Government of the Netherlands

Dutch Good Growth Fund

Financing Local SMEs

ICSR Policy DGGF Track 2:

Financing local SMEs in emerging markets and developing countries via intermediary funds

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1. Introduction

This document sets out the ICSR[1] policy for DGGF Track 2: Financing local SMEs in emerging markets and developing countries via intermediary funds (hereafter: DGGF[2]). It starts with a brief description of the purpose and scope of the policy, before describing the ICSR principles and the way in which ICSR is included in the DGGF Investment process. The fund manager takes ICSR into account for potential investments during the selection process, as well as in monitoring and evaluating investments.

The DGGF ICSR principles are based on the IFC performance standards, the OECD guidelines and the FMO exclusion list. Where the IFC performance standards and OECD guidelines provide general guidance we have made the DGGF CSR principles more specific by referring to commonly accepted international guidelines such as the UN Global Compact, the Ruggie Principles, The Global Reporting Initiative, Social Accountability 8000, and the ILO. These principles also provide guidance but leave room for interpretation and adaptation according to local context when they are applied in practice. The same is true when applying these principles to DGGF, which has its own specific context.

1.1. Purpose and scope of the ICSR Policy

This document focuses on the ICSR aspects that are applicable for intermediary funds (IFs) which apply for funding from DGGF. DGGF will only invest in IFs whose business practices are in line with these ICSR aspects. Where IFs do not yet comply with DGGF's ICSR principles, the fund manager may choose to include ICSR conditions in the investment contract or to offer the IF capacity building as a condition for investment. In this way DGGF will work with IFs to help them improve their ICSR performance over time.

This policy applies to IFs interested in an investment from DGGF. IFs are responsible for encouraging and ensuring good ICSR practices by the SMEs in their portfolios (i.e. IF are responsible for ensuring that SMEs they invest in act in accordance with the DGGF ICSR principles). We will assess the way in which IFs take up this responsibility.

Because this ICSR policy specifically focuses on the ICSR aspects of the investment process it should not be considered in isolation, but should be read together with other policy documents such as the tax policy and the finance criteria as well as the monitoring and evaluation guidelines.

[1] ICSR: International Corporate Social Responsibility. This includes environmental, social and governance aspects. For more information on our interpretation of ICSR we refer to the DGGF ICSR principles in this document.

[2] Each DGGF Track has a separate ICSR policy, based on the IFC performance standards and tailored for the specific needs of that Track. This policy is only applicable for Track 2.

2. DGGF ICSR Principles

DGGF investments are at IF level and often the Fund Manager will invest in an IF until maturity. It is not possible for the Fund Manager to directly decide whether or not to invest in a specific SME. This is fundamentally different to the other two DGGF tracks. It means that while the DGGF ICSR principles often apply to what is being done at SME level, IFs are responsible for showing how they ensure that the SMEs in their portfolio comply with the DGGF ICSR principles. This is irrespective of whether the IF invests in SMEs via taking a share (Equity) or providing a loan (Debt). Although the way in which they do this may differ, IFs generally exert influence on SMEs through the IF's ICSR policies and systems.

In addition, note that some issues will be more relevant and/or easier to implement for larger SMEs than for smaller ones. As a result, IFs that finance small SMEs may not have the same ICSR policy contents as IFs which finance larger SMEs/ or they may not implement it in the same way. The same is true for IFs which have a specific sector focus. Different industry sectors deal with different risks and these need to be taken into account. We would expect such a focus to be reflected in the ICSR policy of the IF.

Finally, the principles below are for ICSR compliance rather than impact, which is monitored separately through the DGGF Impact Monitor.

2.1. ICSR principles based on IFC performance standards and OECD guidelines

The DGGF ICSR principles are based on the IFC performance standards, the OECD guidelines and the FMO exclusion list. Where the IFC performance standards and OECD guidelines provide general guidance we have made the DGGF CSR principles more specific by referring to commonly accepted international guidelines such as the UN Global Compact, the Ruggie Principles, The Global Reporting Initiative, Social Accountability 8000, and the ILO. These guidelines are widely accepted internationally. As a result we have distilled a number of guiding principles for DGGF, outlined below. IFs are expected to comply with these guidelines, as well as with local laws and regulations.

1. Human Rights
    a. Human rights
    b. Land acquisition and involuntary resettlement
    c. Indigenous people
2. Employment and Industrial Relations
    a. Remuneration
    b. Freedom of association and right to collective bargaining
    c. Discrimination
    d. Health and safety (employees and communities)
    e. Issues of forced or child labour
    f. Working hours
3. Environment
    a. Biodiversity conservation and sustainable natural resource management
    b. Pollution prevention and abatement
4. Combating Bribery, Bribe Solicitation and Extortion
    a. Anti-corruption
5. Consumer Interests
    a. Health and safety (consumers)
    b. Responsible lending (MFIs)

The table in the following section describes the DGGF guiding principles in more detail. We refer to the Tax Guidelines for more details on DGGF's tax policy.

2.2. DGGF ICSR Principles

The table below sets out the DGGF ICSR Principles in more detail. For each principle we include the Fund Manager's interpretation, including what is or is not acceptable. We also provide examples by way of illustration.

DGGF ICSR Principle	Interpretation	Suggested application, including FMO exclusion list	Examples
Human rights	IFs should invest in SMEs which support and respect the protection of internationally proclaimed human rights and make sure they are not complicit in human rights abuses. This means SMEs should avoid infringing on the human rights of others and should address adverse human rights impacts with which they are involved. See also the other aspects below.	See specific topics below (Land acquisition and involuntary resettlement; Indigenous people; Remuneration; Freedom of association; Discrimination; Health and Safety, Forced/ Child Labour; Working hours).	See specific topics below (Land acquisition and involuntary resettlement; Indigenous people; Remuneration; Freedom of association; Discrimination; Health and Safety, Forced/ Child Labour; Working hours).
Land acquisition and involuntary resettlement	Land acquisition and involuntary resettlement can have adverse impacts on communities and persons that use this land. Involuntary resettlement refers both to physical displacement (relocation or loss of shelter) and to economic displacement (loss of assets or access to assets that leads to loss of income sources or other means of livelihood) as a result of project-related land acquisition and/or restrictions on land use.	Land acquisition is acceptable, if it can be demonstrated that involuntary resettlement has not taken place. Resettlement is deemed acceptable if involved parties are informed, consulted, compensated and move voluntarily.	Unacceptable: The Three Gorges Dam Project in China would be unacceptable. During the 17 years it took to complete the dam, 1.3 million people were resettled, often without consent. Acceptable: It can be demonstrated that those resettled were informed and gave their voluntary consent (i.e. without undue pressure) prior to the start of the resettlement and that they were given the agreed upon compensation. Furthermore that the compensation was a "fair price".
Indigenous people	Indigenous people are often the most marginalized and vulnerable segments of the population, yet their rights should be protected. In practice IFs should ensure that they themselves or the SMEs they invest in establish and maintain an ongoing relationship with the affected indigenous people, based on informed consultation and participation.	Activities which impact or involve indigenous people are deemed acceptable if these people are informed, consulted, compensated (if applicable), and if free, prior and informed consent is obtained for any such activities.	Unacceptable: Tourism project where tour guides visit local villages, where locals receive little or no compensation for the visit. Acceptable: It can be demonstrated that those involved were informed and gave their voluntary consent prior to the start of the resettlement and that they were given the agreed upon compensation. Furthermore that the compensation was a "fair price".

Remuneration	The organization shall respect the right to personnel to a living wage and ensure the wages for a normal work week, not including overtime, shall always meet at least legal or industry minimum standards, or collective bargaining agreements. Wages shall be sufficient to meet the basic needs of personnel and to provide some discretionary income.	IFs should ensure that the SMEs they invest in pay their employees at least the legal minimum wage and preferably a living wage, based on local circumstances (including average family size). Deductions from wages for disciplinary purposes are not acceptable.	Unacceptable: E.g. investment in an SME which is known for long hours and low wages, below the minimum wage. Acceptable: Relatively low monetary wages may compensated by payment in kind such as free housing and food. This may be acceptable depending on the benefits provided, the amount paid as take-home wage, the possibility for saving and the amount of dependency on the organisation.
Freedom of association and right to collective bargaining	Business should uphold the freedom of association and the effective recognition of the right to collective bargaining. Workers should be able to form and join a trade union of their choice without fear of intimidation or reprisal, in accordance with (inter)national law. Organisations should have in place non-discriminatory policies and procedures with respect to trade union organization, union membership and activity in such areas as applications for employment and decisions on advancement, dismissal or transfer.	Intimidation of workers who form or join a collective association is unacceptable. In countries where freedom of association is prohibited or limited, we expect that IFs explicitly pay attention to how they plan to compensate for this.	Unacceptable: Any form of intimidation, eg. reports of verbal threats made either inside or outside the workplace
Discrimination	Discrimination in employment and occupation means treating people differently or less favourably because of characteristics that are not related to their merit or the inherent requirements of the job. In national law, these characteristics commonly include: race, colour, sex, religion, political opinion, national extraction, social origin, age, disability, HIV/AIDS status, and sexual orientation unless selectivity concerning worker characteristics furthers established governmental policies which specifically promote greater equality of employment opportunity or relates to the inherent requirements of a job.	Discrimination is not acceptable. In countries where discrimination is incorporated into law (for example anti-gay legislation) or limited, we expect that IFs explicitly pay attention to how they plan to compensate for this. The FMO exclusion list specifically prohibits racist and anti-democratic media.	Unacceptable: Any form of discrimination eg. reports of preferential treatment (eg. higher wages/ promotions) for members of a specific trade union

Health and safety (employees and communities)	This relates to Health and Safety in the workplace as well as Health and Safety for Communities. Employees should be able to carry out their work without risk to their health. In case of any minor risks which are deemed acceptable, Employees should be well aware of the risk. Project activities, equipment, and infrastructure can increase community exposure to risks and impacts. In addition, communities that are already subjected to impacts from climate change may also experience an acceleration and/or intensification of impacts due to project activities. These risk should also be taken into account during business activities and stakeholder engagement.	Health and safety risks are undesirable, but acceptable if they lead to substantial positive economic performance and social progress. IFs should at least comply with national and international safety and health regulations and require the same of the SMEs they invest in. In case health and safety issues are present (and within the legal limits), IFs or SMEs should carry out independent inspections, be transparent about the risks and conduct training programmes for staff involved. The FMO exclusion list also specifically prohibits pornography or prostitution.	Unacceptable: Investment in an SME which ignores safety regulations, such as was the case in the Rana Plaza accident. The accident led to 1131 deaths and thousands injured. Acceptable: Physical labour is allowed, as long as national and international safety regulations are met. If incidents take place we will explicitly pay attention to whether these incidents could have been prevented, given the knowledge at the time (rather than hindsight).
Issues of forced or child labour	To avoid being associated with child and/or forced labour, IFs should contribute to the effective abolition of child labour, and take immediate and effective measures to secure the prohibition and elimination of the worst forms of child labour as a matter of urgency. Contribute to the elimination of all forms of forced or compulsory labour and take adequate steps to ensure that forced or compulsory labour does not exist in their operations.	Child Labour and forced labour are never acceptable. The FMO exclusion list specifically prohibits forced labour or child labour, defined as follows: •Forced labour 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. •Persons may only be employees if they are at least 14 years old, as defined in the ILO Fundamental Human Rights Conventions (Minimum Age Convention C138, Art. 2), unless local legislation specifies compulsory school attendance or the minimum age for working. In such cases the higher age shall apply	Unacceptable: Employment of a 14 year old in a country where the minimum working age is 16 years. Unacceptable: Employment of a 13 year old. Acceptable: Employment of a 14 year old in a country with no minimum working age.
Working hours	Compliance with applicable law, collective bargaining agreements and industry standards on working hours, breaks and public holidays. The normal working week should not be excessive. Furthermore, the overtime should be	An acceptable standard working week should be a maximum of 48 hours, and a maximum of 8 hours per day, with a maximum of 12 hours of overtime per week. Deviations from these figures are possible, if it can be demonstrated	Unacceptable: Employees regularly work more than 60 hours per week. Acceptable: Employees regularly work 50 hours per week, and occasionally 70 hours per week.

	voluntary and should not be requested on a regular basis.	that these deviations are in the best interests of the labourers involved.	
Biodiversity conservation and sustainable natural resource management	Biodiversity conservation and sustainable natural resource management relates to topics such as habitat loss, degradation and fragmentation, invasive alien species, overexploitation, hydrological changes, nutrient loading, and pollution. It is important that IFs are aware of the risks and impacts of the SMEs they invest in on biodiversity. IFs should have an identification process in place to consider direct and indirect project-related impacts on biodiversity and ecosystem services and identify any significant residual impacts.	Biodiversity loss is not acceptable, unless the IF/ SMEs have policies in place which they can demonstrate lessen their negative environmental impact within a certain timeframe. These policies should include clear formulations of goals and clear consequences of not adhering to the policy. The FMO exclusion list specifically prohibits: 1) Any product or activity deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international phase-outs or bans, such as: •Ozone depleting substances, PCB's (Polychlorinated Biphenyls) and other specific, hazardous pharmaceuticals, pesticides/herbicides or chemicals; •Wildlife or products regulated under the Convention on International Trade in Endangered Species or Wild Fauna and Flora (CITES); or •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). 2) Cross-border trade in waste and waste products, unless compliant with the Basel Convention and the underlying regulations. 3) Destruction of High Conservation Value areas. 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. 05 Radioactive materials and unbounded asbestos fibres. 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	Unacceptable: Use of hazardous chemicals which are disposed of in water and lead to biodiversity loss. Acceptable: We can accept the above situation if a) the chemicals are allowed under local legislation and b) clear goals are formulated, which clarify a timeframe within which the company will find other ways of disposing of the chemicals.

		and/or adequately shielded.	
Pollution prevention and abatement	Increased economic activity and urbanization generate increased levels of pollution to air, water, and land, and consume finite resources in a manner that may threaten people and the environment at local, regional, and global levels. There is also a growing global consensus that the current and projected atmospheric concentration of greenhouse gases threatens the public health and welfare of current and future generations. It is important to avoid or minimize adverse impacts on human health and the environment by avoiding or minimizing pollution from project activities. Sustainable use of resources, including energy and water, should be promoted, project-related GHG emissions should be reduced.	Pollution (land, water, air) is undesirable, but acceptable if it leads to substantial positive economic performance and social progress. IFs should at least adhere to the minimum requirements of national law in the countries in which they operate, and require the same of the SMEs they invest in.	See above
Anti-corruption	Businesses should work against corruption in all its forms, including extortion and bribery. Corruption can take many forms that vary in degree from the minor use of influence to institutionalized bribery.	Bribery is not allowed and should be avoided at all costs. Small gifts which are given as part of the "normal course of business" are acceptable, but should be reported and registered. Corruption is not acceptable. We consider that it will be useful to put a threshold.	Unacceptable: The fund manager of the IF receives a gift of a goat from an investee (SME) as part of a public holiday celebration. Acceptable: The fund manager of the IF receives a gift of a chicken from an investee (SME) as part of a public holiday celebration, and informs his/her supervisor.

Health and safety (consumers)	Organisations should ensure that the goods and services they deliver comply with all agreed upon norms regarding health and safety of customers. IFs should not invest in SMEs which are involved in weapons in any way or in any part of their supply chain. This applies to both controversial and non-controversial weapons.	The FMO exclusion list specifically prohibits that any of the following products form a substantial part of a company's primary operations, or a financial institution, investment fund or company's financed business activities. •alcoholic beverages (except beer and wine); •tobacco; •weapons and munitions; •gambling, casinos and equivalent enterprises. For FMO "Substantial" means more than 10 % of a financed institution's/company's consolidated balance sheet or earnings. For Financial Institutions, "Substantial" means more than 10% of a Financial Institution's underlying portfolio volume. Note: with regard to weapons, tobacco and gambling we suggest a zero-tolerance policy (i.e. these are never acceptable).	Unacceptable: A company makes soft drinks, but also alcoholic drinks such as vodka and beer, where the vodka accounts for 11% of earnings and the beer for 5%. Acceptable: A company makes soft drinks, but also alcoholic drinks such as vodka and beer, where the vodka accounts for 5% of earnings and the beer for 11%.
Responsible Lending	Specifically for microfinance institutions: MFIs should ensure that they do not lend more than a borrower can afford and that interest rates are reasonable.	Prior to the lending process, MFIs should check whether their lending rates are reasonable, given their specific context (country, sector, client size and risk, etc). As part of the lending process, MFIs should specifically check whether each client can reasonably be expected to afford the interest rate, or whether this could lead to a cycle of bad debt.	Unacceptable: MFI does not check whether client has existing debt and/or can reasonably be expected to afford the offered interest rate. Acceptable: Loan officers fill out an acceptance template for each loan, including an assessment of whether or not the borrower can afford the loan.

2.3. Application of the ICSR principles and the need for a tailored approach

The DGGF criteria should be applied differently for Investment funds as opposed to Microfinance Institutions (MFIs). While IFs select a limited number of companies to invest in for a longer period of time and are able to closely monitor and manage ICSR risks arising from the investees' operations, MFIs typically engage in a large number of relatively small, short-term loans, often by lending money to individuals or micro-enterprises that cannot access mainstream financial services. Businesses served by MFIs are therefore not associated with the same scale and types of environmental and social risks as are larger companies served by other financial institutions.

Imposing the same requirements regarding ICSR MFI loans to individuals or micro-enterprises, as to equity-based investments, might result in excessive transaction costs for MFIs. Therefore each organisation should apply the DGGF ICSR principles in a way which suits its business model, while still addressing the spirit of the principles. In general, IFs are required to implement an ICSR risk assessment for each potential investment. This is not realistic for MFIs. MFIs should implement solid processes to ensure compliance with the DGGF ICSR policy at portfolio level. For example, MFI management may assess ICSR risks at portfolio level, as long as the DGGF ICSR principles are addressed. Individual investments can then be assessed against the ICSR risks identified as "high" in the portfolio-level risk assessment. This addendum provides additional guidance regarding the application of DGGF's ICSR policy for MFIs.

The DGGF ICSR policy encompasses the DGGF exclusion list[3] as well as the DGGF ICSR principles for investment. The criteria of the exclusion list are more strict criteria, while the guiding principles may not be black and white and may leave room for interpretation. The sections below set out the DGGF ICSR requirements and the approach required as a minimum for IFs and MFIs for both the exclusion list criteria as well as the DGGF ICSR principles.

2.3.1. ICSR approach at IFs

IFs typically engage in a limited number of equity-based investments, with relatively large investment amounts in comparison to MFIs. When checking investee compliance with the IF's ICSR policy, the ICSR assessment should be performed at an individual investee level. This means that IFs have to thoroughly check and ensure compliance with the exclusion list and the guiding principles for each individual investee. This applies to both the exclusion list and the broader set of ICSR principles outlined in this policy. Furthermore, management should be involved in the ICSR principles assessment for each individual investee. The table below sets out the DGGF ICSR requirements and the approach that IFs should adopt. The practical implementation may differ per IF.

Compliance with:	Approach
Exclusion list criteria	Full compliance with the DGGF exclusion list
DGGF ICSR principles	Assessment of ICSR principles at investee level

2.3.1.1. Examples of the ICSR approach for IFs

Practical examples illustrating the application of the requirements are provided in the table below.

Risk	Acceptable	Unacceptable
Compliance with the exclusion list for an IF	For every individual investee, senior management assesses the risk of engagement in business activities forbidden by the exclusion list. This could be done through a credit committee decision, based on documentation prepared by other staff members.	Senior management does not play a role in assessing the risk of engagement in business activities forbidden by the exclusion list. It does not take the results of the exclusion list screening into account when making an investment decision.
Compliance with the guiding principles for an IF	For every individual investee, senior management assesses the risk of engagement in business activities that may result in a breach of the guiding principles. In a region where involuntary resettlement without adequate compensation is allegedly common, senior management assessed the extent to which this may pose a risk for each of	Senior management does not play a leading role in assessing the risk that investees act in breach of the guiding principles. When involved, senior management performs a risk assessment by industry/ sector or only covering one portfolio segment, rather than conducting a thorough risk assessment at investee level.

[3] DGGF uses the FMO exclusion list

	the fund's investees that engage in business operations there and whose core business may require land acquisition.	In a region where involuntary resettlement without adequate compensation is allegedly common, senior management does not have access to granular information pertaining to each investee's operations, but rather conducts a group screening of a number of investees that are active in the region.

2.3.2. ICSR approach at MFIs

MFIs typically engage in a large number of relatively small, short-term loans, often by lending money to individuals or micro-enterprises that cannot access mainstream financial services. Businesses served by MFIs are therefore not associated with the same scale and types of environmental and social risks as are larger companies served by other financial institutions. Imposing the same requirements regarding ICSR MFI loans to individuals or micro-enterprises, as to equity-based investments, might result in excessive transaction costs for MFIs. This carries implications for the way in which the ICSR principles should be applied. For MFIs, all loans should be screened against the exclusion list criteria before issuance. MFIs are allowed to adopt a risk-based approach based on risks identified local circumstances such as industry, geographical area, culture, minority issues and other considerations deemed important. Risks should be addressed at portfolio level. MFIs can do this in various ways; the minimum requirements are set out below. The one exception to the portfolio-based approach is checking whether borrowers can afford the loan and whether lending rates are reasonable. The MFI should do this at the level of the individual loan (SME level).

Compliance with:	Approach
Exclusion list criteria	Full compliance with the DGGF exclusion list
DGGF ICSR principles	Risk-based approach at portfolio level

The (minimum) requirements regarding the control over the DGGF ICSR risks by MFIs can be implemented in a way that fits with each MFI's operational capacity and loan cycle. Deviations from the requirements below are therefore acceptable in exceptional circumstances, under the condition that there is an alternative process in place and the MFI is able to demonstrate this alternative process effectively mitigates the ICSR risks.

The internal control regarding ICSR at an MFIs should at a minimum include:

- Full compliance with the DGGF exclusion list. This means that each individual loans should be subject to a sufficiently thorough screening against the exclusion list criteria each time the loan is issued. A sufficiently thorough screening means that at a minimum, the employee performing the screening should be sufficiently capable of applying the exclusion list, and should therefore receive proper training and support from the MFI. All individuals or micro-enterprises that do not meet the exclusion list criteria should be prohibited from obtaining a loan.

- The management of MFIs should have comfort about the effectiveness of the process of screening each individual loan against the exclusion criteria, even if/ especially when they are not personally involved. In practice this will amongst others mean that screening against the exclusion list should be implemented in processes and systems; documented and checked (eg. via a sample-based audit).

- Regarding the ICSR guiding principles a portfolio-based risk assessment is allowed. This means that management should have a risk identification process, in which it identifies the main ICSR risks taking into account local circumstances such as industry, geographical area, culture, minority issues and other considerations deemed important. Risk identification purely based on the nominal loan amount or the duration of the loan is not acceptable, as the MFI is likely to issue a large quantity of loans with a relatively small amount. Loan officers should also be trained in the ICSR risks specific to the local circumstances.

For MFIs it is common practice to issue short-term – e.g. a duration of 1 year - loans only. In this case the above measures should be repeated each time the loan is reissued. Should the duration of the loan be significantly longer, the MFI should implement monitoring controls to ensure the ICSR risks are sufficiently mitigated during the lifecycle of the loan.

2.3.2.1. Examples of the ICSR approach for MFIs

Practical examples illustrating the application of the requirements are provided in the table below.

Risk	Acceptable	Unacceptable
Compliance with the exclusion list for an MFI	The MFI has developed assessment forms/ other equally comprehensive templates that ensure compliance with the exclusion list, with senior management involvement. When performing a check at the application and appraisal stage, loan officers fill the relevant information in the assessment forms, and attach supporting documentation where necessary. The forms and any additional evidence are then shared with loan managers and upper management, enabling the latter to exercise the required oversight role, eg. through a credit committee.	Loan officers perform a check at the application and appraisal stage to ensure that candidates for the MFI loans comply with the list in full. However, the screening is performed informally through site visits and conversations with the applicants, and there is no system or process to file and manage the information collected, so that management is not able to check whether all issued loans have been screened against the exclusion list.
Compliance with the DGGF ICSR principles for an MFI	Management has performed a periodic ESG risk identification process, in which it identified ethnic discrimination and child labor as high risks. Senior management has been able to gain a thorough understanding of the magnitude of such risks, including the sectors and country regions where these risks are more widespread. Senior management has then drafted policies aligned with the international standards specifically on these risks and designed control processes to mitigate the risks throughout the loan cycle. Loan officers are trained on how to assess and report on these risks and management is able to show that all loans granted have been screened against the MFI's policies covering this topic.	In a country where ethnic discrimination a represents a high risk, senior management fails to detect the magnitude of the risk and the potential adverse impacts that could result from it. Loan officers are trained on ESG issues at a very high level, and ethnic discrimination is not specifically discussed in the training modules, including in industry sector or country regions where discriminatory practices appear to be widespread. While performing the screening against the ICSR Principles, loan officers fail to grasp the specific set of issues stemming from the underlying culture of ethnic discrimination and fail to prioritize them in their appraisals.

3. Process

This chapter describes how the ICSR principles are taken into account during the investment process: selection, monitoring, evaluation and capacity building. We focus on the selection process as capacity building will be tailored to the specific needs of the IF and monitoring and evaluation are extensively described in the Monitoring and Evaluation Guidelines.

3.1. Selection

ICSR aspects are important in three steps of the selection process: the exclusion check (EC), the input for the clearance in principle (CiP) and the input for the due diligence (DD). For each of the three steps an explanation is given below regarding ICSR.

While some ICSR compliance aspects are black and white, other aspects are not as these might be dilemma's (eg. financing activities with a positive social impact but which are potentially damaging to the environment). In the selection process we assess ICSR compliance based on 1) past performance, i.e. complaints in the past, if applicable 2) current situation, i.e. is management deemed to be capable and of high integrity and 3) how future performance is ensured by embedding ICSR compliance in the IF's own policies and procedures.

3.1.1. Exclusion check

The ICSR Exclusion check has two elements: the country criterion and the FMO exclusion list. The IF submits a request for finance to the investment manager who assesses whether the IF meets the country criterion. This states that the IF must only invest in countries on the DGGF list of eligible countries. For the full list of countries please refer to the appendix. If this is indeed the case, then the Fund Manager's ICSR expert team will assess whether the IF has an exclusion list in place and if so whether it is at least as strict as the FMO exclusion list. If differences exist between the IF's and the FMO exclusion list, negotiations to amend the list will take place in the next step in the process (CiP). IFs which do not meet these criteria are not eligible for investment.

3.1.2. Input for the Clearance in Principle

DGGF's ICSR expert team provides input for the IC's decision on whether to extend a CiP to a potential investee. The ICSR input for the CiP is based on desk research into the IF's policies. The aim of the initial investigation is to identify any ICSR issues which are no-gos, which require further investigation during the due diligence (the next step in the investment process), or which may require capacity building. The IC receives a memo including an overall conclusion in the form of a traffic light: Green, Orange or Red. The IC then decides whether IFs move on to the DD phase.

3.1.3. Input for the Due Diligence

The DD input builds on the information gathered during the CiP, including any potential issues or open questions. Each IF is also given a risk categorisation in line with the IFC performance standards. The DD is based on further desk research into systems, procedures and management, including telephone calls and email contact. This will culminate in a site visit to the IF. Depending on the outcome of the desk research the ICSR expert team may join the site visit or may ask the Investment Manager to investigate on their behalf. The DD differs from the CiP, in that the DD involves a more in-depth document analysis as well as an on-site investigation into systems, processes, examples and so on while the CiP focuses on desk research into the IF's policies. The ICSR expert team again provides input for the IC in the form of a memo and corresponding traffic light.

3.1.4. Further explanation of the IFC risk categorisation

In the case of financial intermediaries IFC uses the categories FI-1, FI-2 and FI-3. These categories give an indication of the associated E&S risk and are defined as follows:

FI-1: existing or proposed portfolio includes or is expected to include substantial financial exposure to business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible or unprecedented.

FI-2: existing or proposed portfolio includes or is expected to include business activities that have potential limited adverse environmental or social risks or impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures; or includes a very limited number of business activities with potential significant adverse environmental or social risks or impacts that are diverse, irreversible or unprecedented.

FI-3: existing or proposed portfolio includes financial exposure to business activities that predominantly have minimal or no adverse environmental or social impacts.

See also:
http://www.ifc.org/wps/wcm/connect/38d1a68049ddf966af3cbfda80c2ddf3/InterpretationNote_FIs_2012.pdf?MOD=AJPERES

3.1.5. Further explanation of the "ICSR Traffic Light"

The IC receives ICSR input for both the CiP and the DD in a memo including an overall conclusion in the form of a traffic light: Green, Orange or Red.

Green (positive without conditions): A green traffic light means that there are minor or no attention points.

Orange (positive with conditions): An orange traffic light means that there are attention points, but that these can probably be resolved together with the IF, either prior to investment, or by having conditions included in the investment contract. Depending on the nature of the attention point, capacity building may or may not be advised. During the CiP specifically, an orange traffic light could also mean that not all information has been received.

Red (negative): A red traffic light means that there are attention points, which are unlikely to be resolved and that the ICSR expert team would advise against investing in the IF.

Note that this differs from categorization according to the IFC performance standards. The IFC performance standards result in a categorization which gives an indication of the associated risk. In contrast the traffic light above takes into account not only the risks but also the mitigating factors. It is explicitly intended as an investment advice rather than a risk categorization. In addition the traffic light also includes governance considerations, rather than only environmental and social considerations.

3.2. Monitoring

When DGGF invests in an IF, the IF is required to regularly report to the fund manager, so that the fund manager can take timely action to optimise portfolio management. This includes ICSR. ICSR monitoring builds on the understanding gained during the CiP and DD. Where the IF's ICSR policy was found sufficient, monitoring focuses on changes in the IF's ICSR policy and on ICSR performance (such as policy breaches and complaints). In cases where specific ICSR attention points were identified, the IF is also required to report on progress towards resolving these attention points. This may or may not be linked to capacity building and will be agreed upon with the IF on a case by case basis. In principle the ICSR experts will not join monitoring visits, however depending on the attention points for ICSR this may be considered. For more information regarding monitoring we refer to the DGGF Monitoring and Evaluation Guidelines.

3.3. Evaluation

DGGF will appoint an external evaluator to evaluate the DGGF portfolio. This will include ICSR aspects. If and when necessary the external evaluator may make use of information regarding ICSR which was collected during the selection and/ or monitoring phases. For more information we refer to the Monitoring and Evaluation Guidelines.

3.4. Capacity building

One of the main aims of DGGF is to improve the capacity of IFs and SMEs. This is also true for ICSR, either directly or by helping IFs to improve the capacity of SMEs. The specific capacity building need will be determined per IF on a case by case basis as a result of the outcome of the CiP and DD. In general, the decision to provide capacity building will be taken by the IC as part of the decision to invest in an IF. IFs which are promising but have attention points regarding ICSR, may be granted capacity building to assist

them in complying with DGGF's ICSR principles. Capacity building may be carried out by the Fund Manager, or by a consultant, appointed by the Fund Manager. Where possible we will work together with other investors.

3.5. Sanctions

IFs in which DGGF invests are required to comply with this policy; this is included as a contractual obligation in the contract between the find manager and the IF. Non-compliance will be dealt with at contractual level.

3.6. Rio Markers for climate change mitigation and adaptation

IFs will be categorised based on their policy goals and assigned a corresponding climate change marker. There are three marker categories: climate change mitigation and adaptation as a principal (primary) policy objective; as a significant (secondary) policy objective and IFs where climate change is not targeted as an objective. For more information please refer to the appendix.

4. Appendices

4.1. FMO Exclusion List

The FMO exclusion list prohibits the financing of any activity, production, use of, trade in, distribution of or involving:

1. Forced labour or child labour
   Forced labour 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.
   Persons may only be employed if they are at least 14 years old, as defined in the ILO Fundamental Human Rights Conventions (Minimum Age Convention C138, Art. 2), unless local legislation specifies compulsory school attendance or the minimum age for working. In such cases the higher age shall apply.

2. Any product or activity deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international phase-outs or bans, such as:
   Ozone depleting substances, PCB's (Polychlorinated Biphenyls) and other specific, hazardous pharmaceuticals, pesticides/herbicides or chemicals;
   Wildlife or products regulated under the Convention on International Trade in Endangered Species or Wild Fauna and Flora (CITES); or
   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 with the Basel convention and the underlying regulations

4. Destruction of high conservation value areas.
   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. High Conservation Value (HCV) areas are defined as natural habitats where these values are considered to be of outstanding significance or critical importance. For more information please visit the HCV Resource Network.

5. Radioactive materials and unbounded asbestos fibres
   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.

6. Pornography or prostitution

7. Racist and anti-democratic media

8. In the event that any of the following products form a substantial part of a company's primary operations, or a financial institution, investment fund or company's financed business activities:
   - alcoholic beverages (except beer and wine);
   - tobacco;
   - weapons and munitions;
   - gambling, casinos and equivalent enterprises.

   "Substantial" means more than 10 % of a financed institution's/company's consolidated balance sheet or earnings. For Financial Institutions, "Substantial" means more than 10% of a Financial Institution's underlying portfolio volume.

The FMO exclusion list can be found via the following link: https://www.fmo.nl/exclusion-list.

4.2. Country List DGGF

Countries with the denotation 'F' are considered fragile states, according to the World Bank definition, which can be found here: http://siteresources.worldbank.org/EXTLICUS/Resources/511777-1269623894864/HarmonizedlistoffragilestatesFY14.pdf

Afghanistan (F)

Albania

Algeria

Angola

Armenia

Bangladesh

Benin

Bhutan

Bolivia

Bosnia and Herzegovina (F)

Burkina Faso

Burundi (F)

Cambodia

Colombia

Congo, Democratic Republic of the (F)

Djibouti

Egypt

Eritrea (F)

Ethiopia

Philippines

Gambia

Georgia

Ghana

Guatemala

India

Indonesia

Yemen (F)

Jordan

Cape Verde

Kenia

Kosovo (F)

Laos

Libya (F)

Macedonia

Madagascar (F)

Malawi (F)

Maldives

Mali (F)

Morocco

Moldova

Mongolia

Mozambique

Myanmar (F)

Nepal (F)

Nicaragua

Niger

Nigeria

Pakistan

Palestine, Autonomous Territories of (F)

Peru

Rwanda

São Tomé Island

Senegal

Sierra Leone (F)

Somalia(F)

Sri Lanka

Suriname

Tanzania

Thailand

Tunisia

Uganda

Vietnam

Zambia

Zimbabwe (F)

South-Africa

South-Sudan (F)

The country list can be found via the following link: http://english.rvo.nl/sites/default/files/2014/06/COUNTRY%20LIST%20DGGF.pdf.

4.3. IFC Performance standards in short

The IFC's eight performance standards establish standards that organisations should meet throughout the life of the investment. The performance standards below apply to direct investments:

1. Performance standard 1: Assessment and Management of Environmental and Social Risks and Impacts

2. Performance standard 2: Labour and Working Conditions

3. Performance standard 3: Resource Efficiency and Pollution Prevention
4. Performance standard 4: Community Health, Safety and Security
5. Performance standard 5: Land Acquisition and Involuntary Resettlement
6. Performance standard 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources
7. Performance standard 7: Indigenous Peoples
8. Performance standard 8: Cultural Heritage

Performance standard 1 underscores the importance of managing environmental and social performance throughout the life of a project. An effective Environmental and Social Management System (ESMS) is a dynamic and continuous proce initiated and supported by management, and involves engagement between the client, its workers, local community directly affected by the project and, where appropriate, other stakeholders.

Performance standards 2 through 8 describe potential environmental and social risks and impacts that require particular attention. Where environmental or social risks or impacts are identified, the client is required to manage them through an ESMS consistent with performance standard 1.

The IFC Performance standards can be found via the following link:
http://www.ifc.org/wps/wcm/connect/115482804a0255db96fbffd1a5d13d27/PS_English_2012_Full-Document.pdf?MOD=AJPERES

In addition to the above, which apply to direct investments, the IFC has issued an explanatory note on how performance standards one and two can be applied for financial intermediaries. This which can be found via
http://www.ifc.org/wps/wcm/connect/38d1a68049ddf966af3cbfda80c2ddf3/InterpretationNote_FIs_2012.pdf?MOD=AJPERES

4.4. The OECD Guidelines in short

1. General principles and supply chain
   Your company should contribute to the economic, environmental and social progress of the host country; comply with local laws and regulations; identify the risks to responsible business conduct within the supply chain; encourage local capacity building; apply rules of conduct to promote responsible business conduct; abstain from any improper involvement in local political activities.

2. Disclosure
   Your company should ensure that reliable and relevant information is disclosed regularly on your activities, including information about your social and environmental performance, codes of conduct and relationships with stakeholders.

3. Human rights
   Your company should respect the human rights of those affected by your company's activities, identify the risks and take appropriate measures to avoid and rectify human rights infringements.

4. Employment and industrial relations
   Your company should respect the right of employees to representation; refrain from discriminatory treatment of employees; pay a living wage and contribute to the effective abolition of child labour and every form of forced or compulsory labour.

5. Environment
   Your company should take due account of the need to protect the environment and public health and safety; establish and maintain an appropriate environmental management system and provide adequate education and training to workers in environmental health and safety matters.

6. Combating corruption
   Your company should not – directly or indirectly – offer, promise, give or demand a bribe or other undue advantage in order to obtain or retain business or other improper advantage.

7. Consumer interests
   Your company should ensure that the goods and services it provides meet all agreed or legally required standards for consumer health and safety.

8. Science and technology
   Your company should adopt, where practicable in the course of its business activities, practices that permit the transfer and rapid diffusion of technologies and know-how, with due regard to the protection of intellectual property rights.

9. Competition
   Your company should refrain from entering into or carrying out anti-competitive agreements.

10. Taxation
    Your company should contribute to the public finances of the host country.

The OECD Guidelines can be found with the following link: http://www.oesorichtlijnen.nl/en/oeso-guidelines/guidelines-nutshell. DGGF's taxation policy is set out in the DGGF taxation guidelines.

4.5. More guidance regarding complaints mechanisms

We expect intermediary funds (IFs) to implement a complaints mechanism at IF level (i.e. complaints regarding the IF itself) as well as gathering complaints at SME level (i.e. about the SME). The latter implies that SMEs also implement a complaints mechanism. This note sets out more guidance regarding the DGGF ICSR requirements regarding complaints mechanisms[4].

4.5.1. IF level complaints mechanism

DGGF requires that IFs implement a mechanism to allow stakeholders to report complaints about the IF itself. Complaints may be made by SMEs/ staff/ the general public/other parties. The complaints mechanism should be in accordance with the principles below, which are in line with the IFC interpretation note for financial intermediaries[5].

Submission of complaints:

- Transparent, publicly available and easily accessible process for submitting complaints (eg. phone number; website; email address; suggestion box etc). Employees and Investees are informed about their right to complain

Handling of complaints:

- Each complaint is recorded, assessed and the appropriate response determined if applicable. Staff involved in complaints handling have been given appropriate training on how to deal with complaints

Communication regarding complaints:

- Involved parties are informed about the nature of the complaint as well as the response (and may be involved in formulating the response). Communication is appropriate and timely

Governance of complaints process:

- Physical and non-physical safety of person submitting complaint is ensured throughout the process, eg. through anonymity and/ or separation of duties
- A monitoring system is in place to ensure that complaints have been resolved satisfactorily
- IF takes (informal) measures to ensure completeness of complaints, for example complaints mechanisms are well known and complaining will not carry negative consequences
- Complaints are analysed and used to improve policies/ processes/ operations and so on.

4.5.2. SME level complaints mechanism

DGGF requires that IFs implement a mechanism to allow stakeholders to report complaints about the SMEs it invests in. Depending on the size and maturity of each SME, the SME may implement its own complaints mechanism; or SME stakeholders could be given access to the IF's complaints mechanism. Complaints may be made by staff/ the general public/other parties. As with the IF level complaints, the SME level complaints mechanism should be in accordance with the principles below.

Submission of complaints:

- Transparent, publicly available and easily accessible process for submitting complaints (eg. phone number; website; email address; suggestion box etc). Employees and clients are informed about their right to complain

Handling of complaints:

- Each complaint is assessed and the appropriate response determined if applicable. Staff involved in complaints handling have been given appropriate training on how to deal with complaints

Communication regarding complaints:

- Involved parties are informed about the nature of the complaint as well as the response (and may be involved in formulating the response). Communication is appropriate and timely

Governance of complaints process:

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[4] Also known as grievance mechanisms

[5] http://www.ifc.org/wps/wcm/connect/38d1a68049ddf966af3cbfda80c2ddf3/InterpretationNote_FIs_2012.pdf?MOD=AJPERES

- Physical and non-physical safety of person submitting complaint is ensured throughout the process, eg. through anonymity and/ or separation of duties
- An informal monitoring system is in place to ensure that complaints have been resolved satisfactorily, and complaints are analysed and used to improve policies/ processes/ operations and so on, eg. complaints are discussed periodically
- IF and SME take (informal) measures to ensure completeness of complaints

Note for microfinance organisations: Microfinance organisations have a lender-borrower relationship with their clients rather than an investor-investee relationship. Microfinance organisations are not required to ensure that the SMEs they lend to implement a complaints mechanism, or to monitor the completeness of complaints about their borrowers. However, if a complaint about one of their borrowers comes to their attention, they are required to document it and take follow up action. They are also required to report this to the DGGF Fund manager using the appropriate reporting template (see section 1.3 below).

4.5.3. Reporting about complaints

IFs are required to report annually about the number and nature of complaints at both IF level and SME level. The fund manager summarises these results in its reporting to the Dutch Ministry of Foreign Affairs.

4.6. The Rio markers for climate change adaptation and mitigation

The climate markers provide an indication of the policy goals of the donor that contribute to an activity. These climate markers are split up into 'principal' (primary) and 'significant' (secondary) objectives.

Principal policy objectives are those which can be identified as being fundamental in the design of the activity and which are an explicit objective of the activity. They may be selected by answering the question "would the activity have been undertaken (or designed that way) without this objective?" If the answer is negative, the project van be awarded a principal marker.

Significant policy objectives are those which, although important, are not one of the principal reasons for undertaking the activity.

The score 'not targeted' means that the activity hhas been screened against, but was found not to be targeted to, the policy objective.

An activity can have one or more principal of significant policy objective. To qualify for a core 'principal' or 'significant', the objective has to be explicitly promoted in project documentation. Avoiding a negative impact is not a sufficient criterion.

Source: "Rio markers for climate change mitigation and adaptation". Brochure published by the Dutch Ministry of Foreign Affairs.

4.7. Abbreviations

CiP: Clearance-in-Principle

DD: Due Diligence

DGGF: Dutch Good Growth Fund

ESG: Environment, Social, Governance

IC: Investment Committee

ICSR: International Corporate Social Responsibility

IF: Intermediary Fund; Investment Fund