Equator Principles Reporting 2010

FMO

Finance for *Development*

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FMO follows Equator Principles – and goes beyond

In 2006, the Netherlands Development Finance Company (FMO) adopted the Equator Principles. As stipulated by our sustainability policy, FMO has been using the Safeguard Policies / IFC Performance Standards since the year 2000. Additionally, FMO has chosen to apply the standards to all financing, meaning that we apply the standards to financing under US$10 million and not only our project finance transactions but corporate finance as well. Hence FMO goes further than the Equator Principles' requirements.

> *FMO recognizes that integrating environmental, social and governance (ESG) returns into our clients' projects is critical to their long-term financial success. ESG is therefore at the heart of our company and strategy.*

Experience shows that good economic, environmental and social (E&S) management, and corporate governance, are interrelated. FMO is convinced that there is a strong business case for the incorporation of E&S issues in business strategies. As a consequence, FMO recognizes the value of considering environmental and social criteria when financing and therefore decided to endorse the Equator Principles. The main objective is to achieve a more in-depth collaboration with other Equator banks resulting in more efficient and effective application of environmental and social criteria in all financing transactions that FMO concludes.

Table 1: Number of projects reviewed according to IFC performance Standards in FMO's portfolio.

	Direct Investments		Financial Institutions	TOTAL
E&S Category	Project Finance	Non-Project Finance		
A	22	6	35	63
B+	33	35	0	68
B	8	69	299	376
C	0	2	55	57
TOTAL	63	112	389	564

Table 2: Number of projects reviewed according to IFC performance Standards by FMO in 2010

	Direct Investments		Financial Institutions	TOTAL
E&S Category	Project Finance	Non-Project Finance		
A	4	0	3	7
B+	10	6	0	16
B	4	9	29	42
C	0	0	7	7
TOTAL	18	15	39	72

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FMO's Environmental and Social Policy:

Minimum requirements

FMO can work with a broad array of privately owned companies, financial institutions (FI) and private equity funds (PEF). It chooses not to select clients which are part of our Exclusion List. The Exclusion List relates to activities that out of their nature are not supported by development banks such as FMO. Moreover, FMO also requires its FI and PEF clients to apply this Exclusion List to the clients they select in their portfolio.

Pricing incentives / penalties

As with Corporate Governance, FMO can support the E&S business case in structuring its financial products. From a risk-return perspective, FMO is able to support implementation of major milestones of the ESAP by offering pricing incentives and/or requiring pricing penalties (in case of non-compliance with the Environmental and Social Action Plan).

Other requirements

FMO makes a distinction between on the one hand Direct Investments, being corporates or project finance companies and on the other hand Indirect Investments, being Financial Institutions (FIs) or Private Equity Funds (PEFs).

DIRECT INVESTMENTS

All our direct investment clients (including those in which we take equity) are required to comply with national E&S law as a minimum standard, and with the Environmental and Social Performance Standards, as developed by the International Finance Corporation (IFC), member of the World Bank Group, whichever stricter.

To help our direct investment clients establish sound E&S practices, we use a practical framework. The framework comprises of three parts: (1) Risk Categorization of clients, (2) Establishing applicable requirements, (3) Environmental and Social Action Plans and (4) pricing incentives.

Ad (1) Risk Categorization of Clients

All new and existing clients are subject to a Risk Categorization of their (potential) Environmental and Social impacts. There are four risk categories A, B+, B and C:

A = high risk: Projects / clients with potential significant adverse social or environmental impacts which are diverse, irreversible or unprecedented.
B+ = medium high risk: Clients with potential adverse social or environmental impacts that are generally beyond the site boundaries, largely reversible and can be addressed through relevant mitigation measures.
B = medium risk: Clients with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures.
C = low risk: Projects with minimal or no adverse social or environmental Impacts.

The categorization of clients into the A, B+, B, or C category is largely based on an assessment against the applicable IFC Environmental and Social Performance Standards. At the same time, we cooperate closely with the European Development Finance Institutions (EDFI's) with the purpose to harmonize our definitions and requirements.

Ad (2) Applicable requirements

Below table provides an overview of the minimum requirements per category of company. For direct investment clients in category A and B+, an assessment of the E&S practices is required as part of FMO's due diligence. All FMO's higher risk clients are required to implement an Environmental and Social Management System (ESMS). This ESMS is customized for each type of client.

Direct Investments	**A**	**B+**	**B**	**C**
Risk / impact	**High**	**Medium / high**	**Medium**	**Low**
IFC Performance Standards (PS)	Often project finance with PS 1-8 triggered	Often corporate finance with PS 1-4 triggered, and potentially high risk aspects (PS 5-8)	Corporate in medium risk sector PS 1-3	Corporate in low risk sector
Requirements	- IFC Performance Standards - ESAP (usually)	-IFC Performance standards -ESAP (if necessary)	-IFC Performance Standards -ESAP (on request)	-National Law -No ESAP

Ad 3 Methodology: Environmental and Social Action Plans

Based on the outcomes of the assessment carried out, an Environmental and Social Action Plan (ESAP) is to be agreed upon as necessary, with clear and practical milestones to be achieved within a certain period of time. The ESAP would normally allow clients a three year period at the maximum to reach full compliance with the requirements. For clients in category B and C, no in-depth assessment is required. However, on a voluntary basis we try to identify potential value creation that can be achieved with these clients.

The ESAP is, in cooperation with the client, made “SMART”, i.e. Specific, Measurable, Achievable, Realistic and Time-Bound, and included in the loan documentation. Non-compliance with key milestones of the ESAP constitutes an event of default under the loan documentation. For FMO’s direct equity transactions, the ESAP shall be firmly agreed and under implementation before disbursement of FMO’s funds and the E&S principles applied by the company shall be firmly constituted in the Shareholders Agreement.

Effective implementation of the ESAP adds value to the client, it mitigates E&S risks and it contributes to E&S development impact that FMO achieves through its financing.

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INDIRECT INVESTMENTS

For our financial institution (FI) clients and private equity funds (PEF) in which we invest, we focus on how they handle the environmental and social risk in their portfolio's. Depending on the risk category, we expect the FIs and PEFs to apply certain environmental and social standards when financing or investing in their clients. Basically, FIs and PEFs will be required to establish and maintain an E&S Management System to ensure that its investments meet (or over time become compliant with) FMO's requirements. The level of detail and sophistication of this management system and of the monitoring approach will depend on the E&S risk profile of the FI / PEF and the type of financing that they provide.

(1) Categorisation and requirements

In the tables below, the risk categorisation for FIs and PEFs is presented, together with the applicable requirements.

Indirect Investments: Financial Institutions	FI-A	FI-B	FI-C
Risk / impact	**High**	**Medium**	**Low**
Financial Institutions	Portfolio > 20% in high risk sectors	Portfolio < 20% in high risk sectors, as well as Microfinance Institutions	Portfolio > 80% retail finance or micro businesses
FI Requirements	- Apply Exclusion List - Client has or develops an ESMS according to ESAP - Applies IFC PS, national law and ratified ILO Conventions to their Category A projects	- Apply Exclusion List - Client has or develops an ESMS according to ESAP - Applies national law and ratified ILO Conventions to their projects	- Apply Exclusion List - National Law and ILO core conventions

Indirect Investments: Private Equity Funds	FI-A	FI-B	FI-C
Risk / impact	**High**	**Medium**	**Low**
Private Equity Funds	>15% Investee companies in high risk sectors	<15% Investee companies in high risk sectors	In principle Investments in low risk sectors only
Fund Requirements	-Apply exclusion list - Commit to E&S Investment Code before first investment - ESMS based on IFC PS for high risk clients -ESMS ready before first investment	- Apply exclusion list - Commit to E&S Investment Code before first investment - ESMS based on IFC PS for high risk clients -ESMS ready before first investment	- Apply exclusion list - Commit to E&S Investment Code before first investment - ESMS based on IFC PS for high risk clients -ESMS ready before first investment
Investee Company Requirements	- National Law and ILO core conventions. - Work to ultimately comply with IFC PS (for high risk investee companies only) - Policy for continuous improvement	- National Law and ILO core conventions. - Work to ultimately comply with IFC PS (for high risk investee companies only) - Policy for continuous improvement	- National Law and ILO core conventions. - Work to ultimately comply with IFC PS (for high risk investee companies only) - Policy for continuous improvement

(2) Environmental and Social Action Plans

For those FIs where an ESMS is required, an action plan can be agreed upon with timelines for the various elements (policy, training, procedures, full implementation). The Environmental and Social Action Plan (ESAP) is to be agreed upon as necessary, with clear and practical milestones to be achieved within a certain period of time. For FI clients in category FI-B and FI-C, opportunities will be actively explored on how FMO can assist these clients with development of an ESMS for their portfolio, on a voluntary basis. Through this, we identify potential value creation that can be achieved with these clients.

Figure 1: How E&S is incorporated into FMO's credit approval process