



Environmental and Social Performance Management (ESPM) Framework

Alterfin

Version 1.0 ¹

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¹ Please note that this document is pending approval by the Board of directors of Alterfin CV on November 30, 2021

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1. Purpose

This document presents the **Environmental and Social Performance Management (ESPM) Framework of Alterfin** and aims to guide Alterfin to evaluate the social and environmental sustainability of its partners, central to its operations. Generating sustainable impact and serving the “Missing Middle”² through the provision of financial services to rural economically disadvantaged communities in low and middle-income countries at the core of Alterfin’s mission. This is driven by the mobilization of funds from individual investors and socially responsible institutions; the structuring and promoting of sustainable investments and collaboration with like-minded organizations.

This Framework is designed to allow Alterfin to identify Environmental and Social Risks at the early stages of the investment cycle, to further assess the magnitude of such risks, and take proactive steps to mitigate them. The goal of such a Framework is also to provide the means to evaluate the social and environmental performance of Alterfin and more broadly to track the progress of Alterfin towards the achievement of its mission.

2. Scope

The ESPM Framework has a two-pronged approach, the first of which is to apply the principle of “do no harm” through efficient **management of Environmental and Social Risks (“E&S Risks”)**. These risks are defined as “the potential negative consequences to a business that result from its impacts (or perceived impacts) on the natural environment (i.e., air, water, soil) or communities of people (e.g., employees, customers, residents)”³.

The second approach is to support Alterfin at different stages to **maximize its social and environmental performance** through a better selection of projects with potential deeper impact. This will allow continuous data collection on social and environmental performance, further informing operational decisions that will allow Alterfin to pursue deeper impact.

² Definition by Oxfam, <https://policy-practice.oxfam.org/resources/the-missing-middle-in-agricultural-finance-relieving-the-capital-constraint-on-112348/>

³ Definition by the European Bank for Reconstruction and Development (EBRD), <https://www.ebrd.com/downloads/about/sustainability/ebrd-risk-english.pdf>

2.1 Legal & Compliance

Alterfin executes this Framework to comply with the following regulations:
REGULATION (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a Framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 involving the:

- EU Sustainable Finance Disclosure Regulation (SFDR), published.
- EU Taxonomy regulation.

3. ESPM Framework

The Framework is designed to assess **the E&S Risks and the impact potential** that an investment presents to inform investment decisions. The principles underpinning the ESPM Framework are:

Risk-Based Principles

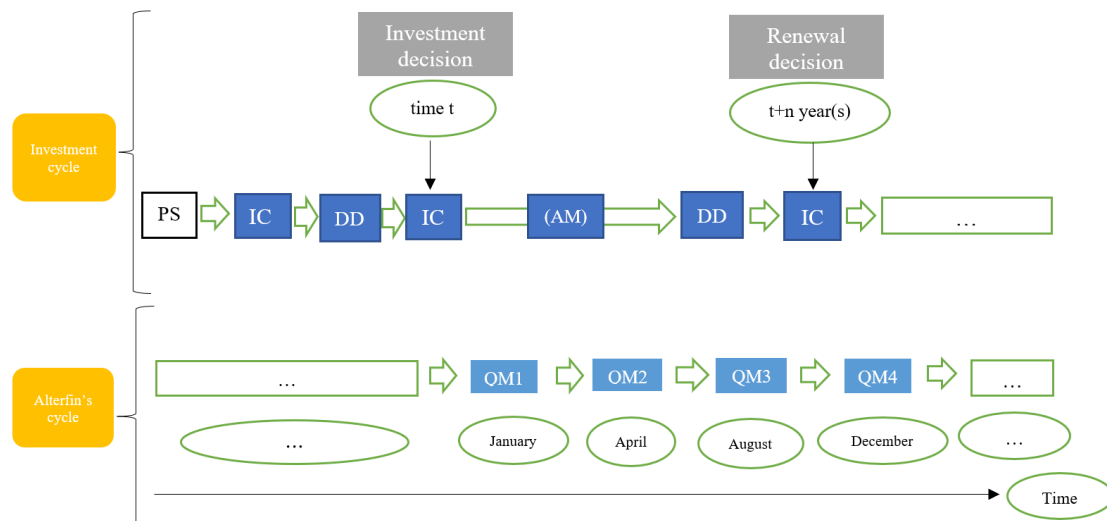
- The ESPM Framework incorporates a risk-based approach to mitigate any potentially negative Social/Environmental impact.
- This will involve the integration of E&S Risks identification and assessment at the Due Diligence (DD) and Renewal stages and will further inform the Loan Monitoring process.

Monitoring & Evaluation Principles

- The ESPM process is embedded in the *management cycles and decision-making processes* of Alterfin.
- The ESPM Framework is built on a *systematic and dynamic data collection* process that will allow us to assess Alterfin's impact on partners.
- The ESPM process is geared towards *learning to improve*, i.e. enhance the effectiveness of the investment process and the investments;
- The ESPM results are shared and analysed openly and transparently.

Identify	Assess	Control	Report
<ul style="list-style-type: none"> • Exclusion List • Minimum Sustainability Criteria • Qualitative information to give an overview of social values 	<ul style="list-style-type: none"> • ESPM Scorecard • SPI4 Alinus Tool • Risk Scoring • Data on exogenous shocks 	<ul style="list-style-type: none"> • Portfolio Monitoring • E&S Covenants in contracts 	<ul style="list-style-type: none"> • E&S Risk Analysis • SDGs • Qualitative & Quantitative impact analysis on partners and beneficiaries

To ensure that the ESPM **Framework** is embedded and connected to the management, decision-making, and planning processes of Alterfin, it is crucial that all related steps (data collection, reporting, data analysis, reflection/learning, and use of insights) are embedded and aligned with the main events and processes of Alterfin's work, i.e., the phases of the investment cycle and the organizational rhythms of a calendar year.



3.1 Material considerations to manage E&S Risk

Social Performance		Dimensions
Human resource issues (incl. board)		<ul style="list-style-type: none"> • Representativity of staff/board (gender, youth, ethnicity, etc.) • Fair employment conditions • Staff development on social issues (training, etc.)
Diversity, adequacy, and inclusiveness of the services provided		<ul style="list-style-type: none"> • Product diversity • Vulnerability and products to reduce the vulnerability of clients. • Product adequacy • Other services provided to clients/members (training, counselling, literacy, etc.) • Beneficiary inclusion: gender, age group, ethnicity, rural/urban, disadvantaged areas/communities, disaster-prone areas, population density, poverty level, etc.
Social policies & Framework		<ul style="list-style-type: none"> • Policies: Code of ethics, corruption policies, non-discriminatory policies, decent work, labour rights, ... • Internal social performance • Certification • Transparency with staff • Treat clients responsibly. • Balance social and financial performance
Environmental Performance		Dimensions
Staff development and actions		<ul style="list-style-type: none"> • Staff development on environmental issues • Services related to environmental issues to clients/member
Services to members/producers		<ul style="list-style-type: none"> • Financial services for environmental purposes • Direct actions, services & products provided to clients/members related to environmental issues. • Adaptation and mitigation to climate change • Re-allocation of premium to environmental aspects
Environmental policies and Framework		<ul style="list-style-type: none"> • Environmental policies • Certification • Environmental audits & monitoring systems for clients/members • Internal environmental measures in the office
Economic performance		Dimensions
Governance		<ul style="list-style-type: none"> • Sustainability Management by Board • Disclosure • AML-CFT⁴ • Corporate Governance Practice
Economic sustainability		<ul style="list-style-type: none"> • (Return on equity, return on assets, gross loan portfolio, etc.)
Business Development		<ul style="list-style-type: none"> • Business Plan • Sustainable growth strategy

⁴ AML-CTF: Anti-Money Laundering and Counter Terrorism Financing

The ESPM is designed in a manner that aligns with key international industry benchmarks relevant to Alterfin’s market segment which comprises Microfinance and Sustainable Agriculture and will evolve per the below:

- Universal Standards on Social Performance Management by SPTF⁵
- Responsible Lending Principles of CSAF members
- UN Guiding Principles on Business and Human Rights
- UN Principles for Responsible Investment
- UN Sustainable Development Goals
- Risk-based approach: Identify, Assess, Monitor and Report⁶.

3.2 Identify and Assess E&S Risks

The table below summarises E&S assessment needs at each stage of the investment cycle or Alterfin’s cycle. The documents and data points required at each stage of the investment process facilitate the identification and assessment of the E&S Risks posed by a potential investee and at the same time highlight their Social and/or Environmental impact potential. Rows in Yellow indicate the identification stage and rows in green the assessment tools. It is important to note that identification and assessment tools/processes serve a double function and act as control mechanisms which are detailed in the next section.

Identification mostly relies on the team of experienced Investment Managers, who as showed below utilizes a mix of quantitative and qualitative information and tools to identify and assess ES risks.

<u>Event</u>	<u>Purpose of the event</u>	<u>Time/frequency</u>	<u>Who participates</u>	<u>Coordinator</u>	<u>Expected output</u>	<u>All Information Collected</u>	<u>ESP data required</u>
Pre-Screening (PS)	Screen a potential new partner.	Once before initiating a potential partnership	- The IM in charge of the project	- The IM in charge of the project - The Head of Investment	Pre-selection report	- Historical data - Interview with staff & other stakeholders - Company documents	- Minimum E&S sustainability criteria - Exclusion list - Qualitative information to give an overview of social values

⁵ SPTF: Social Performance Task Force

⁶ EBRD’s Environmental & Social (E&S) Risk Management Procedures for Corporate Loans, SME and Micro Loans

IC (PS)	Decide whether to proceed with a DD	Once before the first DD	IC	IC	Decision report "Minutes"	- Investment Proposal presented to IC	- Minimum E&S sustainability criteria - Exclusion list - Qualitative information to give an overview of social values
DD (+AM for MFIs)	- Get a clear understanding of the partner - Agree on investment + terms	Before each potential new investment	- The IM in charge of the project - The Head of Investment	- The IM in charge of the project - The Head of Investment	DD report	- extensive list of internal documents and reports produced by the investees - historical data on the financial and operational performance of the investee - detailed interview with staff, beneficiaries, and stakeholders	- Risk scoring - Alinus (MFI) - Main ESPM data for the scorecards - Value-added (if renewal)
IC (DD)	Decide whether to proceed with an investment	Before each new investment	IC	IC	Decision report "Minutes"	- DD Memo, Alinus, risk scoring, and E&S Scorecard results presented	- Main ESPM data (for the scorecards)
QM (partner)	- Monitor general/outreach - Monitor financial performance - Key qualitative aspects and covenants - ESPM-related risks	Quarterly	- Monitoring officer - ESPM officer - IMs	The monitoring officer	Partner monitoring report	- Key financial, social, and environmental parameters monitored quarterly	- Data on exogenous shocks - Qualitative data on IMs' impact /Alterfin's impact on partners

3.3 Control and Mitigation

A Multi-stage screening and control process is employed to ensure compliance as below:

Stage 1: Exclude institutions if they fail to meet the minimum criteria based on the Exclusion List and pre-selection analysis.

Stage 2: Due diligence screening based on usage of internal tools and international standards. Alterfin only invests in institutions with strong E&S performance and/or willingness to strengthen such practices as determined by Alterfin's Scorecard. As we collect more data through the usage of the ES Scorecard, minimum thresholds will be set based on the sector and country of operation.

Stage 3: Social and financial covenants. Through the inclusion of relevant clauses in the contract with investees in terms of compliance and reporting

Stage 4: Technical Assistance. Alterfin is also able to provide grants to implement TA projects to mitigate some of the risks identified.

4. Monitoring and Reporting

To monitor to ensure compliance with Alterfin's E&S standards, specific indicators are embedded in the yearly monitoring process. This will also help to monitor compliance, progress, and performance of investees over time. The indicators designed are relevant to Sustainable Agriculture and Microfinance respectively and recently elements on the Covid-19 pandemic and its impact have also been included. Reporting will take place yearly, and this will include the results we obtain from yearly monitoring, the impact assessment conducted through the ESPM Scorecard, and yearly surveys/case studies. To complement this, Alterfin will also map its performance against SDGs. This will ensure that the investee is subject to regular compliance checks with regards to their Environmental and Social Performance. Finally, Alterfin will share its yearly findings on Environmental and Social Performance in the Annual Report

5. Organizational Capacity

To effectively manage E&S risks, it is recognized that Alterfin needs the right resources and tools that will allow timely intervention. Thus, all team members involved in the investment process must be well equipped to identify and assess E&S Risks as well as institutions with high impact potential. The following represent the resources that Alterfin must effectively manage E&S Risks:

- Investment Managers at Alterfin under the Head of Investments will be the point of contact and the first line to identify and assess the E&S Risks and

Impact Potential along with playing an active role in monitoring and compliance.

- As a second line, a strong Portfolio Management team under the Head of Portfolio Management will ensure that investees meet the requisite standards.
- A dedicated Environmental & Social Impact Manager will help to develop the relevant tools at various stages of the investment cycle along with measuring Alterfin's impact on its partners and their beneficiaries.
- The Investment Committee will further apply the E&S/Impact lens when approving potential partners for due diligence and then further for a loan. Additional training and guidelines will be put in place to facilitate this.
- The Monitoring Committee to play an active role to ensure investees comply with E&S covenants and provide data points as agreed upon.