

FMO

Entrepreneurial
Development
Bank

THE FMO ESG TOOLKIT

FOR PE FUNDS

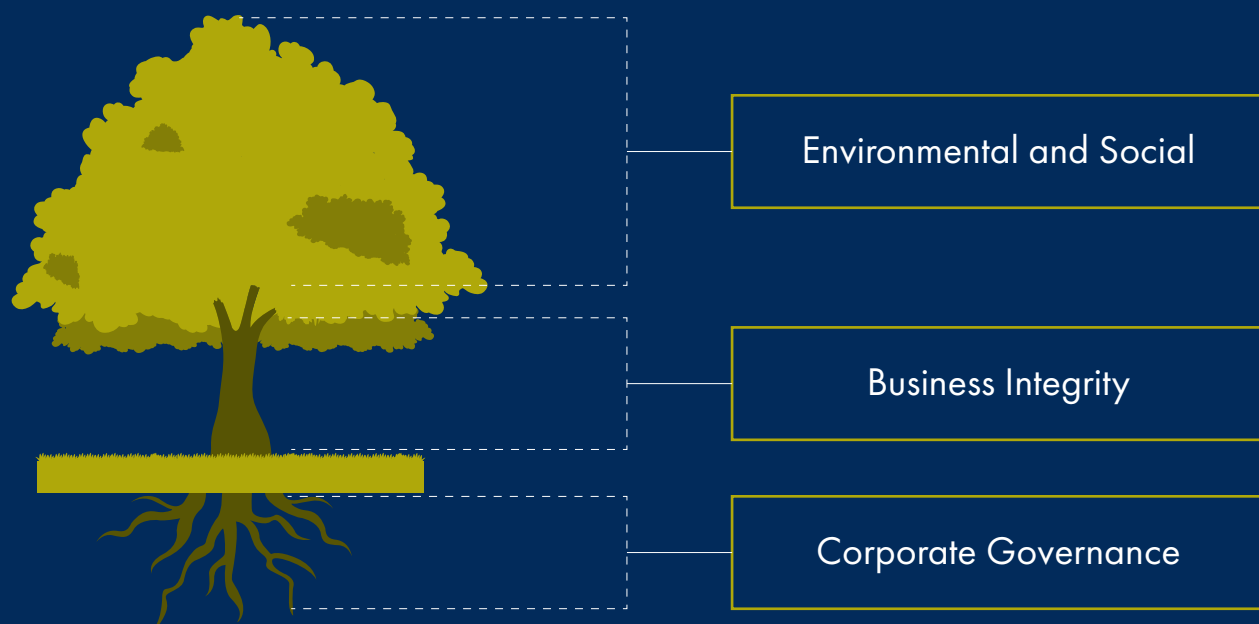


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01. INTRODUCTION

The FMO ESG Toolkit supports generalist Private Equity Funds in the assessment and management of Environmental, Social, Corporate Governance and Business Integrity risks of investees.



A combination of strong Corporate Governance and Business Integrity will support good management of Environmental and Social risks and opportunities and enable the investee to grow and thrive.

There are many sector specific tools and guidance documents available on ESG reporting and ESG Due Diligence from Development Finance Institutions, rating agencies and consulting firms. For Fund Managers that have investees in many different sectors or in many different countries, it can be challenging to know where to start their ESG analysis. The FMO ESG toolkit addresses this need

by providing a high-level comprehensive tool for generalist Private Equity Funds to screen investments and monitor the ESG performance of their portfolios. The tool references relevant international best practices and standards and has several other useful features as outlined in the rest of this document.

FMO WORKED TOGETHER WITH AN ESG CONSULTANT FIRM, STEWARD REDQUEEN, TO DEVELOP THE TOOLKIT. THE TOOL IS BUILT AROUND THE FOLLOWING INTERNATIONALLY RECOGNISED SOURCES:



ENVIRONMENTAL AND SOCIAL

The IFC Performance Standards



CORPORATE GOVERNANCE

The Corporate Governance Development Framework (a collaboration between 34 Development Finance Institutions)



BUSINESS INTEGRITY

CDC Group's Toolkit and the section on Business Integrity and the CFA Institute's Code of Ethics and Standards of Professional Conduct



02. TECHNICAL FEATURES AND CONFIDENTIALITY

01 CONFIDENTIAL



Information is not shared with FMO



Secure cloud environment



Some data can be exported from the tool

02 TECHNICAL



Works on pcs, tablets & phones



Centralised updates, no need to re-download, available off-line



Live connections to external databases through APIs

- 2.1.** FMO makes the Toolkit available free of charge to support ESG management for Private Equity Funds.
- 2.2.** The Toolkit is a web-based application with a user-friendly interface. It is connected to various other live databases using APIs (Application Programming Interfaces) and as a result any changes in the data of such databases are instantly reflected in the Toolkit.
- 2.3.** The Toolkit itself is updated on a centralised basis and automatically distributed to users without the need for them to re-download the Toolkit. Users will therefore always have access to the most recent version of the Toolkit.
- 2.4.** Even though the Toolkit is web-based, it is also available off-line. It is also designed to work on PCs, tablets and phones.
- 2.5.** The toolkit runs in a secured cloud environment and any information inserted in the Toolkit, is confidential to the user and not shared with FMO.
- 2.6.** It is possible to separately export the sector and country ESG risks and the ESG risk mitigants for every investment in a portfolio. In future updates of the Toolkit, additional reporting features, such as the export of ESG performance, may be added.

03. USEFUL THROUGH THE ENTIRE INVESTMENT PROCESS

THE TOOL IS INTENDED TO BE USEFUL THROUGH THE ENTIRE INVESTMENT CYCLE FROM INITIAL SCREENING TO EXIT AS SHOWN BELOW:



SCREENING

- Help to identify key sectoral E&S risks at an early stage
- Rank E&S Risks in the relevant sector
- User-friendly and quick to complete



DUE DILIGENCE

- Screen & highlight key E&S risks and opportunities
- Guidance on ESG and Business Integrity risk level
- Identify Corporate Governance development stage
- Links to more detailed DD guidance documents & sources



INVESTMENT AGREEMENT

- Identify actions to mitigate risk and capitalise on opportunities (potential input for an action plan).
- Highlight DFI requirements (eg. EDFI exclusion list, IFC EHS Guidelines, and FMO position statements)



MONITORING

- Links to international best practices.
- Track investee performance and development over time.
- Identify ESG opportunities at investee level



PORTFOLIO MANAGEMENT

- Comparative analysis across investees in a Fund and across peers in the sector
- See ESG portfolio and risk as a whole in the fund in addition to individual investee level.



EXIT

- Show ESG value creation over the life of the investment

04. INDIVIDUAL INVESTEE VIEW OR PORTFOLIO VIEW

4.1. TOOLKIT DASHBOARD

The Toolkit has a dashboard for each individual investee, but also a dashboard for the fund portfolio as a whole. A user can therefore zoom in to analyse and review information about a single investee or alternatively zoom out to get an overview of the performance and risk of the portfolio as a whole.



05. MULTIPLE PORTFOLIO VIEW



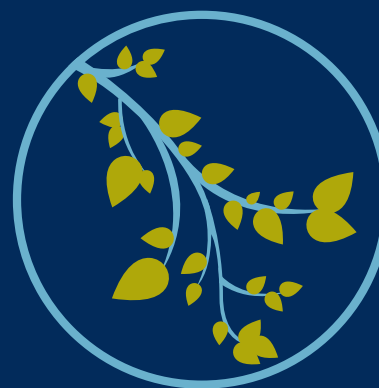
FUND 1



FUND 2



FUND 3



FUND 4

Companies



Funds



In addition to having a dashboard for one fund's portfolio, it is possible to add more than one fund. A Fund Manager that manages multiple funds, can therefore use the Toolkit to manage the ESG aspects of each fund separately and to compare the overall risks and performance between investees of all funds.

06. INDIVIDUAL INVESTEE PERFORMANCE REVIEW: QUICK OR DEEP ANALYSIS

Depending on the investment phase of an investee or prospect, a Fund Manager may want to do either a high-level analysis or a deeper analysis. For example, at the initial screening stage, it may be useful to only complete a high-level assessment of a

company's ESG risk management and performance. On the other hand, at the due diligence stage, it could be useful to do a more in-depth analysis and to refer to more detailed guidance documents.

HIGH LEVEL/QUICK ANALYSIS

7 MAIN ENVIRONMENTAL AND SOCIAL ELEMENTS	5 MAIN CORPORATE GOVERNANCE ELEMENTS	6 MAIN BUSINESS INTEGRITY ELEMENTS
Policy	Commitment to CG	BI Management System
ESG Risk and Opportunity Identification	Board Structure & Functioning (in the case of an established corporate)/ Decision making & oversight (in the case of less formalised company eg. SME)	BI Integrity Alert & economic sanctions
Organisational Capacity and Competency		Compliance with laws and regulations
Processes	Control Environment & Processes	Anti-Bribery and Corruption Management
Performance Management and Monitoring		Whistleblower system
Reporting	Transparency & Disclosure Shareholder rights (in the case of an established corporate)/Ownership (shareholder/family in the case of a less formalised company eg. SME)	Cyber and Data Security
Emergency Response and Preparedness		

DEEP ANALYSIS

7 MAIN ENVIRONMENTAL AND SOCIAL ELEMENTS & 24 SUB-ELEMENTS	5 MAIN CORPORATE GOVERNANCE ELEMENTS & 13 OR 20 SUB-ELEMENTS DEPENDING ON COMPANY TYPE (SME/EARLY STAGE OR CORPORATE)	6 MAIN BUSINESS INTEGRITY ELEMENTS AND 21 SUB-ELEMENTS				
<div>1. Policy</div> <div>1.1. Objectives and Principles</div> <div>1.2. Legal Compliance</div> <div>1.3. Accountability</div> <div>1.4. Communicating Policy</div> <div>1.5. Board/Management Approval</div> <div>2. ESG Risk and Opportunity Identification</div> <div>2.1. Risk Assessment</div> <div>2.2. Process Adequacy</div> <div>2.3. Risk Rating and Prioritisation</div> <div>3. Organisational Capacity and Competency</div> <div>3.1. Internal ESG Organisation</div> <div>3.2. Training</div> <div>3.3. Oversight</div> <div>4. Processes</div> <div>4.1. Process description</div> <div>4.2. Grievances</div> <div>4.3. ESG Reporting Process</div> <div>5. Performance Management and Monitoring</div> <div>5.1. Goals and Targets</div> <div>5.2. Action Plan Follow-up</div> <div>6. Reporting</div> <div>6.1. Content</div> <div>6.2. Frequency</div> <div>6.3. Serious Incidents</div> <div>6.4. Corrective Actions</div> <div>7. Emergency Response and Preparedness</div> <div>7.1. Internal, short term emergency</div> <div>7.2. External, longer term disruptive</div> <div>7.3. Basic Elements</div> <div>8. Business Continuity</div>	<div>1. Commitment to CG</div> <div>1.1. Formalised view</div> <div>1.2. Authority</div> <div>1.1. Strategy formulation (SME/early stage) Information disclosure (corporate)</div> <table><tr><th>SME</th><th>CORPORATE</th></tr><tr><td><div>2. Decision making & oversight</div><div>2.2. Strategic guidance & input</div><div>2.3. Decision processes</div><div>2.4. Capabilities & Performance</div><div>2.5. Succession planning</div><div>2.6. Division of authority</div><div>3. Control Environment & Processes</div><div>3.2. Financial controls</div><div>3.3. Compliance</div><div>3.4. Internal & external audit</div><div>3.5. Management information</div><div>4. Transparency & Disclosure</div><div>4.2. Financial disclosures</div><div>4.3. Consistency of information</div><div>4.4. Public Information</div><div>5. Ownership (shareholder)/Ownership (family owned company)</div></td><td><div>2. Board structure and functioning</div><div>2.1. Board size & meetings</div><div>2.2. Board composition</div><div>2.3. Board Committees</div><div>3. Control Environment & Processes</div><div>3.1. Internal controls</div><div>3.2. Audits</div><div>3.3. Oversight responsibility</div><div>4. Transparency & Disclosure</div><div>4.1. Financial disclosures</div><div>4.2. Financial transparency</div><div>5. Shareholder rights</div><div>5.1. Shareholder meetings</div><div>5.2. Conflicts of interest</div></td></tr></table>	SME	CORPORATE	<div>2. Decision making & oversight</div> <div>2.2. Strategic guidance & input</div> <div>2.3. Decision processes</div> <div>2.4. Capabilities & Performance</div> <div>2.5. Succession planning</div> <div>2.6. Division of authority</div> <div>3. Control Environment & Processes</div> <div>3.2. Financial controls</div> <div>3.3. Compliance</div> <div>3.4. Internal & external audit</div> <div>3.5. Management information</div> <div>4. Transparency & Disclosure</div> <div>4.2. Financial disclosures</div> <div>4.3. Consistency of information</div> <div>4.4. Public Information</div> <div>5. Ownership (shareholder)/Ownership (family owned company)</div>	<div>2. Board structure and functioning</div> <div>2.1. Board size & meetings</div> <div>2.2. Board composition</div> <div>2.3. Board Committees</div> <div>3. Control Environment & Processes</div> <div>3.1. Internal controls</div> <div>3.2. Audits</div> <div>3.3. Oversight responsibility</div> <div>4. Transparency & Disclosure</div> <div>4.1. Financial disclosures</div> <div>4.2. Financial transparency</div> <div>5. Shareholder rights</div> <div>5.1. Shareholder meetings</div> <div>5.2. Conflicts of interest</div>	<div>1. BI Management System</div> <div>1.1. Principles & policies</div> <div>1.2. Roles & responsibilities</div> <div>1.3. Engagement Program</div> <div>1.4. Performance Management</div> <div>2. BI Integrity Alert & economic sanctions</div> <div>2.1. PEP involvement</div> <div>2.2. Sanctions list</div> <div>3. Compliance with laws and regulations</div> <div>3.1. Awareness</div> <div>3.2. Compliance</div> <div>3.3. Audits</div> <div>3.4. Monitoring & oversight</div> <div>4. Anti-Bribery and Corruption Management</div> <div>4.1. Policies & procedures</div> <div>4.2. Accountability, roles & responsibilities</div> <div>4.3. Senior level endorsement and public statement</div> <div>5. Whistleblower system</div> <div>5.1. Policy & commitment</div> <div>5.2. Procedures</div> <div>5.3. Public statement</div> <div>6. Cyber and Data Security</div> <div>6.1. User privileges & access</div> <div>6.2. Secure systems & configuration</div> <div>6.3. Network & endpoint protection</div> <div>6.4. Risk management</div>
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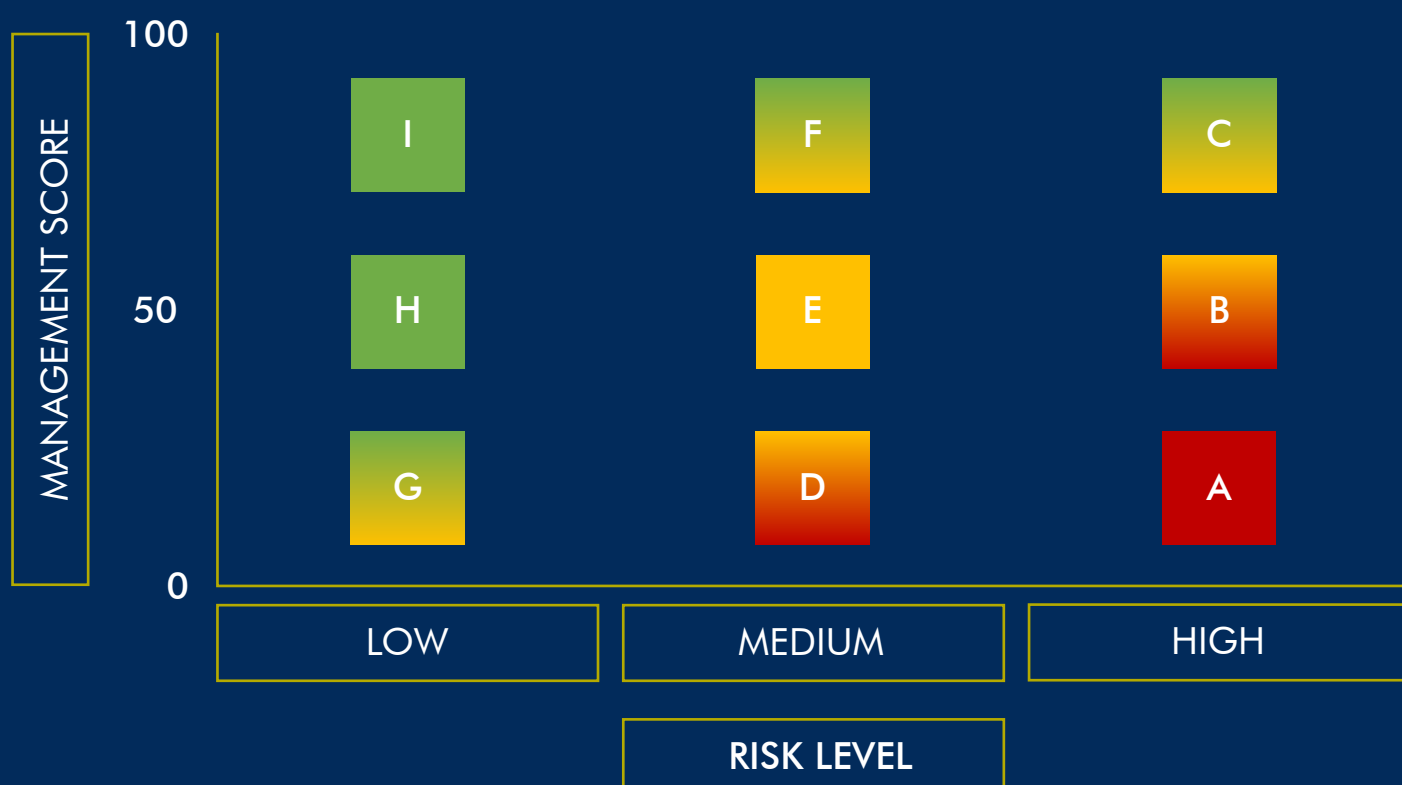
07. THE TOOLKIT METHODOLOGY: COMBINING RISK & QUALITY OF MANAGEMENT OF THE RISK

The Toolkit answers the question: How high is the risk and how well is that risk being managed by the Investee?

When a user adds an investment, the tool assigns a risk level based on sector information in the case of E&S risk and country information in the case of Business Integrity Risk. After assigning a risk level, the toolkit helps the user to assess how well those risks are managed by assigning a Management Score as explained in more detail in the following sections of this document.

By combining the two dimensions of risk and performance, a Fund Manager is able to prioritize

and focus their attention on those investees with the highest risk, but lowest quality of risk management in the Fund's portfolio. As shown in the diagram below, if each of the squares below is an investee, the Fund Manager would want to focus most of its attention on the companies in shades of red, with the highest risk, but lowest ability to manage those risks. So the Fund Manager would focus on companies with red and orange (i.e. A, B and D below) and less on companies in green (i.e. G, H and I below).



08. ENVIRONMENTAL AND SOCIAL

8.1. ENVIRONMENTAL AND SOCIAL RISKS

Environmental and Social risks are categorised as Low Medium or High depending on the risks that are prevalent in the sector. The risks are categorised according to IFC Performance Standards.

E&S risk

low, medium or high based on SECTOR

SECTOR risks

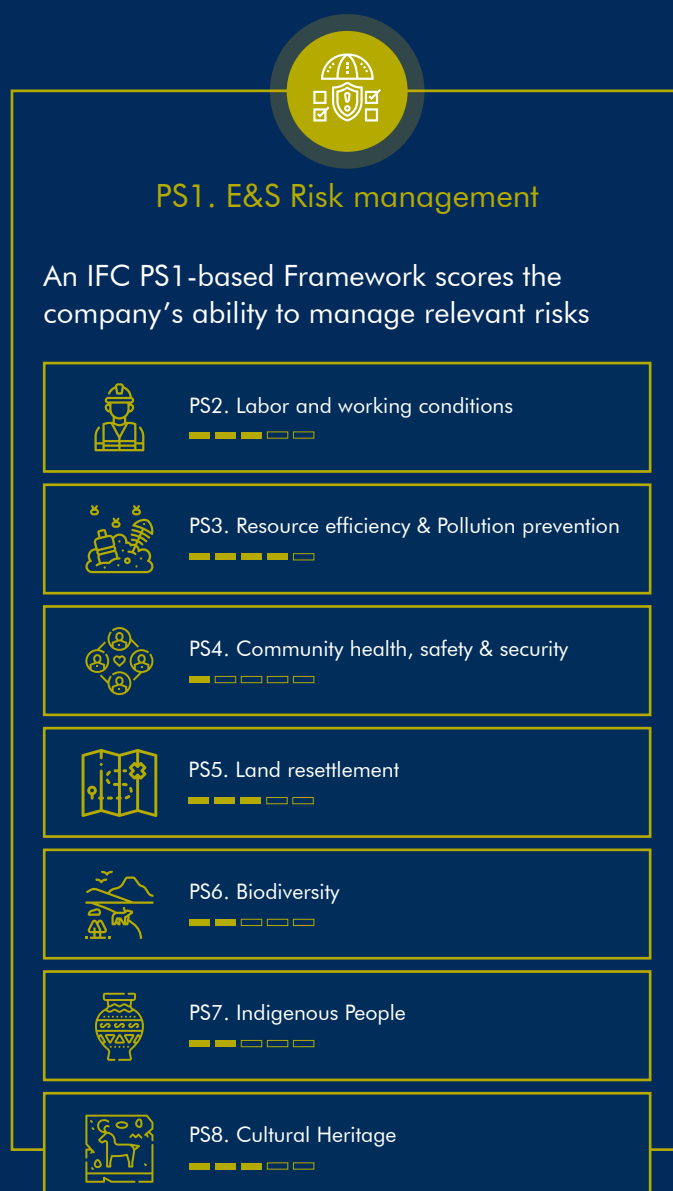
sub-classified according to IFC Performance Standards

8.2. IFC PS RISKS

In the investee dashboard, the tool will highlight those IFC PS risks in the sector that scores 3 or more out of 5 in terms of relevance to help the user to focus on those risks that are most likely to be relevant in the sector. See the five blocks below each IFC PS in the diagram on the right. However, the user can choose to expand the tool to see more risks that could arise, but that are typically less relevant (i.e. with a relevance score of less than 3 out of 5).

8.3. MANAGING RISKS

To assess the investee's ability to manage relevant E&S risks, an IFC PS-1 based framework is used to compile an E&S Risk Management Score for the investee.



8.4. CALCULATING E&S MANAGEMENT SCORE

To calculate the E&S Risk Management Score, a user scores each main element (in the case of a Quick Analysis) or each sub-element (in the case of a Deep Analysis) is scored as shown in the table below:

7 MAIN ENVIRONMENTAL AND SOCIAL ELEMENTS OR 24 SUB-ELEMENTS

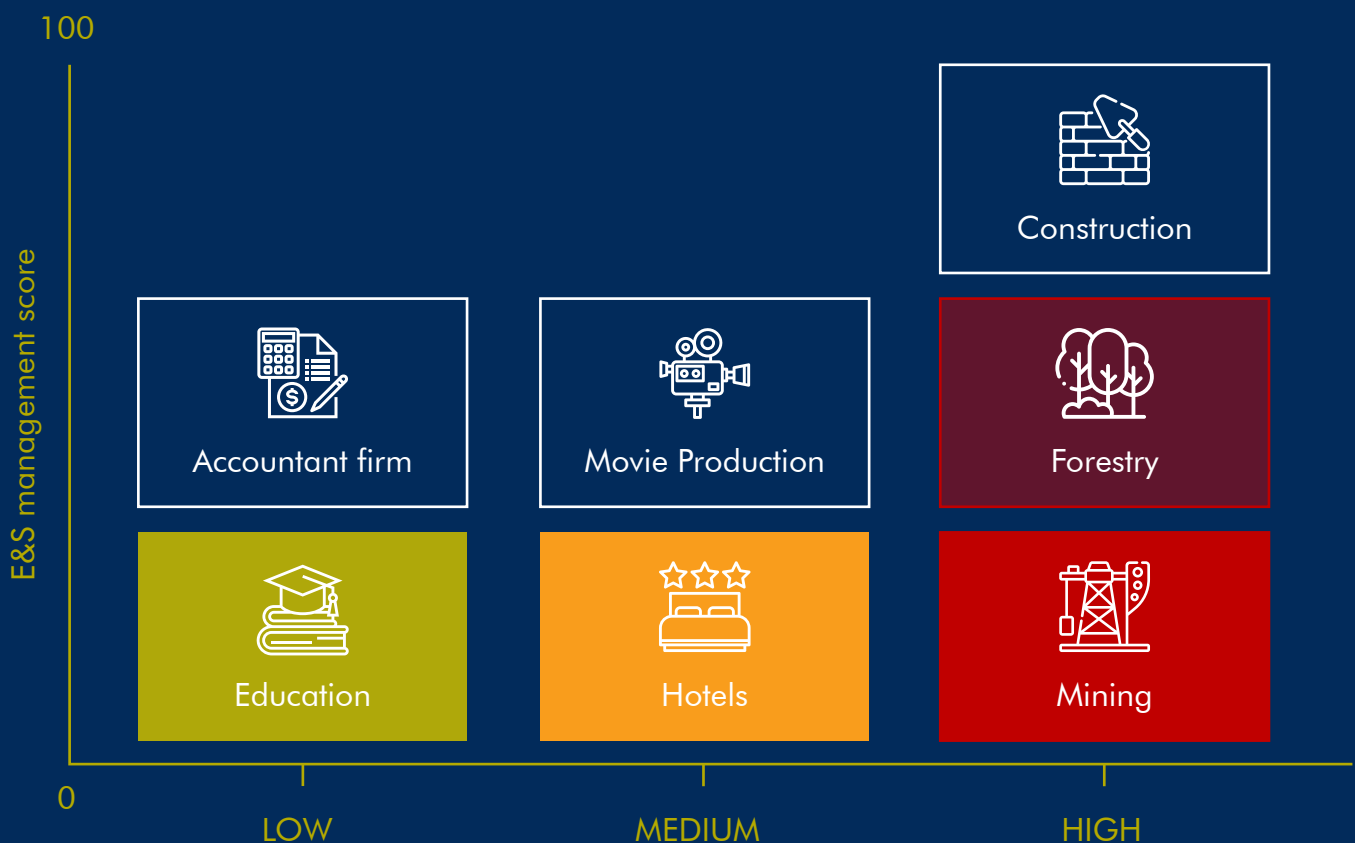
	Non-existing: number of points 0	Basic: number of points 1	Good: number of points 2	Very Good: number of points 3
1. Policy 1.1. Objectives and Principles 1.2. Legal Compliance 1.3. Accountability 1.4. Communicating Policy 1.5. Board/Management Approval			✓	
2. ESG Risk and Opportunity Identification 2.1. Risk Assessment 2.2. Process Adequacy 2.3. Risk Rating and Prioritisation			✓	
3. Organisational Capacity and Competency 3.1. Internal ESG Organisation 3.2. Training 3.3. Oversight			✓	
4. Processes 4.1. Process description 4.2. Grievances 4.3. ESG Reporting Process			✓	
5. Performance Management and Monitoring 5.1. Goals and Targets 5.2. Action Plan Follow-up			✓	
6. Reporting 6.1. Content 6.2. Frequency 6.3. Serious Incidents 6.4. Corrective Actions			✓	
7. Emergency Response and Preparedness 7.1. Internal, short term emergency 7.2. External, longer term disruptive 7.3. Basic Elements 7.4. Business Continuity			✓	

The E&S review will result in an E&S Management Score based on the points awarded. For example, if the user scores all main elements for an investee as “good” the number of points received is 14/21 and the business integrity management score will be 67%.

8.5. CALCULATING E&S MANAGEMENT SCORE

Combining an investee's risk level with its Management Score, allows a Fund Manager to identify red flags in the portfolio. One of the outputs of the tool, is a chart that plots the ability to manage risks on the y-axis and the E&S risk category on the x-axis. As shown in the image below, if a fund has an investee that is an education institution, it is quite low risk from an E&S point of view. A hotel would be medium risk and a mining company would be high

risk. The fund would want to ensure that the mining company is able to manage E&S risks properly, ensure that it has a high E&S management score. Any high risk investments that have a low E&S management score, would be a red flag (bottom right of the graph). On the other hand, low ability to manage risk, would not be a red flag if the E&S risk is also low (for example education).



8.6. MITIGATION ACTIONS

The tool also suggests actions that could be undertaken by the investee to mitigate E&S risks that are identified for the sector. The mitigation actions could assist the Fund Manager in preparing an action plan to agree with the investee.

8.7. SECTOR OPPORTUNITIES

In addition to looking at risks and suggesting mitigation actions, the tool also highlights E&S opportunities per sector.

E&S opportunities are actions that an investment company could undertake to potentially improve E&S performance, for example to strive for sustainable certification of the product produced. Furthermore, Environmental and Social management performance improvements translate into financial benefits (e.g. energy savings, waste reduction etc.) or improve exit opportunities.

HERE IS ONE EXAMPLE FOR TEXTILE MANUFACTURING.



SECTOR OPPORTUNITIES: TEXTILE

- Sector-specific certifications (WRAP)
- Labor/E&S standard certification (SA 8000, ISO 14001)
- Improve sub-contractor management
- Reuse process water to reduce energy and water use

AND AN EXAMPLE FOR FORESTRY



SECTOR OPPORTUNITIES: FORESTRY

- Promotion of agro-forestry
- Community forestry programs
- Certified logging (FSC)
- Occupational Health and Safety (OHSAS 18001)

8.8. MITIGATION ACTIONS

Here are two examples of how the tool would provide information on the relevant E&S risks in the sector, mitigating actions that can be taken in respect of the risks, and opportunities that may be relevant in the sector.

8.8.1. EXAMPLE PAPER FACTORY:



IFC PS?

PS 6, Biodiversity: Risk of (critical) habitat alteration & supply chain issues

PS 4, Community: Security personnel Risk of attack due to chemicals and materials stored

PS 3, Resource efficiency & pollution prevention: Air Emissions (and Ambient Air Quality), Energy use, significant energy consumption, historical pollution Soil & Groundwater Risk of spillage/ chemical contamination, solid waste, water use & pollution

PS 2, Labor: contract violations & labor standards, exposure to hazardous waste, supply chain issues, working conditions & OHS



SOME SUGGESTED MITIGANTS:

Biodiversity action plan, supplier code of conduct, Avoid generating pollutants (substituting raw materials, energy sources with less polluting practices)



OPPORTUNITIES:

Recycling, certified logging, re-use process water to reduce energy and water consumption, labour & E&S certification (SA 8000, ISO 14001)

8.8.2. EXAMPLE FOOD MANUFACTURING:



RELEVANT IFC PERFORMANCE STANDARDS:

PS 2, Child and Forced Labor: contract violations and labor standards, contractors, third parties and temporary workers, supply chain issues, working conditions and OHS

PS 3, Resource Efficiency: air emissions, energy use, GHG emissions/climate change, soil & ground water, (historical) pollution, waste

PS 6, Biodiversity: (critical) habitat, impact on traditional land, supply chain issues

PS 4, Community: natural resources issues re. communities, exposure to disease, security personnel, traffic safety & transport of hazardous materials.

SOME SUGGESTED MITIGANTS:



General Safety Design and Operations; Accident investigation and reporting; Training of workers and communication; supplier code of conduct, monitor primary supply chain, ensure contracted workers have access to grievance mechanism, built emergency preparedness and response plan



OPPORTUNITIES:

Increase local sourcing of raw materials; Sell residual products to farmers rather than dispose them, minimize energy and water use through reuse of process streams; certifications ISO/SA

8.9. OTHER NOTEWORTHY E&S FEATURES

8.9.1. COUNTRY RISKS:



The tool also highlights specific E&S country risks classified according to IFC Performance Standards. It includes a set of 10 environmental risks based on the Environmental Performance Index database and a set of three social risks (capturing country specific issues related to “gender, equal opportunities and discrimination”, “Trade Union Rights” and “Child labour”). The E&S country risks will appear when reaching a specific threshold.

8.9.2. PEER COMPARISON:



This is a feature which fully anonymizes the management scores that the tool produces. Users can compare the management scores of their own investees to those of anonymized companies of other funds within the same (sub)sector, to get a sense of where the investment stands in the overall sector.

8.9.3. TRACKING PERFORMANCE OVER TIME:



The tool also allows users to measure performance over time by seeing how the management score per investee is evolving each time a performance review is completed.

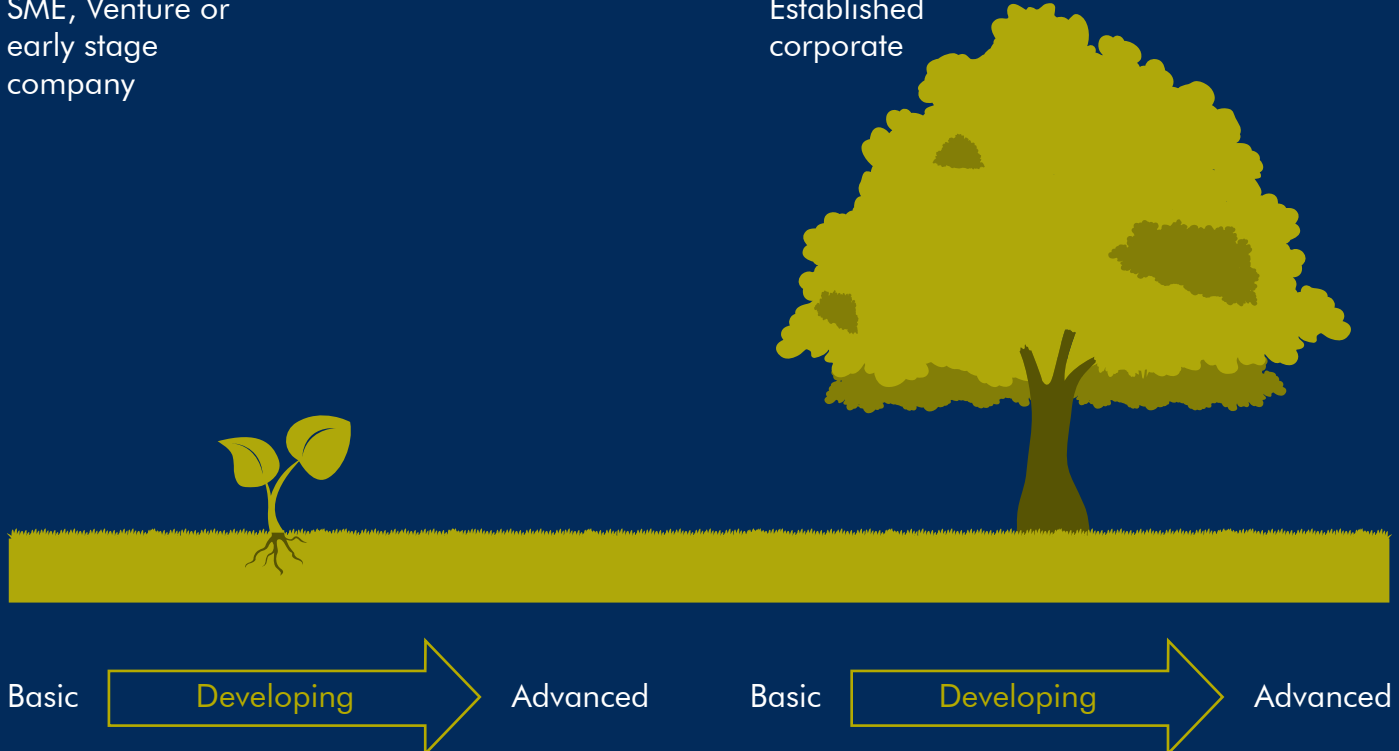
09. CORPORATE GOVERNANCE

GOOD CORPORATE GOVERNANCE

Good Corporate Governance is a continuing development journey, so in the Corporate Governance part of the tool, it plots whether a company's Corporate Governance is basic, developing, developed or advanced rather than assigning a risk category. The tool differentiates between two types of companies – established corporates on the one hand and companies that are small or in an early development phase on the other.

SME, Venture or
early stage
company

Established
corporate

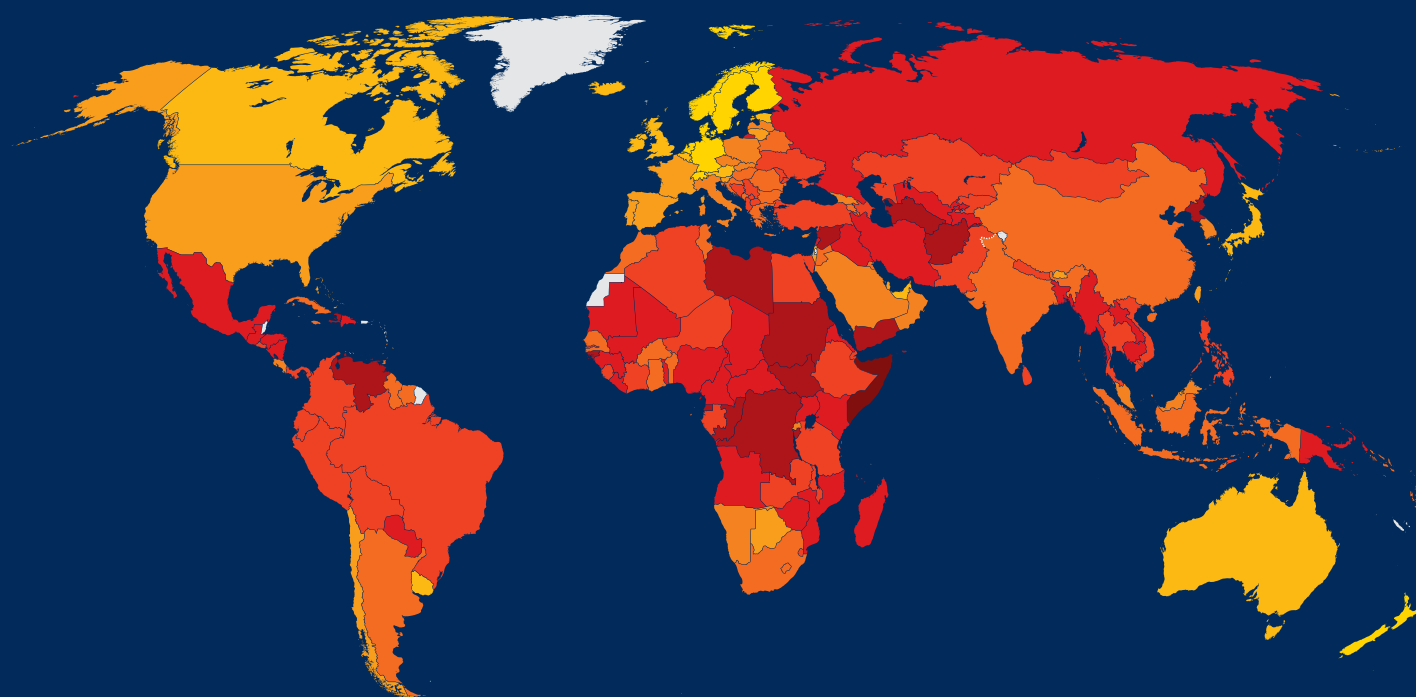


Both tools are broadly based on tools of the Corporate Governance Development Framework, a framework that is widely used and adopted by 34 Development Finance Institutions. The development framework is useful for a Fund Manager to identify next steps for an investee in its Corporate Governance journey. For example, if a company has

a basic level of development when looking at its Board of Directors, the Fund Manager can check what the requirements are for a company's Board to classify as "Developed" and agree steps for improvement in the shareholders agreement.

10. BUSINESS INTEGRITY

Business integrity risk is ranked as low, medium or high, based on the country where the company operates. Low business integrity exposes an investee to high reputational, management and financial risks. The Business Integrity aspect of the ESG Toolkit is based on CDC Group's Toolkit and the CFA Institute's Code of Ethics and Standards of Professional Conduct.



RISK LEVEL

LOW



HIGH

6 MAIN BUSINESS INTEGRITY ELEMENTS AND 21 SUB-ELEMENTS

	Non-existing: number of points 0	Basic: number of points 1	Good: number of points 2	Very Good: number of points 3
1. BI Management System 1.1. Principles & policies 1.2. Roles & responsibilities 1.3. Engagement Program 1.4. Performance Management			✓	
2. BI Alert & Economic sanctions 2.1. PEP involvement 2.2. Sanctions list			✓	
3. Compliance with laws and regulations 3.1. Awareness 3.2. Compliance 3.3. Audits 3.4. Monitoring and oversight			✓	
4. Anti-Bribery and Corruption Management 4.1. Policies & procedures 4.2. Accountability, roles & responsibilities 4.3. Senior level endorsement and public statement			✓	
5. Whistleblower system 5.1. Policy & commitment 5.2. Procedures 5.3. Public statement			✓	
6. Cyber and Data Security 6.1. User privileges & access 6.2. Secure systems & configuration 6.3. Network & endpoint protection 6.4. Risk management			✓	



The business integrity review will result in a Business Integrity Management Score based on the points awarded. For example, if the user scores all main elements for an investee as “good” the number of points received is 12/18 and the business integrity management score will be 67%.

11. THE TOOL DOES NOT REPLACE ESG ANALYSIS

It is very important to realise that the tool is general and highlights typical risks in a sector. Users should pay attention to risks beyond what the toolkit may flag. To highlight this point, we point to an example from FMO's portfolio in the telecom sector.

FMO CASE

If you were to enter 'Telecommunications' in the toolkit, the tool will highlight IFC Performance standard 2 (labour and working conditions) and the E&S risk level would be medium. However, depending on the specific context of the investment, on some occasions there could be additional risks, for example PS4 risks in community health, safety and security. To highlight this point, we point to an example from FMO's portfolio in the telecom sector.

- 01** PE Fund invested in telecom business with several telecom towers under management
- 02** IFC PS 4 (community health, safety and security) was not specifically looked at by the fund manager
- 03** After investment, theft started taking place as local people were trying to steal fuel and batteries (stored at the telecom towers)
- 04** As a result, security guards encountered serious issues/conflicts which even resulted in several fatalities over the course of the investment

ATTENTION POINTS

Pay attention to risks beyond what the toolkit may highlight. In this case;

- 01** Challenges working with 3rd party security suppliers (how to conduct background checks on 3rd party security personnel - e.g. is security staff trained in accordance with international best practices etc.);
- 02** How to properly store valuable goods on the premises and how to propose sufficiently stringent actions to ensure these cannot be stolen,
- 03** And Community engagement in general

CONCLUSION

The toolkit provides guidance to conduct ESG screening on a company but is never a replacement of a fund manager's own analysis

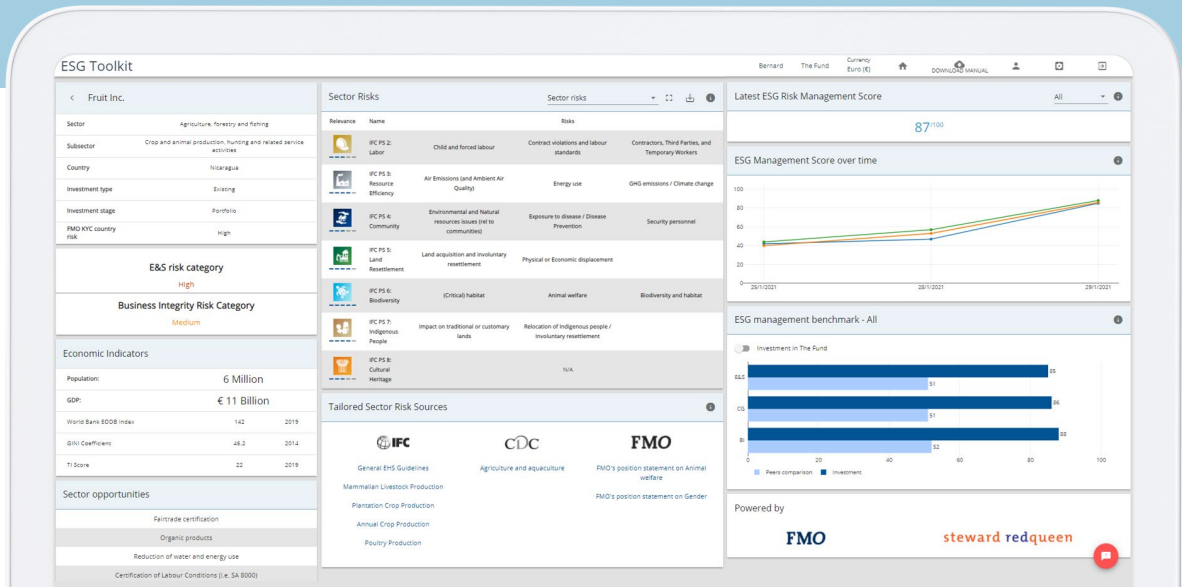


12. HOW TO GET STARTED



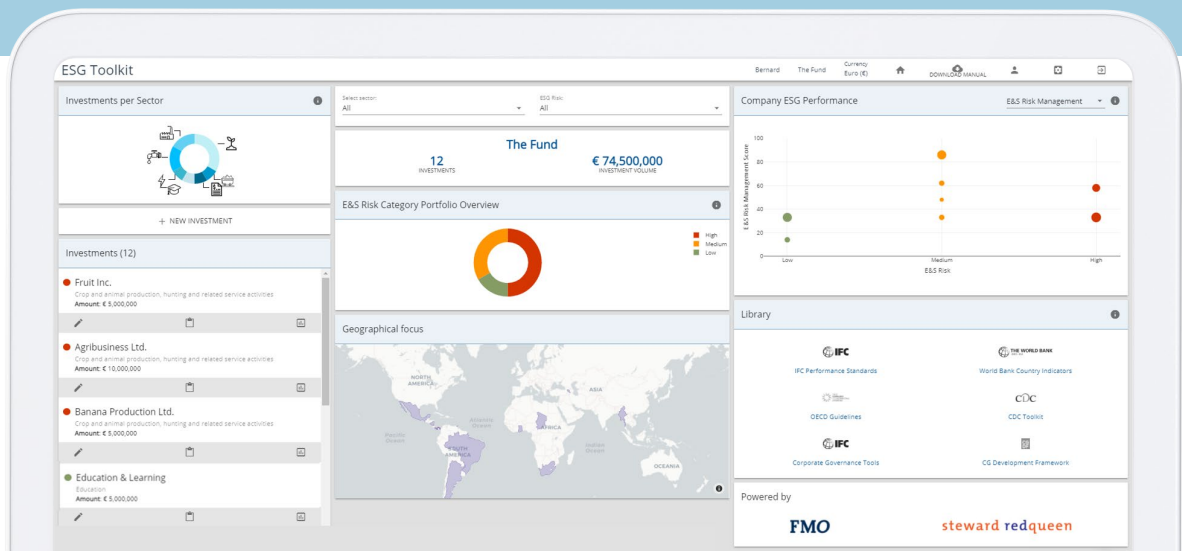
1. FIRST INVESTMENT

After creating a free account, add your first investment and complete a review.



2. PORTFOLIO OVERVIEW

When more investments have been added, you will be able to get a portfolio overview in the fund overview part of the tool.



FMO

Entrepreneurial
Development
Bank



TO CREATE A FREE ACCOUNT, VISIT
www.fmo.nl/esg-toolkit

**FOR QUESTIONS ABOUT THE TOOL,
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