Ministry of Foreign Affairs

ESG Policy

DGGF Track 2: Financing local SMEs in emerging markets and developing countries via intermediary funds

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Dutch Good Growth Fund

Financing Local SMEs

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1. Introduction

This document sets out the ESG[1] policy for DGGF Track 2: Financing local SMEs (hereafter: DGGF[2]). First, it provides a brief description of the purpose and scope of ESG in the context of DGGF Track 2. Secondly, it lays out the exclusion list and the ESG principles that are applicable to all intermediary funds (hereafter: IFs). Finally, the document elaborates on the selection process for IFs that want to join DGGF and on the technical assistance that the ESG team can offer to those who already joined.

1.1. Purpose and scope of the ESG Policy

This document outlines the ESG standards that all IFs applying for DGGF funding need to consider and integrate in their investment approach and processes. Because this ESG policy specifically focuses on the ESG 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.

DGGF will only invest in IFs whose business practices are in line with these ESG standards. IFs are responsible for encouraging and ensuring good ESG practices by the SMEs in their portfolios. We will assess the way in which IFs take up this responsibility.

In cases where IF practices do not align with DGGF's ESG standards, the DGGF Fund Manager may choose to include ESG conditions for investment in the investment contract with the IF and/or to offer ESG technical assistance to the IF's investment team. By doing so, DGGF will collaborate with IFs to help them improve their understanding and management of ESG issues and to improve ESG performance over time.

[1] ESG: This includes environmental, social and governance aspects. For more information on our interpretation of ESG we refer to the DGGF ESG principles in this document.
[2] Each DGGF Track has a separate ESG 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 ESG Guidance for IFs

DGGF investments are at the IF level and often the DGGF Fund Manager will invest in an IF until maturity. It is not possible for the DGGF Fund Manager to directly decide whether or not to invest in a specific SME (unless explicitly mentioned in the side letter, for example in case of ESG Category A risk SMEs). This differs fundamentally from the other two DGGF tracks. It implies that while the DGGF ESG 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 act in line with the DGGF ESG 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 ESG policies and systems in place at IF level.
For the purpose of this document, a distinction is made between two different categories of IFs: financial institutions and funds. ‘Financial institutions’ refers mainly to SME banks, leasing companies, fintech platforms and other lending facilities catering to SMEs in the DGGF target countries. ‘Funds’ mainly refers to private equity and venture capital firms that fund SMEs in DGGF target countries. Detailed guidance for the two different IF categories is included in this document.

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 ESG policy contents as IFs which finance larger SMEs and/or they may not implement it in the same way. The same is true for IFs that have a specific sector focus. Different industry sectors deal with different risks and these need to be considered. We expect such a focus to be reflected in the ESG policy of the IFs.

Finally, it should be noted that the principles below are for ESG risk management rather than impact, as impact is monitored separately through the DGGF Impact Monitor.

2.1. Sustainable Development Goals for IFs

DGGF endorses the Sustainable Development Goals (SDGs) and encourages IFs to consider integrating the SDGs into their ESG and impact approaches and – where relevant- in their investment strategies. IFs can use the SDGs as a holistic framework, i.e. both as an ESG risk compass and a capital allocation guide. There are other strategic considerations for engaging with the SDGs, such as clear communication to stakeholders, attracting investments, public and private partnerships, and engaging in innovative business opportunities.

The rationale for this endorsement and open call is that in frontier markets, where DGGF operates, the financial sector has a catalyst role to ensure that capital is deployed where it is most needed and where it can have the greatest impact.

2.2. EDFI Exclusion list as foundation for ESG Principles

DGGF uses the Exclusion list from the European Development Finance Institutions (EDFI) as a non-negotiable starting point for the ESG Principles. The EDFI Exclusion List has been benchmarked against the UN Declaration of Human Rights, the ILO Core Conventions and the IFC Performance Standards on Economic and Social Sustainability. The complete EDFI Exclusion list can be found in the Appendices.

2.3. ESG principles based on IFC Performance Standards, UN Guiding Principles on business and human rights and OECD Guidelines

In addition to complying with the EDFI Exclusion list, all IFs are expected to do business in line with the ESG principles. The ESG principles are based on the IFC Performance Standards, the United Nations Guiding Principles on business and human rights (UNGPs) and the OECD Guidelines. Each principle covers a specific E, S or G issue. Acceptable business conduct is defined in accordance with international guidelines. For example: labour issues include issues ranging from working hours to living wage to the prohibition of child labour and are defined in line with the ILO Core Conventions.
The table in the following section describes the DGGF ESG principles in more detail. We refer to the Tax Guidelines for more details on DGGF's tax policy.

Environmental	**Social**	**Governance**
Biodiversity conservation	Human rights*	Anti-corruption
Sustainable natural resource management	Land acquisition and involuntary resettlement	Responsible lending
Pollution prevention and abatement	Indigenous people	Complaints mechanism (access to remedy for all stakeholders)
	Cultural heritage	Politically exposed people
	Non-discrimination (employees and customers)	
	Non-discrimination (in Artificial Intelligence (AI)	
	Health and safety (employees and communities)	
	Health and safety (customers)	
	Working hours	
	Remuneration (incl. living wage provisions)	
	Freedom of association and right to collective bargaining	
	Information privacy and data security	

*Human rights issues include commonly encountered issues such as working hours and remuneration (e.g. living wage), but may also include other civil, political, economic, social and cultural rights

2.4. DGGF ESG Principles

The table below sets out the DGGF ESG principles in more detail. For each principle we include an extensive definition, suggested application in line with relevant standards and frameworks, and specific examples outlining what acceptable and unacceptable behaviour look like.

Environmental			
DGGF ESG Principle	**Interpretation**	**Suggested application, including EDFI exclusion list**	**Examples**
Biodiversity conservation	IF shall invest in SMEs that do not engage in any activity that might lead or be linked to habitat loss, degradation and fragmentation, overexploitation, hydrological changes or related risks.	Biodiversity loss is not acceptable, unless the IF/SMEs have policies in place with which they can demonstrate to lessen their negative environmental impact within a certain timeframe. 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. See the EDFI Exclusion list found in the Appendices for a list of activities that are specifically prohibited because they lead to biodiversity loss.	**Unacceptable:** An SME using hazardous chemicals that cause irreversible damage to the local ecosystem. **Acceptable:** The situation above is deemed acceptable if: a) local legislation allows the use of such chemicals b) the company formulates a clear plan, including timeframe and milestones, for the phase-out of such chemicals.
Sustainable natural resource management	IFs shall invest in SMEs that manage natural resources in a sustainable manner, through the application of industry-specific sustainable management practices and available technologies. Sustainable use of resources, including energy and water, should be promoted. This is even more important in regions that are heavily impacted by climate change and may therefore experience an acceleration and/or intensification of negative impacts.	IFs should at least comply with national and international natural resource management regulations and require the same from the SMEs they invest in. IFs are advised to follow the IFC Performance Standard 6: Sustainable Management of Natural Resources.	**Unacceptable:** An SME that produces soft drinks is intensively using a key natural resource (water), resulting in scarcity of clean drinking water in the region. This negatively impact the communities living in the region. **Acceptable:** An SME that produces soft drinks has engaged in a stakeholder consultation process with the representatives of the local community and has agreed on setting thresholds to current water usage

Pollution prevention and abatement	IFs shall invest in SMEs that avoid or minimize pollution from project activities in order to lower adverse impacts on human health and the environment. Project-related GHG emissions should be reduced. Pollution prevention is defined as the use of materials, processes, or practices to reduce or eliminate the creation of pollutants or waste. It includes practices that reduce the use of toxic or hazardous materials, energy, water and/or other resources. Pollution abatement refers to technology applied, or measures taken to reduce pollution and/or its impacts on the environment. The most commonly used technologies used in pollution abatement include filters, waste-water treatment facilities, composting, and the use of renewable energy sources.	IFs should at least comply with national and international pollution prevention and abatement regulations and require the same from the SMEs they invest in. IFs are advised to follow IFC Performance Standard 3: Resource Efficiency and Pollution Prevention.	**Unacceptable:** A pharmaceutical company disposes of unfiltered toxic residuals into the river. **Acceptable:** An SME is reducing the GHG-emittance of a carbon intense production line by installing solar panels.

Social			
DGGF ESG Principle	**Interpretation**	**Suggested application, including EDFI Exclusion List**	**Examples**
Human rights* * Human rights issues include commonly encountered issues such as working hours and remuneration (e.g. living wage), but may also include other civil, political, economic, social and cultural rights	IFs shall invest in SMEs that support and respect the protection of internationally recognised human rights and are not complicit in human rights abuses. This implies that SMEs shall: (1) avoid infringing on the human rights of individuals and (2) address adverse human rights impacts resulting from their own operations, supply chains or business relations.	The responsibility of organisations to respect human rights should be understood in the context of the UN Guiding Principles on business and human rights, with a particular focus on Pillar II (the corporate responsibility to respect human rights) and Pillar III (access to remedy). See the EDFI Exclusion list found in the Appendices for matters relating to forced and child labour.	**Unacceptable**: An SME narrowing down the scope of the corporate responsibility to respect human rights to its own operations. **Acceptable**: An SME conducting human rights due diligence to identify, assess and mitigate adverse human rights impacts arising at operations, supply chain and business relations level. For additional examples relating to specific human rights issues, see the ESG principles: indigenous peoples, remuneration, non-discrimination, working hours, health and safety, land acquisition and involuntary resettlement.
Land acquisition and involuntary resettlement	IFs shall invest in SMEs that take all necessary measures to ensure that land acquisition does not lead to involuntary resettlement. Involuntary resettlement can have adverse impacts on communities and persons that either live on the acquired land or depend on it for their livelihood. Involuntary resettlement refers to: (1) physical displacement (relocation or loss of shelter) (2) economic displacement (loss of assets or access to assets that leads to loss of income sources or other means of livelihood)	IFs should at least comply with national and international land acquisition and resettlement regulations and require the same from the SMEs they invest in. This includes the application of the principle of Free, Prior and Informed consent – i.e. ensuring that all involved parties (communities and persons) have been consulted and have voluntarily agreed with a resettlement and compensation plan. IFs are advised to follow IFC Performance Standard 5: Land Acquisition and Involuntary Resettlement.	**Unacceptable:** The Three Gorges Dam Project in China is considered unacceptable. During the 17 years it took to complete the dam, 1.3 million people were resettled, often without consent. **Acceptable:** the SME can demonstrate that those resettled were informed and gave their voluntary consent (i.e. without undue pressure) prior to the start of the project. Also, the SME can demonstrate that fair, agreed-upon compensation has been provided to those resettled.

Indigenous peoples	IFs shall invest in SMEs that take all necessary measures to ensure that indigenous peoples' rights are respected and that relations with indigenous communities are based on ongoing consultation and engagement.	IFs should at least comply with national and international standards applicable to indigenous peoples, and require the same from the SMEs they invest in. This includes the application of the principles outlined in the UN Declaration on the Rights of Indigenous Peoples. IFs are advised to follow IFC Performance Standard 7: Indigenous People.	**Unacceptable:** An SME offering tours of indigenous land and villages without consulting or involving in any way the indigenous communities. **Acceptable:** An SME offering tours of indigenous land and villages in coordination with the local governing body representing indigenous communities, and with a business model that clearly channels part of the revenues to the indigenous communities.
Cultural heritage	IFs shall invest in SMEs that take all necessary measures to ensure that cultural heritage is protected and preserved. In addition, SMEs shall promote the equitable sharing of benefits from the use of cultural heritage in business activities. Cultural heritage refers mostly to tangible forms of cultural heritage, such as tangible property and sites having archaeological, paleontological, historical, cultural, artistic, and religious values, as well as unique natural environmental features that embody cultural values, such as sacred groves. There are also intangible forms of culture, such as cultural knowledge, innovations and practices of communities embodying traditional lifestyles.	IFs should at least comply with national and international standards regulating the protection and preservation of cultural heritage, and require the same from the SMEs they invest in. This includes the application of the principles outlined in the UN Declaration on the Rights of Indigenous Peoples. IFs are advised to follow IFC Performance Standard 8: Cultural Heritage.	**Unacceptable:** An SME that has built a factory on a natural heritage site, ignoring the cultural value of the site and the concerns raised by local communities. **Acceptable:** An SME that has built a factory just off a natural heritage site, after extensive consultation with NGOs representing the local communities whose cultural life is dependant on the site. Given the physical distance between the site and the factory, and the fact that local communities' concerns were taken into account in the context of a broad-based stakeholder engagement, the investment is considered acceptable.
Non-discrimination (employees and customers)	IFs shall invest in SMEs that refrain from any form of discrimination concerning worker and consumer characteristics.	IFs should at least comply with national and international regulation prohibiting discrimination of employees and	**Unacceptable (employees):** Discriminating against women in hiring and promotion practices, sometimes going as far

	Discrimination in employment and occupation implies treating people differently or less favourably because of characteristics that are not related to their merit or the inherent requirements of the job. Additionally, consumer discrimination occurs when consumers are treated less favourable due to certain characteristics. Common discrimination grounds include: sex or gender, racial or ethnic origin, age, religion or belief, disability, sexual orientation and gender identity, language, political opinion, HIV/AIDS status.	customers, and require the same from the SMEs they invest in. Discrimination is never acceptable. In countries where discrimination is incorporated into law (for example anti-LGBT legislation) or limited, we expect that IFs and SMEs explicitly pay attention to how they plan to compensate for this. IFs should also pay attention to gender equality and actively work towards narrowing the gender gap at IF level and encourage the SMEs they invest in to do the same.	as to terminate the contracts of female employees who get pregnant. **Acceptable (employees):** Hiring speakers of a certain language because that gives the company a competitive advantage in operating in a given market. **Unacceptable (customers):** A private school denying applicants from a certain ethnic or racial background. **Acceptable (customers):** A women-only gym and fitness chain is considered an acceptable investment.
Non-discrimination (Artificial Intelligence (AI)	IFs investing in AI should be aware of the social and human rights risks that might arise in this context. SMEs whose products or services rely on AI applications including machine learning and deep learning are expected to be aware of actual and potential risks arising from algorithm biases and other inherently discriminatory models (the most common example being incomplete datasets resulting in the exclusion of women or ethnic minorities).	We recommend the following three steps in order to identify, mitigate or avoid biases in AI: 1. Identifying social and human rights risks linked to business models and specific AI-driven products or services. 2. Taking effective action to prevent and mitigate identified risks. 3. Being transparent about efforts to identify, prevent, and mitigate identified risks. IFs are advised to reach out to the ESG expert team and actively seek technical assistance to ensure that their due diligence is in line with DGGF ESG expectations. This is particularly important for venture capital and other IFs whose portfolio composition shows most investments in tech and specifically AI/ machine learning.	**Unacceptable:** A human resources platform that uses an algorithm to match job seekers with potential employers but does not compensate for inherent bias that exists in historical data. As a result, the platform consistently identifies men as the best candidates for jobs. **Acceptable:** A human resources platform that is actively preventing gender discrimination through (ethical) monitoring and human oversight and that is actively report on any red flags in an effort to gradually improve the selection and matching processes.

Health and safety (employees and communities)	IFs shall invest in SMEs that provide a safe and healthy workplace environment and shall take effective steps to prevent potential health and safety incidents and occupational injury or illness associated with work. SMEs are also expected to take into account the actual and potential health and safety effects of their operations on local communities.	IFs should at least comply with national and international health and safety regulation and require the same of the SMEs they invest in. IFs are advised to follow the IFC Performance Standard 4: Community Health, Safety, and Security.	**Unacceptable:** A textile factory that does not comply with national and international safety regulation, e.g. does not have emergency exists or a fire safety plan. **Acceptable:** A textile factory that has worked towards full compliance with national and international standards, including by carrying out regular independent inspections, being transparent about the actual and potential risks of using factory equipment and ensuring all work floor staff have access to health and safety training.
Health and safety (consumers)	IFs and SMEs should broaden the scope of health and safety beyond employees and communities. They are expected to be aware of actual and potential health and safety impacts on consumers and end-users of their products. Consumers need to be able to access non-hazardous products and services, offered to them through transparent and fair marketing practices. Vulnerable and disadvantaged consumers should be protected.	IFs should at least comply with national and international health and safety, product quality and transparent marketing regulation and require the same of the SMEs they invest in. We advise IFs to consult the United Nations Guidelines for Consumer Protection.	**Unacceptable:** An SME sells pre-packaged meals without informing potential consumers on the ingredients used to prepare the meal. This regardless of the fact that (inter)national law requires all food processing companies to clearly state which ingredients have been used, in an effort to avoid negative health impacts (e.g. allergic reactions cause by consumption of gluten, nuts etc.) **Acceptable:** A pharmaceutical company sells sleeping pills that contain melatonin. The company has consulted national law regarding the legitimacy of the use of melatonin and informs consumers of any potential side effects on the pills' packaging.
Working hours	IFs shall invest in SMEs that are compliant 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, any overtime should be voluntary and should not be requested on a regular basis.	IFs should at least comply with national and international working hours regulation and require the same of the SMEs they invest in. IFs are advised to follow the IFC Performance Standard 2: Labour and Working Conditions, to be read in conjunction with the ILO Core Conventions.	**Unacceptable:** Employees regularly work more than 60 hours per week. Peer and top-down pressure on the work floor create a culture in which employees are de facto unable to work 40-48 hours a week. **Acceptable:** Employees regularly work 50 hours per week, and occasionally 70 hours per week because of the seasonal nature of the job/ employment sector.

	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 that these deviations are in the best interest of the labourers involved.		
Remuneration	IFs shall invest in SMEs that are compliant with applicable law, collective bargaining agreements and industry standards on the right for personnel to receive a living wage. SMEs are expected to ensure that wages for a normal work week, not including overtime, always meet at least legal or industry minimum standards, and are in line with collective bargaining agreements. Deductions from wages for disciplinary purposes are never acceptable.	IFs should at least comply with national and international remuneration regulation and require the same of the SMEs they invest in. IFs are advised to follow the IFC Performance Standard 2: Labour and working conditions, to be read in conjunction with the ILO Core Convention 100 on Equal Remuneration.	**Unacceptable:** An SME that pays minimum wage (legal minimum) in a country where the gap between minimum and living wage is so large that the employees are forced to live below the poverty line. **Acceptable:** An SME pays relatively low monetary wages but compensates through benefits such paying for the employees' housing, transport to and from work, and food. The benefit scheme has been discussed and agreed upon with the employees.
Freedom of Association and Right to Collective Bargaining	IFs shall invest in SMEs that respect and promote 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. SMEs are expected to have non-discriminatory policies and procedures regarding trade union membership and adequate union channels that allow workers' participation in decisions on advancement, dismissal or transfer.	IFs should at least comply with national and international freedom of association regulation and require the same of the SMEs they invest in. IFs are advised to follow the IFC Performance Standard 2: Labour and working conditions, to be read in conjunction with the ILO Core Convention 87 on Freedom of Association and Protection of the Right to Organize and ILO Core Convention 98 on the Right to Organize and Collective Bargaining. In countries where freedom of association is prohibited or limited, we expect that IFs	**Unacceptable:** Any form of intimidation, e.g. reports of verbal threats made either inside or outside the workplace, towards workers who are planning to join a trade union. **Acceptable:** Where freedom of association is restricted by national law, the SME sets up an internal stakeholder engagement plan. This might include: frequent stakeholder consultation on matters of advancement, dismissals and transfers, as well as a complaints mechanism that workers can use to voice their concerns in a safe manner, without fear of reprisals.

		explicitly pay attention to how they plan to compensate for this.	
Information privacy and data security	IFs shall invest in SMEs that ensure that personal data is collected and used in a responsible manner, in line with (inter) national norms on privacy and security of data. SMEs are also expected to develop data security capacity and policies to limit digital and data-related threats, e.g. protection against hackers. Personal data must be secured against unauthorised and unlawful processing and accidental loss, destruction or damage by means of appropriate technical and organisational measures. Measures must enable organisations to restore access and availability and where appropriate, organisations should look into measures such as pseudonymisation and encryption.	IFs should at least comply with national and international standards relating to information privacy and security and require the same of the SMEs they invest in. IFs are advised to follow the OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data. IFs are also advised to reach out to the ESG expert team and actively seek technical assistance to ensure that their due diligence is in line with DGGF ESG expectations. This is particularly important for venture capital and other IFs whose portfolio composition shows a majority of investments in tech companies that heavily rely on the collection and use of personal data.	**Unacceptable:** An SME disclosing personal data such as name, date of birth and address without consent of data subject or authority by law. **Acceptable:** An SME that can demonstrate that those involved gave their conscious and voluntary consent prior to the sharing of their personal data to third parties.

Governance			
DGGF ESG Principle	**Interpretation**	**Suggested application, including EDFI Exclusion List**	**Examples**
Anti-corruption	IFs and SMEs shall work against corruption in all its forms, including bribery, facilitation payments and extortion. DGGF defines corruption as the offering, requesting, giving or receiving of a financial or other advantage in order to induce or reward the improper performance of a role, duty or function.	IFs should at least comply with national and international anti-corruption regulation, and require the same of the SMEs they invest in. Corruption can take many forms, ranging from the minor use of influence to institutionalized bribery. Small gifts given as part of the "normal course of business" are acceptable but should be reported and registered. DGGF has a zero-tolerance policy on corruption in all its forms. If the IF/ SME operate in a country where bribery is commonplace, they are advised to reach out to the ESG expert team to seek tailored advice.	**Unacceptable:** The investment manager of the IF receives a coupon for a weekend trip in an expensive resort from the CEO of one of the SME companies he invested in. **Acceptable:** The investment manager of the IF receives a small gift from the HR and Communication department of an investee company (SME) as part of a public holiday celebration. The investment manager immediately informs his/her supervisor which evaluates whether the gift falls within the predetermined threshold.
Responsible Lending	Financial institutions (and Fintech platforms) that provide loans shall ensure that they do not lend more than a borrower can afford and that interest rates are reasonable.	Prior to the lending process, financial institutions 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, financial institutions 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:** Financial institution that do 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.

		In addition, the financial institutions should communicate information clearly, sufficiently and timely in a manner and language clients can understand so the clients make informed decisions.	
Complaints mechanism	The organisation shall 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 complaints mechanism should be in accordance with the principles on submission, handling, communication and governance of complaints as laid out in the appendix. These principles are in line with the IFC interpretation note for financial intermediaries.	**Unacceptable:** An employee (or consumer at SME level) verbally reports a discrimination complaint, which is not documented and consequently not appropriately followed up on. **Acceptable:** A stakeholder files an anonymous complaint, which is documented, assessed and handled in a timely matter by a member of staff who has received appropriate training.
Politically Exposed People (PEPs)	The organisation shall address risks and take appropriate measures to prevent as well as detect the misuse of the financial system and non-financial businesses by PEPs. PEPs are natural persons who are or have been entrusted with prominent political functions and immediate family members or persons known to be close associates of such persons.	IFs should implement risk management systems to determine whether customers or beneficial owners are (foreign) PEPs, and if so, take measures beyond performing normal customers due diligence. Risk mitigation measures should be aligned with FATF Guidance on Politically Exposed Persons (recommendations 12 and 22).	**Unacceptable:** A PEP is able to exert substantial influence in decision-making (e.g. being a majority shareholder). **Acceptable:** A PEP has a minority share in the SME and has no day-to-day involvement in running the business activities or decisions.

2.5. The need for a tailored approach in application of the ESG principles

All IFs that DGGF invests in are required to incorporate ESG standards into their investment or lending cycles by means of specific policies, processes and systems. IFs are also responsible for ensuring that these same ESG standards are incorporated by the SMEs they invest in.

2.5.1. Financial institutions

When applying the DGGF ESG principles, the approach for (private equity) funds and financial institutions differ slightly. As funds select a limited number of companies to invest in for a longer period, they can closely monitor and manage ESG risks arising from the investees' operations. Furthermore, as private equity and mezzanine funds often have board representation, this allows for stricter enforcement of ESG principles at the SME-level. Financial institutions typically engage in a large number of relatively small and short-term loans, often by lending money to individuals or small enterprises that cannot access mainstream financial services. These businesses served by financial institutions are generally not associated with the same scale and type of ESG risks as are larger companies.

The EDFI Exclusion list implies strict and non-negotiable criteria for both funds and financial institutions.
The main difference is in the application of the DGGF ESG principles. It lies in the fact that funds are able to ensure compliance on the individual investee level, whereas financial institutions are better suited to apply a risk-based approach at the portfolio level.

Financial institutions can find tailored guidance in the *DGGF ESG E-learn for SME finance institutions*. The DGGF ESG team developed the e-learn in 2019 with the aim of outlining DGGF's ESG expectations for this specific group of IFs.

The e-learn is available offline. Please reach out to the DGGF ESG team to access the latest version.

2.5.2. Venture capital

Venture capital (VC) is a relatively new asset class in many of the emerging markets where DGGF operates. The VC model is associated with specific challenges, including rapidly evolving business models and lean governance and compliance processes. These challenges need to be taken into account when applying the DGGF ESG principles. For example, ESG risks may be perceived to be 'lower' if compared to those encountered by mature private equity investors, often because VC investees are seed or nascent companies.

While we encourage every VC fund to conduct their own due diligence, we want to emphasize that the approach taken needs to be proportionate and appropriate to the size of the investee company.

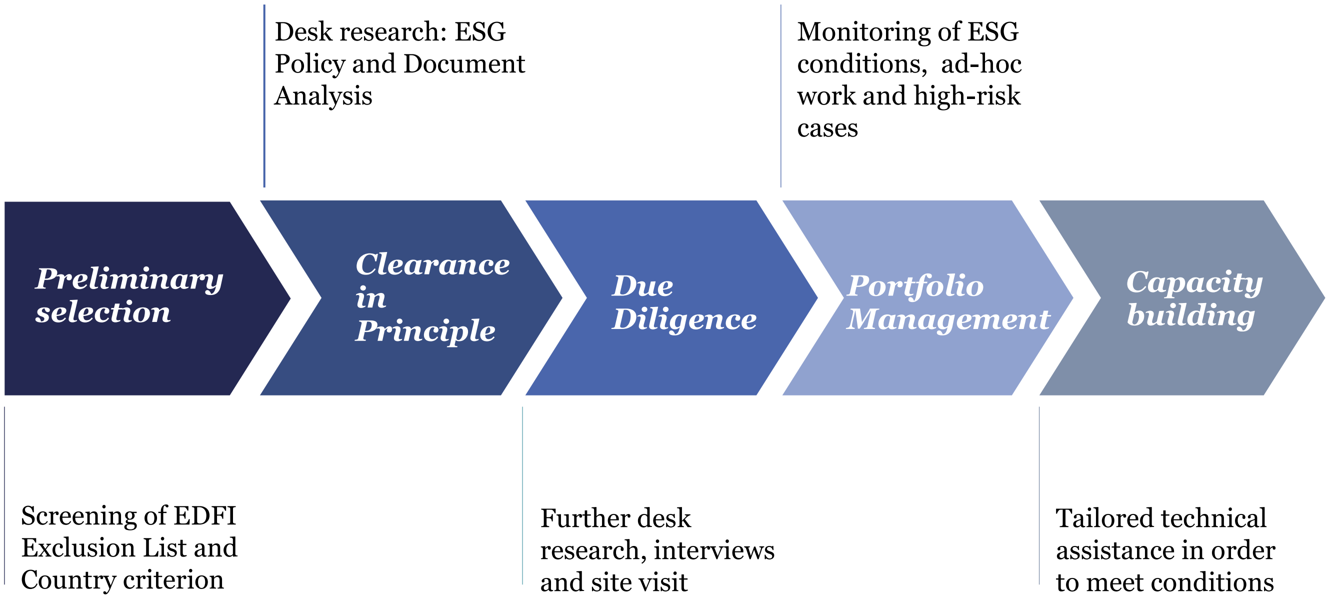
VC funds can find tailored guidance in the FMO-CDC Good Practice Note on *Responsible Venture Capital*, a publication released in 2019, to which the DGGF ESG team also contributed.

The Good Practice Note is available online. Please refer to the following link:

FMO-CDC Good Practice Note on Responsible Venture Capital

3. DGGF Process

This chapter describes the DGGF process during the different stages of the investment in IFs: Preliminary selection, Clearance in Principle, Due Diligence, Portfolio Management, and Capacity Building. Moreover, evaluation and sanctions are briefly touched upon.



3.1. Preliminary selection

ESG aspects are important considerations in the first 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 ESG.

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

3.1.1. Exclusion check

Part of the preliminary selection is the ESG Exclusion check. The DGGF Fund Manager's ESG 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 EDFI Exclusion List. If differences exist between the IF's and the EDFI Exclusion List, negotiations to amend the list will take place in the next step in the process (CiP). IFs that do not meet these criteria are not eligible for investment.

3.2. Clearance in Principle (CiP)

DGGF's ESG expert team provides input for the IC's decision on whether to extend a CiP to a potential investee. The ESG input for the CiP is based on desk research and analysis of received documentation regarding the IF's policies. The aim of the initial investigation is to identify any ESG issues which are no-go's and consequently require further investigation during the due diligence 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.

3.3. Due Diligence (DD)

The DD input builds on the information gathered during the CiP, including any potential ESG issues that were identified or open questions. 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 ESG 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, and risk management measures in place whereas the CiP solely focuses on desk research into the IF's policies. Similar to the CiP phase, the ESG expert team provides input for the IC in the form of a memo and corresponding traffic light.

3.3.1. Further explanation of the "ESG Traffic Light"

The IC receives ESG 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. The "ESG Traffic Light" categorization considers environmental, social and governance aspects and is explicitly intended as an investment advice rather than a risk categorization.

- Green (positive without conditions): A green traffic light means that there minor or no attention points have been identified during CiP or DD.
- Orange (positive with conditions): An orange traffic light means that attention points have been identified, yet in a likelihood these can be resolved together with the IF. This can be done either prior to investment or by including conditions for investment 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 ESG expert team would advise against investing in the IF.

3.4. Portfolio management

ESG Portfolio Management consists of the monitoring of the IFs in the DGGF portfolio and builds on the understanding gained during the CiP and DD. After an IF is closed or a disbursement has taken place, DGGF will actively and continuously monitor ESG related matters. DGGF differentiates three types of monitoring: follow-up on conditions for investments, regular monitoring and high-risk cases.

3.4.1. Following-up on conditions for investment

As mentioned above, the "ESG Traffic Light" categorization could result in conditions for investment in some cases. These conditions for investment will be specifically targeted at the attention points identified during the CiP and DD and be included as additional clause in the side letter of the investment contract. These conditions can range from providing additional documentation to drafting or aligning policies (e.g. the Exclusion list, ESG Policy or ESMS) or implementing certain risk mitigating measures (e.g. setting up a complaints mechanism, hiring additional staff and providing appropriate training). The exact conditions and timeframe in which these conditions should be met differ per IF. IFs are expected to give timely updates on the status of the conditions for investment and progress towards resolving the attention points, but the DGGF ESG Expert team will also do check-ins on a regular basis. Updates and documentation received from IFs concerning the conditions for investment will be reviewed carefully. In case the conditions for investment have been complied with, the IFS will be notified of their achievement.

3.4.2. Regular monitoring

Every year regular monitoring of the entire DGGF portfolio takes place. The goal is to gain insights into the current situation at the IF and whether any changes, newly emerged risks or trends have been identified. Monitoring also focuses on changes in the IF's ESG Policy and on ESG performance (e.g. policy breaches and complaints).

For more information regarding monitoring we refer to the DGGF Monitoring and Evaluation Guidelines.

3.4.3. High risk cases

Over the course of the year, issues could be flagged by the IF, investment manager, other investors or brought to the attention by media outlets. In such cases, issues will be categorized, and ad-hoc work may be required. It is also possible that flagged issued need to be resolved by setting up a capacity building track, which is elaborated on in the section 3.5.

IFs have an obligation to report on any serious incidents that occurred in their portfolio or potential investments that could be deemed high risk. To categorize and reflect the magnitude of risks and impacts related to the flagged issues, DGGF makes use of the IFC Environmental and Social Categorization. These categories are:

- Category A: business activities with potential significant adverse environmental or social risks and/or impacts that are diverse, irreversible or unprecedented.
- Category B: business activities with potential limited adverse environmental or social risks and/or impacts that are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures.
- Category C: business activities with minimal or no adverse environmental or social risks and/or impacts.

Potential serious incidents, IFC category A investments or category B investments with negative media attention and high reputational risk are deemed priority issues.

3.5. Capacity building

One of the main objectives of DGGF is to improve the capacity of funds and financial institutions. This is also true for ESG, either directly or by helping IFs to improve the capacity of SMEs in their portfolio. The specific capacity building needs will be determined on a case by case basis as a result of the outcome of the CiP and DD or in case issues are flagged during monitoring. 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 ESG, may be granted capacity building to assist them in complying with DGGF's ESG principles. Capacity building may be carried out by the Fund Manager, or by a consultant, appointed by the Fund Manager. Where possible we strive to work together with other investors.

ESG capacity building focuses on the following topics: training, workshops, development of ad hoc materials (e.g. ESG or SDG e-learns suitable for larger IFs and handbooks on effective ESG engagement) and coaching on how to build effective ESG policies and processes.

3.6. Evaluation

DGGF will appoint an external evaluator to evaluate the DGGF portfolio. The evaluation will include ESG aspects. If and when deemed necessary, the external evaluator may make use of information regarding ESG at the IFs which was collected during the selection and portfolio management stages. For more information we refer to the Monitoring and Evaluation Guidelines.

3.7. Sanctions

IFs in which DGGF invests are required to comply with the principles outlined in this policy. A contractual obligation to do so is in included in the investment contract between the DGGF fund manager and the IF. Non-compliance will be dealt with at contractual level.

4. Appendices

4.1. EDFI Exclusion List[3]

The European Development Finance Institutions (EDFI) have as a result of their harmonization process mutually agreed on the following Harmonized EDFI Exclusion list for co-financed projects:

EDFI members will not finance any activity, production, use, distribution, business or trade 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. *Activities or materials deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international phase-out or bans*, such as:
   a. Ozone depleting substances, PCBs (Polychlorinated Biphenyls) and other specific, hazardous pharmaceuticals, pesticides/herbicides or chemicals;
   b. Wildlife or products regulated under the Convention on International Trade in Endangered Species or Wild Fauna and Flora (CITES); or
   c. Unsustainable fishing methods (e.g. blast fishing and drift net fishing in the marine environment using nets in excess of 2.5km 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 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 and/or prostitution.*

7. *Racist and/or anti-democratic media.*

8. *In the event that any of the following products form a substantial part of a project's primary financed business activities*:
   a. Alcoholic beverages (except beer and wine);
   b. Tobacco;
   c. Weapons and munition; or
   d. Gambling, casinos and equivalent enterprises.

   For companies, 'substantial' means more than 10% of their consolidated balance sheets or earnings. For financial institutions and investment funds, 'substantial' means more than 10% of their underlying portfolio volumes.

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[3] Please note that Addendums to the EDFI Exclusion List may be applicable for the DGGF Context. These can be found at https://english.dggf.nl

4.2. Country List DGGF

The country list can be found online via the following link: https://english.dggf.nl/countries

Countries with the denotation 'F' are considered fragile states, according to the World Bank definition, which can be found here: http://pubdocs.worldbank.org/en/892921532529834051/FCSList-FY19-Final.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 People*
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 proces 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[4]:

IFC Performance Standards

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[5]:

IFC Interpretation Note on Financial Intermediaries of IFC Performance Standards

[4] We refer to the 2012 version of: "Performance Standards on Environmental and Social Sustainability".
[5] We refer to the 2018 updated version of: "Interpretation Note on Financial Intermediaries".

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 bribery, bribe solicitation and extortion*
   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. *The OECD Guidelines - on the Protection of Privacy and Transborder Flows of Personal Data – in short*

Collection Limitation Principle

- There should be limits to the collection of personal data and any such data should be obtained by lawful and fair means and, where appropriate, with the knowledge or consent of the data subject.

Data Quality Principle

- Personal data should be relevant to the purposes for which they are to be used, and, to the extent necessary for those purposes, should be accurate, complete and kept up-to-date.

Purpose Specification Principle

- The purposes for which personal data are collected should be specified not later than at the time of data collection and the subsequent use limited to the fulfilment of those purposes or such others as are not incompatible with those purposes and as are specified on each occasion of change of purpose.

Use Limitation Principle

- Personal data should not be disclosed, made available or otherwise used for purposes other than those specified in accordance with Paragraph 9 except:
  a) with the consent of the data subject; or
  b) by the authority of law.

Security Safeguards Principle

- Personal data should be protected by reasonable security safeguards against such risks as loss or unauthorised access, destruction, use, modification or disclosure of data.

Openness Principle

- There should be a general policy of openness about developments, practices and policies with respect to personal data. Means should be readily available of establishing the existence and nature of personal data, and the main purposes of their use, as well as the identity and usual residence of the data controller.

Individual Participation Principle

- An individual should have the right:
  a) to obtain from a data controller, or otherwise, confirmation of whether or not the data controller has data relating to him;
  b) to have communicated to him, data relating to him within a reasonable time;
  at a charge, if any, that is not excessive;
  in a reasonable manner; and
  in a form that is readily intelligible to him;
  c) to be given reasons if a request made under subparagraphs(a) and (b) is denied, and to be able to challenge such denial; and
  d) to challenge data relating to him and, if the challenge is successful to have the data erased, rectified, completed or amended.

Accountability Principle

- A data controller should be accountable for complying with measures which give effect to the principles stated above.

The elaborate OECD Guidelines can be found with the following link OECD Guidelines Protection of Privacy and Transborder Flows of Personal Data.

4.6. Guidance regarding complaints mechanisms

We expect 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 ESG requirements regarding complaints mechanisms[6].

4.6.1. 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[7].

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, e.g. 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.

4.6.2. 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

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[6] Also known as grievance mechanisms

[7] https://www.ifc.org/wps/wcm/connect/a6de7f69-89c8-4d4a-8cac-1a24ee0df1a3/FI+Interpretation+Note+November+2018.pdf?MOD=AJPERES&CVID=mUtZoXY

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, e.g. 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, e.g. complaints are discussed periodically
- IF and SME take (informal) measures to ensure completeness of complaints

4.6.3. Reporting about complaints

IFs are required to report 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.

4.7. Abbreviations

CiP: Clearance in Principle

DD: Due Diligence

DGGF: Dutch Good Growth Fund

ESG: Environment, Social, Governance

IC: Investment Committee

IF: Intermediary Fund