Sustainability Risk Policy

Incofin Investment Management
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Version control				
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1 Purpose

Incofin Investment Management (henceforth “Incofin IM”) is an AIFM[1] licensed global impact fund management company promoting access to basic services to vulnerable people in emerging markets with a focus on inclusive financial services, sustainable agriculture and food value chain, and safe water.

Sustainability is the core objective of all of Incofin IM’s financial products. Incofin IM aspires to drive sustainable business solutions that provide the underserved, underserviced, and less privileged end customers in emerging economies with access to sustainable and inclusive goods and services. As an impact investor, Incofin IM seeks to invest in companies that are not only financially sustainable, but also contribute to solving socio-economic problems, while avoiding harm to its clients, local communities, and the environment in which it invests.

Sustainability risk is defined as environmental, social and governance events or conditions, which if they occur can have or may potentially have significant negative impacts on the assets, financial and earnings situation, or reputation of the company[2].

This Sustainability Risk Policy spells out Incofin IM’s general framework for identifying, assessing and mitigating ESG risks. This policy does not describe the detailed procedures of Incofin IM’s environmental and social management system (ESMS), which can be found in separate procedure manuals for each investment product.

2 Scope

This Policy is intended for investors who invest into the products of Incofin IM.

Incofin IM acts in this context in accordance with the following legal provisions and their implementation:

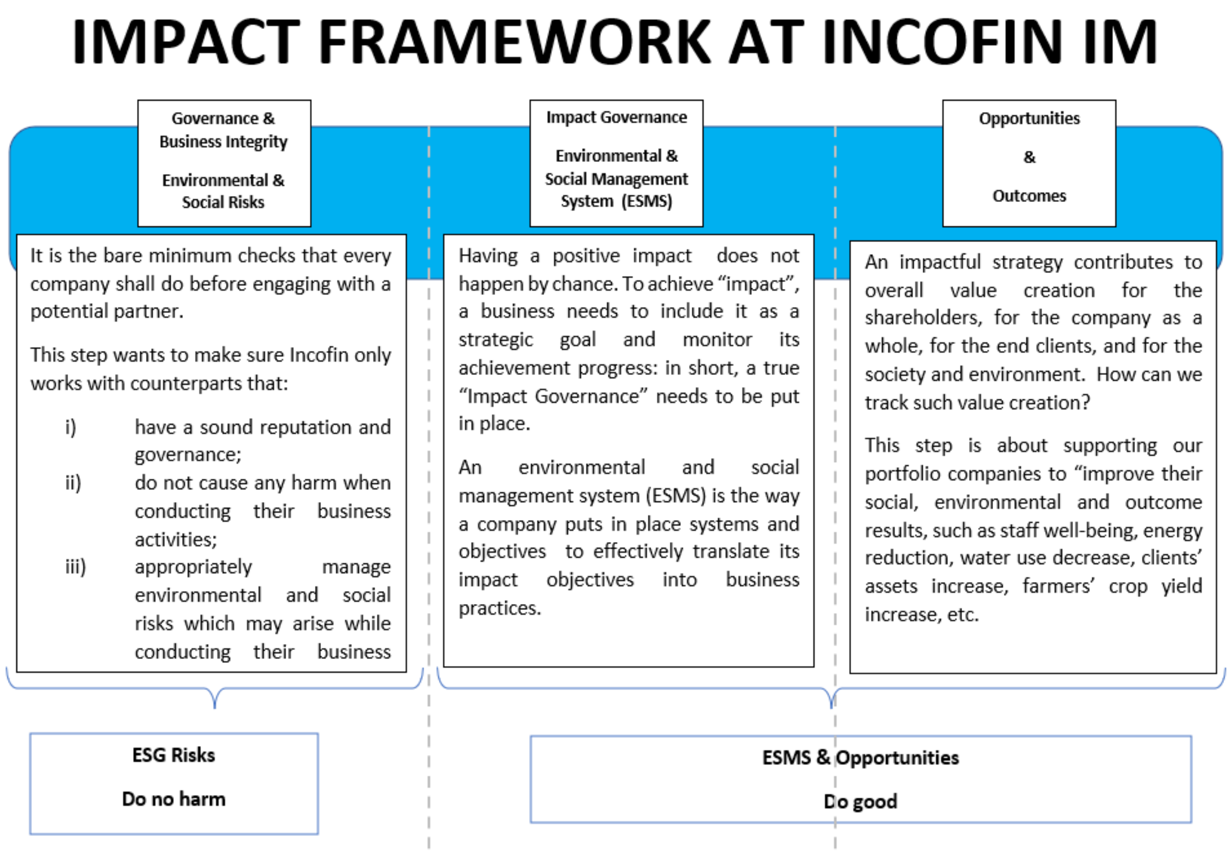
- REGULATION (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 involving the:
    - EU Sustainable Finance Disclosure Regulation (SFDR), published;
    - EU Taxonomy regulation.

- Applicable amendments to the AIFMD law.

[1] Alternative Investment Fund Manager.
[2] BaFin Guidance Notice on Dealing with Sustainability Risks. BaFin is Bundesanstalt für Finanzdienstleistungsaufsicht, which is the Federal Financial Supervisory Authority of Germany.

3 Framework

Incofin IM views the mission of sustainability as a continuum. The "do no harm" ESG risk screening of all investments is the starting point to a more ambitious target of doing good and contributing to value creation for the shareholders, company, end clients, society and environment. This Sustainability Risk Policy focuses primarily on the first link of the framework, ESG risks.



4 ESG Factors and Materiality

There are a number of sustainability risks inherent in the investment sectors/product targeted by Incofin IM. The most relevant ESG factors that are taken into consideration in the investment decision are listed below:

Most relevant ESG factors		Investment sector / Product		
		Inclusive Finance	Sustainable Agriculture and Food Value Chain	Safe Water
Environment	Pollution prevention and resource use efficiency		✓	✓
	Climate change: physical risks such as extreme weather events (heatwaves, droughts, forest fires, etc.) or long-term changes in climate and environmental conditions (e.g. rainfall frequency, volatile weather conditions, rising sea levels, etc.)	✓	✓	✓
	Protection of biodiversity and natural resource management		✓	✓
	GHG emissions and air quality		✓	✓
	Energy management		✓	✓
	Water and wastewater management		✓	✓
	Waste and hazardous materials management		✓	✓
Social	Client protection including consumer data protection, fair lending practices, pricing transparency, collection practices	✓		
	Access and affordability	✓	✓	✓
	Compliance with recognized labour standards (no child labour, forced labour or discrimination)	✓	✓	✓
	Compliance with employment safety and health protection	✓	✓	✓
	Appropriate remuneration, fair working conditions, diversity, training and development opportunity	✓	✓	✓
	Guarantee of adequate product safety, nutrition security		✓	✓
	Land acquisition and involuntary resettlement		✓	✓
	Protection of indigenous people and cultural heritage		✓	✓
Governance	Sustainability management by the board	✓	✓	✓
	Tax honesty	✓	✓	✓
	Anti-corruption measures	✓	✓	✓
	Financial transparency	✓	✓	✓
	General corporate governance practices	✓	✓	✓

These ESG factors are assessed against external, international standards. Incofin has voluntarily agreed to abide by relevant international standards and principles on ESG risk management:

- IFC Performance Standards
- World Bank Group Environmental Health and Safety Guidelines
- UN Guiding Principles on Business and Human Rights
- ILO Declaration on Fundamental Principles and Rights at Work
- UN Principles for Responsible Investment
- Universal Standards on Social Performance Management
- Responsible Lending Principles of CSAF members

The above mentioned sustainability risks can translate into significant adverse impact on Incofin IM through its direct and indirect transmission into existing risk types. Some examples:

Counterparty default risk	Impact of extreme weather events and climate change on business operations, outputs and incomes of portfolio companies and/or their end clients can affect asset quality (NPL)
Market risk	Oversupply of coffee in the international market drives down prices, reducing the revenues of portfolio company (SME coffee exporter) and capacity to repay.
Liquidity risk	Withdrawal of funding from investors who are not convinced of the company’s or fund’s sustainability performance
Operational risk	A labor strike at a portfolio company violating labor regulations could shut down operations
Strategic risk	Due to lack of evidence, investors lose interest in impact investment as an asset class
Reputational risk	Negative media attention linked to a portfolio company failing to comply with good ESG practices
Litigation and Compliance risk	Claims may be filed against the company for allegedly aiding and abetting the violation of child labor in an agri-food SME, where the company is a shareholder.

5 Risk-based approach

Sustainability Risk is integrated into the risk management structure of Incofin IM through a **4-step risk management approach** (identify, assess, control, and monitor). ESG checks are carried out at each stage of the investment process to best as possible filter out companies that violate the do no harm principle.

5.1 Identify

Incofin IM uses an iterative process for the early recognition of sustainability risks that continues throughout the investment period. Good quality information is the starting point for identifying sustainability risks. Incofin IM has a specialized team of investment professionals trained to collect relevant information and assess risks with an impact lenses. The main sources of information include:

- interviews with relevant stakeholders (i.e. company, industry experts, regulators, end borrowers)
- review of external and internal audit reports
- historic data analysis
- benchmarking against peer group
- market and sector information

At the origination stage, Investment Managers will conduct a **negative screening** to exclude companies engaging in activities, practices or countries with high ESG risks:

- Exclusion by activities: no investment in companies engaged in prohibitive production as defined in the Fund's exclusion list (i.e. gambling, tobacco, weapons, etc.).
- Exclusion by business practices: no investment in companies violating any of the 10 principles of the UN Global Compact (human rights, labour, environment and anti-corruption). This is verified through reputational checks and blacklists.
- Exclusion by AML-CFT[3] screening: No investments in companies operating in countries labeled as FATF[4] high risk and non-cooperative jurisdictions including blacklisted countries and countries under FATF monitoring that have not committed to an action plan. Background screening on company, qualified shareholders, beneficial owners, board members, authorized representatives and senior members.

During the due diligence, Investment Managers and/or E&S specialized auditors dig deeper into the potential ESG risks and the ESG management system of the company through desk review, onsite visits, and consultation with local industry experts. The findings during the due diligence could lead to modification of the transaction (including cancellation), and will serve as important input for monitoring and engagement throughout the investment.

[3] AML-CTF: Anti-Money Laundering and Counter Terrorism Financing.
[4] Financial Action Task Force (FATF) is the global money laundering and terrorist financing watchdog.

5.2 Assess

A mix of quantitative audit tools and judgement based techniques are used to process the information and evaluate the materiality of the sustainability risks.

Classification - A comprehensive social and environmental audit tool, adapted to the specific investment sector, is used to rate a company's ESG practices against the industry's best practices and furthermore, classify the risk level. Minimum thresholds corresponding to the risk appetite of the fund are set as another safeguard.

Escalation– Transactions falling outside the defined credit and ESG risk thresholds are escalated to the Risk Department for further assessment before it can pass to the to the Investment Committee (IC), serving as another safety net to catch any potential ESG risks and weaknesses of the company.

Decision – The investment proposal presented to the IC includes a thorough analysis of the financial and ESG risks of the transaction, specifically documenting the results of the E&S audit, sustainability risks (and opportunities) identified and an opinion on its materiality; thus allowing the IC members to make a double-bottom line investment decision.

5.3 Control

Incofin IM employs the following strategies to avoid and limit sustainability risks:

- **Negative screening:** as mentioned in section 5.1, one of the first strategy used is to exclude companies based on predefined activities, business practices and countries that are exposed to serious sustainability risks.
- **Standards based screening**: as mentioned in section 4, Incofin aligns its assessment tools to relevant international standards and principles.
- **Best-in-class approach:** as mentioned in 5.2, minimum threshold limits on social and environmental audit scores and criteria are in place to ensure that the fund only invests in companies performing above a certain level.
- **Additional mitigation**: during the signing and/or post investment stage:
    - ***Social covenants* -** Legal documents include clauses requiring portfolio companies to commit to ESG conditions and reporting requirements, thus providing another layer of protection to mitigate the risk of ESG violations. At minimum, the company must agree to comply with the Fund's exclusion list.
    - ***Corporate engagement and shareholder action* -** For equity investments, Incofin IM strives to gain an active board seat to influence strategic decisions and embed a culture of sustainability risk management in the portfolio company, including advocating for the implementation of an Environmental and Social Action Plan (ESAP).
    - ***Technical Assistance* -** Provision of technical assistance to support and build investee's capacities to improve their ESG management system.
    - ***Responsible exits* -** For equity investments, a fitness and compatibility assessment is conducted on all potential new partners to avoid social mission drift once the fund exits.

5.4 Monitor and Report

In order to transparently monitor compliance, progress and performance, indicators are defined and tracked for all investments. Indicators are specific to each fund and in the case of equity investments, investees also, and are further mapped to the UN Sustainable Development Goals (SDGs). The indicators identified include those that not only promote good ESMS practices but also impact to the end customer.

Some of the areas measured and tracked are included below:

Sector	Targeted UN SDGs and indicators
Inclusive Finance 	 *Examples of indicators:* - Number of active clients, rural clients, women clients - Agriculture loan portfolio - Number of female management staff - Number of loans disbursed below GNI per capita
Sustainable Agriculture and Food Value Chain 	 *Examples of indicators:* - Number of smallholder farmers and collectors served - Increase in producer organizations' productivity - Premium received per farmer - Number of beneficiaries of Technical Assistance - Number of farmers trained on good agricultural practices - Crop yields
Safe Water 	 *Examples of indicators:* - Number of liters of safe drinking water provided - Number of beneficiaries

The performance of the ESMS is reported to the respective funds and shareholders on an annual basis in the Annual Report, E&S Report and/or Impact Report.

6 Organizational Capacity

As an impact investor, Incofin IM has a low tolerance for sustainability risk. Therefore, the organization's processes and resources are framed around how to best mitigate such risks. The sustainability risk management strategy is based on an inclusive management policy of training and assigning responsibility to ESG topics to a broader group of employees than typically seen in the industry. Incofin's IM strong capacity are reflected in the following:

- The investment team consists of > **40 investment professionals globally**, trained to look through an impact lens and perform E&S due diligence. The Investment team is specialized by sector: financial inclusion, agriculture value chain, and water.
- As a second line of control, the **Risk department** monitors compliance with E&S risks against the fund's requirements.
- A dedicated **Technical Assistance department** leads the capacity building efforts to improve investees' impact measurement and management processes.
- The **Investment Committees** consists of members sensitive to ESG risks.
- Incofin IM launched a web-based platform called ECHOS 2.0 in 2019 to house all impact tools. The motivation behind the investment was to make the assessment and management of E&S risks easier, faster and more transparent. Through this web-based platform, a Social Performance Dashboard is automatically generated for each investee, including tracking of SDGs contribution.