactive source is understood to be trivial and/or adequately shielded.

<sup>14</sup> This is an SIFEM specific requirement (i.e., it is more stringent than the EDFI requirement).

<sup>15</sup> For portfolio companies, "substantial" means more than 10% of their consolidated balance sheets or earnings. For financial institutions (banks), "substantial" means more than 10% of their underlying portfolio.