

# FMO SUSTAINABILITY BOND

## FRAMEWORK OVERVIEW AND SECOND OPINION BY SUSTAINALYTICS

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## 1. INTRODUCTION

In 2015, Sustainalytics was retained by FMO to provide an evaluation of FMO's Sustainability Bond framework in order to ensure alignment with the Green Bond Principles and industry best practices. In May 2017, FMO engaged Sustainalytics to update its 2015 Sustainability Bond framework to include additional Use of Proceeds Criteria (refer to section 3).

As part of this engagement, Sustainalytics held conversations with members of FMO's treasury and sustainability teams and reviewed relevant public and internal documents to understand FMO's planned use of proceeds, project selection process, management and reporting for its Sustainability Bond.

This document contains three sections: Overview of the issuer and its ESG Performance; Sustainability Bond Framework Overview – a summary of FMO's Sustainability Bond framework; and Sustainalytics' Opinion – an opinion on the framework.

## 2. OVERVIEW OF THE ISSUER - FMO

Founded in 1970 by the Dutch government, FMO is the Dutch development bank, and one of the largest financial institutions focussed on development. With operations in over 85 countries, FMO provides financing for businesses, projects and financial institutions in developing and emerging markets, with the aim of supporting sustainable, private sector development. In general, FMO's activities focus on having a large, long-term impact in the following areas: Financial Institutions, Energy and Agribusiness.

FMO's vision is that by 2050, nine billion people live well within the limits of our planet. FMO states that its strategy is based on the conviction that economic growth that is both inclusive and green will lead to a better world. Hence green development and inclusive development are key parts of FMO's Theory of Change.

FMO's ambition for 2020 is to be the leading impact investor by:

- Doubling its impact by doubling direct and indirect jobs, and
- Halving its footprint by doubling avoided Greenhouse Gas (GHG) emissions<sup>1</sup>.

The footprint objective is translated into an operational objective to double the proportion of new green commitments to 40% in 2020. In addition, FMO aims to contribute to the United Nations Sustainable Development Goals (SDGs) as part of its core business, with a particular focus on SDG 8, 10 and 13, in line with its ambition to be a leading impact investor. As part of this endeavour, FMO plans to issue Sustainability Bonds to fund both its green and inclusive finance commitments.

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<sup>1</sup> As per FMO's 2016 Annual Report, these goals will be measured with respect to FMO's annual new investments in 2018-2020 versus the 2010-2012 baseline period.

### **FMO's Sustainability Policy**

FMO has a *Sustainability Policy*<sup>2</sup>, defining, amongst others, environmental and social criteria for direct and indirect investments (see Appendix 1). All FMO's direct investment clients (including those in which it takes equity stake) are required to comply with applicable national and international E&S laws as a minimum standard. In addition, FMO upholds the IFC (International Finance Corporation) Performance Standards as applicable for its clients. For FMO's financial institution (FI) clients and private equity funds (PEF) in which it invests, FMO focuses on how they address the environmental and social risk in their portfolios. Depending on the risk category (see Appendix 1), FMO expects the FIs and PEFs to apply certain environmental and social standards when financing or investing in their clients. This entails that, FIs and PEFs will be required to establish and maintain an E&S Management System to ensure that their investments meet (or over time become compliant with) FMO's requirements. The level of detail and sophistication of this management system and the monitoring approach will depend on the E&S risk profile of the FI / PEF and the type of financing that they provide.

With regard to ESG oversight, FMO's E&S team has oversight over environmental and social issues, while the management board is responsible for setting the sustainability agenda and developing ESG policies. FMO's E&S team is comprised of 26 members, three of whom are on the sustainability team coordinating all sustainability-related activities, while the other 23 are integrated in the investment and credit review teams.

## **3. SUSTAINABILITY BOND FRAMEWORK OVERVIEW**

For the purpose of issuing Sustainability Bonds, FMO has developed the following framework, which addresses the four key pillars of the Green Bond Principles<sup>3</sup>: Use of proceeds, Project evaluation and selection process, Management of proceeds, and Reporting.

### **2017 FRAMEWORK UPDATE**

This framework has been updated in May 2017, to include "SME Financing" as one of the eligible criteria for use of proceeds. This newly added eligibility criteria does not apply retroactively to FMO's Sustainability Bonds issued under the previous framework<sup>4</sup>, but is applicable to future bonds, and hence affects only future investments.

### **3.1 Use of Proceeds**

FMO plans to use proceeds of its Sustainability Bonds to fund environmental ("green") and inclusive finance projects to support FMO's mission. FMO's definition of green projects focuses on climate-related projects, that should be value added, and go beyond complying with regulatory standards in order to initiate and/or enable a market shift. FMO defines two sub categories under green finance: climate change mitigation and climate change adaptation, and one category under inclusive finance. FMO's definition of green and inclusive finance categories are provided in Table 1.

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<sup>2</sup> <https://www.fmo.nl/policies-and-position-statements>

<sup>3</sup> "Green Bond Principles, 2016" dated 16 June 2016 issued by the International Capital Market Association (ICMA)

<sup>4</sup> Dated from April 2015 and available at <https://www.fmo.nl/sustainability-bonds>

**Table 1**

Category	Definition
<b>Climate Change Mitigation</b>	An activity is considered to be mitigating climate change if it contributes to either, reducing greenhouse gas (GHG) emissions into the atmosphere, or sequestering GHG emissions from the atmosphere. If the project or activity relates to Energy efficiency, it should achieve at least 20% reduction in energy consumptions or GHG emissions.
<b>Climate Change Adaptation</b>	An activity is considered as climate change adaptation if the intention of the activity or project design is to reduce the vulnerability of human or natural systems to the impacts of climate change and climate-related risks, by maintaining or increasing adaptive capacity and resilience.
<b>Inclusive Finance<sup>5</sup></b>	Inclusive finance focuses on expanding access to affordable and responsible financial products and services to the poor and vulnerable populations. This includes microfinance as well as directly financing organizations that are often unable to gain access to financial products and services such as small- and medium-sized enterprises.

## Eligibility Criteria

### Climate Change Mitigation Eligibility Criteria

FMO's definitions of climate change mitigation, and the eligibility criteria, align with the definitions and the types of projects set forth by the Multilateral Development Banks (MDBs) in the "Joint Report on MDB Climate Finance 2012"<sup>6</sup>. FMO is not formally a member of the MDB group, but closely follows the group's developments through regular communication with it. FMO commits to re-align with MDB's definitions on a rolling basis, as and when FMO partners with MDBs on climate deals, and will re-align at the end of each year based on MDB's annual climate report.

To be eligible for Sustainability Bond proceeds, FMO states that a mitigation activity:

- Should contribute to the mitigation of climate change by reducing or avoiding GHG, or contribute to the protection and/or enhancement of GHG sinks and reservoirs that absorb GHGs;
- Can be a project or project component;
- Should be disaggregated from non-mitigation activities through a reasonable level of data granularity. For example, a project with a total cost of EUR 100 million may have a EUR 10 million component for energy efficiency improvements – only the EUR10 million should be allocated.

A full list of eligible climate mitigation activities can be found in Appendix 2a. Broadly, they can be categorised as:

- Energy efficiency;
- Renewable Energy;
- Transport;
- Agriculture, forestry and land use;

<sup>5</sup> <http://www.unpri.org/areas-of-work/implementation-support/piif/what-is-inclusive-finance/>

<sup>6</sup> <http://www.ebrd.com/downloads/sector/sei/climate-finance-2012.pdf>

- Waste and wastewater;
- Non-energy GHG reductions; and
- Cross-sector activities.

### Climate Change Adaptation Eligibility Criteria

FMO defines this category along the lines of the Joint Report on MDB Climate Finance and states that to be eligible for Sustainability Bond proceeds an adaptation-related activity needs to demonstrate that it potentially contributes to reducing the vulnerability to climate change identified in the project area, and that the following should be provided to substantiate this:

- A description of the context of climate vulnerability of the project based on an investigation of the vulnerabilities to climate change of the project's geographical area;
- An explicit statement of intent to address climate vulnerability as part of the project. This should be supported by an analysis of the project's planned activities to decipher a positive list of actions that can contribute to reducing vulnerability, or strengthening the resilience of communities, goods, or ecosystems to climate change;
- Articulating a clear and direct link between the climate vulnerability context and the specific project activities; and
- Evidences that the project does not have negative impacts in terms of climate change mitigation (e.g., enhancing carbon intensive infrastructures).

A few examples of climate change adaptation activities can be found in Appendix 2b.

### Inclusive Finance Eligibility Criteria

FMO is committed to provide funds generated through the issuance of its Sustainability Bonds to microfinance institutions (MFIs) as well as directly to small- and medium-sized enterprises (SMEs) in developing and emerging markets.

#### Finance of microfinance institutions (MFIs)

FMO provides funds to microfinance institutions (MFIs) to provide loans to micro-enterprises. FMO plans to use the Sustainability Bonds proceeds to fund such MFIs. FMO undertakes a detailed due diligence exercise, including an assessment of ESG related risks, before selecting a MFI to receive funding from FMO. Projects are classified as microfinance if they meet the following criteria:

- a) The end-client should meet two of three criteria to be eligible for the Sustainability Bond (see table 2): 1) number of employees <10; 2) turnover <USD 100,000; 3) total assets <USD 100,000; or
- b) If data mentioned in point 'a' is not available, then the loan size should be < USD 10,000.

FMO carries out an annual review of each MFI and their lending to evaluate if MFIs are meeting the conditions, including the above condition, set by FMO.

### Financing small- and medium-sized enterprises (SMEs)

FMO commits to finance SMEs in developing and emerging markets, typically through financial intermediaries, such as SME (focused) Banks, non-bank financial institutions and corporates<sup>7</sup>. FMO is committed<sup>8,9</sup> to invest in some of the poorest countries in the world. To be eligible for the use of proceeds, financial institutions should:

- specifically target one or more of the following populations: females; rural populations who are focusing on agricultural production and agricultural value chains; economically excluded individuals; and low-income populations who earn less than USD 8 per day; and
- be identified as an SME, as defined by the International Finance Corporation (IFC)<sup>10</sup>, as outlined in Table 2.

**Table 2. IFC's definition for Micro-, Small- and Medium-size Enterprises**

Indicator/Size of enterprise	Micro-size enterprise	Small-size enterprise	Medium-size enterprise
Number of employees	< 10	10 < 50	50 – 300
Total assets	< USD 100,000	USD 100,000 < USD 3 million	USD 3 million < USD 15 million
Annual sales	< USD 100,000	USD 100,000 < USD 3 million	USD 3 million < USD 15 million

FMO undertakes a detailed due diligence exercise, similar to that is being applied in case of selecting MFIs. This includes an assessment of ESG related risks, before providing finance to SMEs or financial intermediaries. An SME average loan size should be between USD 10,000 or more, but less than USD 1,000,000 (10,000 < USD < 1,000,000).

### Exclusionary Criteria

In addition to eligibility criteria, FMO specifies the following exclusionary criteria with regard to use of proceeds. FMO will not finance any business or trade involved in:

1. Forced labour<sup>11</sup> or child labour<sup>12</sup>.
2. Activities or materials deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international phase-outs or bans, such as:

<sup>7</sup> FMO Investment Criteria, February 2017

<sup>8</sup> <https://www.fmo.nl/l/library/download/urn:uuid:638188d0-5def-49f4-bf5a-7db9c94ddb52/2016+fmo+annual+report.pdf>

<sup>9</sup> [https://www.fmo.nl/l/library/download/urn:uuid:9978eafe-864f-4b3a-bed1-5e0563df0c85/fmo+sustainability+policy.pdf?format=save\\_to\\_disk&ext=.pdf](https://www.fmo.nl/l/library/download/urn:uuid:9978eafe-864f-4b3a-bed1-5e0563df0c85/fmo+sustainability+policy.pdf?format=save_to_disk&ext=.pdf)

<sup>10</sup> [http://www.ifc.org/wps/wcm/connect/635f64804efbe2b18ef5cf3eac88a2f8/IFC\\_Factsheet\\_SME\\_Loan+Size+Proxy\\_Brief.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/635f64804efbe2b18ef5cf3eac88a2f8/IFC_Factsheet_SME_Loan+Size+Proxy_Brief.pdf?MOD=AJPERES)

<sup>11</sup> 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.

<sup>12</sup> 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.

- a) Ozone depleting substances, PCB's (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 2.5 km in length).
3. Cross-border trade in waste and waste products, unless compliant with the Basel Convention and the underlying regulations.
  4. Destruction<sup>13</sup> of High Conservation Value areas<sup>14</sup>.
  5. Radioactive materials<sup>15</sup> and unbounded asbestos fibres.
  6. Pornography and/or prostitution.
  7. Racist and/or anti-democratic media.
  8. The following products forming a substantial part of a project's primary financed business activities<sup>16</sup>:
    - a) Alcoholic Beverages (except beer and wine);
    - b) Tobacco;
    - c) Weapons and munitions;
    - d) Gambling, casinos and equivalent enterprises; or
    - e) Nuclear energy.

### *Eligible projects*

Projects eligible to be financed with the proceeds of FMO's Sustainability Bonds include projects that meet the eligibility criteria described above and are:

- Projects committed after the issuance of the Sustainability Bond; or
- Projects committed before the issuance of the Sustainability Bond but funded (disbursed) after the issuance of the Sustainability Bond; or
- Projects funded (disbursed) within 12 months before the issuance of the Sustainability Bond.

## 3.2 Project Selection Process

FMO follows a two-stage process for the selection of green and inclusive finance projects for the Sustainability Bond portfolio:

*Stage 1- Approve projects under green or inclusive finance category;*

*Stage 2- Allocate bond funds to approved projects.*

<sup>13</sup> 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.

<sup>14</sup> High Conservation Value (HCV) areas are defined as natural habitats where these values are considered to be of outstanding significance or critical importance

<sup>15</sup> 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.

<sup>16</sup> 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.

*Stage 1: The following steps detail the approval process for green projects*

- 1) The deal team prepares a proposal substantiating why a project qualifies as green (consults an external advisor if needed), submits the deal to sustainability team for approval;
- 2) The sustainability team, which is a part of the strategy department, receives proposals and assesses the transaction against the green project definition and criteria as per FMO's Green Definitions document. If the project activity automatically meet the eligibility criteria, then the sustainability team approves this and notifies the deal team. For project activities that do not automatically meet the eligibility criteria, the sustainability team can consult the Green Business Knowledge Street (GBKS) that consists of environmental specialists.
- 3) Based on the outcome of the GBKS, the sustainability team confirms whether the transaction qualifies as green and what percentage of the investment qualifies as a green investment;
- 4) The transaction is then recorded into an internal system with all the relevant details pertaining to the project and the decision on the green investment amount and percentage.

The GBKS consists of members from different departments who have expertise in sustainability, and is chaired by the manager of the sustainability department. If required, the green team may engage external experts to make a decision on green credentials of complex deals. The mandate of the GBKS is to advise deal teams and the sustainability team, and to provide final approval whether a transaction is green and the percentage of green for complex green transactions and learn from partner (IFC, EBRD, ADB, AfDB, EIB, IDB, and WB) definitions and calculations.

*The following steps detail the approval process for inclusive finance projects (micro finance):*

- 1) The deal team checks whether the project meets the inclusive finance eligibility criteria as described in paragraph 3.1;
- 2) When the project meets the inclusive finance criteria, it is then labelled as micro-finance\SME in an internal system (ACBS) with all the relevant details pertaining to the project.

*Stage 2: Allocate bond funds to approved projects.*

FMO reviews semi-annually, all the approved and recorded projects under green or inclusive finance category, and selects only those projects for the bond proceeds allocation, that meet the eligibility criteria defined in section 3.1. above. The Sustainability Bond funds are then allocated to these eligible projects and reported.

The steps in Appendix 3 highlight the process to select green and inclusive finance projects.

### 3.3 Management of Proceeds

The net proceeds of the Sustainable Bond issue are held within FMO's Treasury in a special sub-portfolio that is linked to FMO's lending operations in the fields of green finance and inclusive finance. As long as the Sustainability Bond is outstanding, the balance of the sub-portfolio will be reduced by amounts matching the disbursements to the eligible projects. Pending such disbursement, the net proceeds of the Sustainability Bond will be held in FMO's liquidity portfolio and may temporarily be used for different

purposes in case of liquidity stress situations. FMO expects the bond proceeds to be fully allocated within two years from the issue date.

## 3.4 Impact Measurement & Reporting

### Impact Measurement

Within FMO, green transactions can either be *direct* (i.e. FMO finances a project or company directly), or *indirect* (i.e. FMO participates in a private equity fund targeting green investments, or provides a so-called green credit line to a bank or other financial intermediary). For all *direct* green investments, FMO calculates, accounts and reports the greenhouse gas (GHG) emission reductions that these investments are estimated to realize, by calculating the difference between the emissions caused by the project and the emissions 'without the project' or 'most likely alternative' scenario. The methodology FMO applies aligns with guidance provided by the following broadly accepted bodies and initiatives: (i) the GHG Protocol (accounting basics on scope 1,2,3 emissions and direct and indirect emission reductions), (ii) the UNFCCC, (iii) the IFI Framework on the Accounting of GHG Reductions. FMO accepts the following source data for its calculations, in order of preference:

- First preference: project-specific data from the *Validation Report* (or, if not yet available, from the most recent *Project Design Document*), issued as part of the project registration under the Clean Development Mechanism (CDM).
- Second preference: project-specific validated data from the Gold Standard or voluntary carbon credit scheme (VCS), or another voluntary carbon scheme or standard with an equal assurance level.
- Third preference: for electricity producing projects, compare the project's estimated power production and the project's estimated GHG emission with the emission from the same power production, using a grid emission factor endorsed by the UNFCCC or the IFI Harmonization Initiative on GHG Accounting, or published by the IEA. For other projects, use dedicated methodologies or independent consultant studies.

FMO calculates estimated annual GHG emission reduction based on the sum of the ex-ante estimate of each project financed through direct green investments, in proportion to the Sustainability Bond allocation. For example, for a EUR 100 million project with project savings of 100,000 tons of CO<sub>2</sub>eq per year, if, total FMO financing is EUR 20 million and total Sustainability Bond allocation is EUR 10 million (i.e., 10% of total project size), then total attribution to the Sustainability bond would be 10,000 tons of CO<sub>2</sub>eq per year (i.e., 10% of total GHG savings).

FMO has developed metrics that measure and capture positive outcomes from inclusive finance funding, namely the number of (in)direct jobs supported with its investments.

### Reporting

FMO provides investors with a semi-annual newsletter highlighting the following:

- The progress on allocation of use of proceeds;
- Details about each project such as country of location, sector, project description and amount allocated from the bond including a hyperlink to a detailed project description on FMO's website;

- A few case studies;
- An estimation of annual GHG emission reduction from direct green investments
- An estimation of the number of (in)direct jobs supported with our investments

In addition, FMO has moved towards a fully integrated annual report with financial and non-financial information including GHG emissions. FMO has the integrated report audited by its auditors providing (limited) assurance. FMO has published seven Sustainability Bond newsletters to date on its website<sup>17</sup>. Additionally, the website provides detailed project information such as client info, the funding objective, and the rationale for funding.

### 3.5 Compliance Review

On the first anniversary of each Sustainability Bond issuance, FMO will engage Sustainalytics to review projects funded by the Sustainability Bond in order to assess the compliance of projects with the use of proceeds criteria of the bond. Sustainalytics will review a broad sample of projects from the total allocated projects in order to determine whether or not they meet the use of proceeds criteria defined in the framework. Sustainalytics will provide a report of the evaluation, which FMO may plan to disclose publicly. In an unlikely event that a project did not meet the use of proceed criteria, FMO would reallocate the bond funds to a different project that is aligned with the criteria.

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<sup>17</sup> [https://www.fmo.nl/news?search=&newsType=snippet&publicationYear=&filterLabel%5B%5D=sustainability\\_bonds](https://www.fmo.nl/news?search=&newsType=snippet&publicationYear=&filterLabel%5B%5D=sustainability_bonds)

## 4. SUSTAINALYTICS OPINION

### Section 1: Sustainability Performance of the Issuer

#### **Amongst the industry leaders in ESG performance**

Of the companies that Sustainalytics tracks globally in the diversified financials industry, FMO has been assessed as an industry leader compared to its industry peers. As of May 2017, the company's total ESG score places FMO in the top 10 performing companies in the *Banks* industry<sup>18</sup>. In comparison to its peers, the company ranks at the top of its industry based on its good performance in environmental, social, and governance issues. Given its mission, vision and programmes aimed at creating positive sustainability outcomes, and its industry leading ESG performance among its peers, Sustainalytics is of the opinion that FMO is well positioned to issue Sustainability Bonds.

#### **Due diligence efforts to evaluate environmental and social risks associated with the projects**

FMO performs thorough social and environmental assessments prior to providing (direct or indirect) financing. All projects are required to comply with strong social and environmental criteria, in alignment with the strict IFC Environmental and Social Performance Standards. These standards are recognized as best practice internationally, and Sustainalytics considers this due diligence level of particular importance given FMO's involvement in developing and emerging markets, where the environmental and social risks associated with the projects are potentially greater.

In recent years, FMO has seen two of the projects financed by the bank criticized due to social impacts on indigenous people. One refers to the Agua Zarca project in Honduras, and the other to the Barro Blanco hydro dam in Panama. According to information on FMO's website on these incidents, for Agua Zarca project, FMO is in discussion with involved stakeholder to realize a responsible exit<sup>19</sup>, and for the Barro Blanco project issues are being addressed following an agreement between the government of Panama and the indigenous groups on cultural, social, economic and environmental aspects related to the hydro project<sup>20</sup>. Sustainalytics recognizes that due to its focus on developing and emerging economies, FMO is particularly exposed to social and environmental risks associated with the projects. However, Sustainalytics considers that FMO's policies and due diligence efforts, in line with international best practices, strengthen the bank's ability to address and mitigate social and environmental risks in its portfolio.

### Section 2: Impact of the use of proceeds

#### **Strong internal expertise ensuring that proceeds are allocated to high-quality assets**

FMO has developed strong internal expertise in the identification, evaluation and assessment of green and socially inclusive projects and in the measurement of the impacts of these projects. When assessing a project, FMO takes an in-depth and critical look at the project and follows a rigorous approval process, as highlighted in section 3.2 above. This practice will enable FMO to allocate Sustainability Bond funds to

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<sup>18</sup> Sustainalytics analyses the ESG performance of 319 companies as part of the Banks industry.

<sup>19</sup> <https://www.fmo.nl/agua-zarca>

<sup>20</sup> <https://www.fmo.nl/barro-blanco>

high-quality and impactful assets. Furthermore, in the area of impact measurement, FMO has developed internal capability to quantify GHG emission reductions, which will enable it to measure and track actual positive impacts achieved by the bond. FMO's expertise in areas of project selection and measurement make it highly likely that assets selected for the Sustainability Bond will have a strong impact in the areas of climate change mitigation, climate change adaptation and inclusive finance.

#### **Providing a positive contribution to climate change mitigation and adaptation**

FMO defines two categories for the use of Sustainability Bond proceeds – Green and Inclusive Finance. Eligibility criteria for the Green category are based on the definitions and the types of projects set forth by the Multilateral Development Banks (MDBs) in the “Joint Report on MDB Climate Finance 2012.”<sup>21</sup> The MDBs’ Joint Report further breaks down the Green category into Climate Change Mitigation and Climate Change Adaptation. The MDBs’ eligibility criteria for climate change mitigation are specific and detailed, and by adopting these criteria FMO is providing sufficient clarity to investors regarding the intended use of bond proceeds. With regard to climate change adaptation, the eligibility criteria in the Joint Report include any project or activity that has a clear link to addressing climate change vulnerability. It should be noted, however, that some climate change adaptation activities, such as enhancing the resilience of oil and gas infrastructure or adapting mining practices to climate change, have negative sustainability impacts in the long run. Excluding such projects from a Sustainability Bond that aims to provide positive impact is therefore necessary. Rightly, FMO takes this extra step and specifies that it will only fund adaptation projects that do not have any negative sustainability impacts. This will provide assurance to investors that only positive impact activities are funded with the Sustainability Bond.

#### **Advancing inclusive finance in developing and emerging economies**

With regard to Inclusive Finance, FMO is committed to provide loans to MFIs and SMEs. Through those loans, it specifically targets developing and emerging economies. In those countries, it focuses on populations who are at the Base of the Pyramid, and who typically would benefit from financing programmes specifically tailored to their needs and economic possibilities. FMO is diligent in its selection of SMEs or financial intermediaries that support lending to enterprises. While lending to SMEs in developing countries generally has a positive impact through its contribution to local economic opportunity and development, it also exposes FMO to the possibility of financing activities that may breach international norms, such as the use of child labour. Carrying out due diligence when selecting MFIs and SMEs, and undertaking an annual review of MFIs to ensure that their lending practices are compliant with FMO’s policies and exclusionary criteria mentioned in section 3.1, will help FMO to mitigate this risk.

#### **Contributing to FMO’s sustainability ambition and to the advancement of the SDGs**

Sustainalytics considers that FMO’s Sustainability Bonds will positively contribute to FMO’s vision and ambition for 2020, as outlined in section 2, as well as to the advancement of the SDG agenda. Specifically, the use of proceeds will be impactful for, for instance, the following SDGs:

- Goal 7: Ensure access to affordable, reliable, sustainable and modern energy for all;
- SDG 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all;

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<sup>21</sup> <http://www.ebrd.com/downloads/sector/sei/climate-finance-2012.pdf>

- Goal 10: Reduce inequality within and among countries;
- SDG 13: Take urgent action to combat climate change and its impacts.

#### **Excellent reporting leading best practices**

FMO's Sustainability Bond reporting is very detailed and includes a description of each project along with the information regarding location, amounts allocated and relative ESG risk level. FMO publishes two Sustainability Bond newsletters per year, providing detailed and insightful project allocation information. Sustainalytics considers this to be amongst leading reporting practices.

#### **Alignment with the Green Bond Principles**

Sustainalytics has determined that FMO's Sustainability Bond Framework aligns with the four pillars of ICMA's Green Bond Principles, 2016. An overview of these four pillars is provided in Appendix 5: Green Bond Programme External Review Form.

### **Conclusion**

Sustainalytics considers that FMO is well positioned to issue Sustainability Bonds. The proceeds will be directed towards climate change mitigation and adaptation activities, and towards inclusive finance, contributing to FMO's vision, sustainability targets and to advancing the Sustainable Development Goals. FMO has outlined a clear decision-making process to evaluate and select eligible projects to be financed by Sustainability Bonds' proceeds. This evaluation is supported by a thorough social and environmental assessments prior to providing (direct or indirect) financing to all its projects. Sustainalytics considers this due diligence level of particular importance given FMO's involvement in developing and emerging markets, where the environmental and social risks associated with the projects are potentially greater. FMO's reporting is very detailed and transparent, which will provide investors clarity about the bond investments. In addition, FMO has engaged Sustainalytics to provide an annual compliance review on each bond issued under the framework, which will provide additional assurance that the bond is fully compliant with eligibility criteria.

Sustainalytics considers that FMO's Sustainability Bond framework follows the guidance provided by the Green Bond Principles 2016 and is in alignment with the Principles' four components: the use of proceeds, project evaluation and selection process, management of proceeds and reporting.

Based on the above points, Sustainalytics considers FMO's Sustainability Bond to be robust, credible and transparent.

## 5. APPENDICES

### APPENDIX 1: FMO Environmental and Social approach – integrated in FMO's Sustainability Policy

#### Direct investments

##### Risk Categorization

All new and existing clients for FMO are subject to a Risk Categorization of their (potential) Environmental and Social impacts. There are four risk categories A, B+, B and C:

A = high risk: Projects / clients with potential significant adverse social or environmental impacts which are diverse, irreversible or unprecedented.

B+ = medium high risk: Clients with potential adverse social or environmental impacts that are generally beyond the site boundaries, largely reversible and can be addressed through relevant mitigation measures.

B = medium risk: Clients with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures.

C = low risk: Projects with minimal or no adverse social or environmental Impacts.

The categorization of clients into the A, B+, B, or C category is largely based on an assessment against the applicable IFC Environmental and Social Performance Standards. At the same time, FMO cooperates closely with the European Development Finance Institutions (EDFI's) with the purpose to harmonize its definitions and requirements.

##### Applicable requirements

For direct investment clients in category A and B+, an assessment of the E&S practices is required as part of FMO's due diligence. All FMO's higher risk clients are required to implement an Environmental and Social Management System (ESMS). This ESMS is customized for each type of client. Below table provides an overview of the minimum requirements per category of company.

Direct Investments	A	B+	B	C
Risk / impact	High	Medium / high	Medium	Low
IFC Performance Standards (PS)	Often project finance with PS 1-4 triggered as well as high risk aspects (PS 5-8)	Often corporate finance with PS 1-4 triggered, and potentially high risk aspects (PS 5-8)	Corporate in medium risk sector PS 1-3	Corporate in low risk sector
Requirements	- IFC Performance Standards - ESAP (usually)	-IFC Performance standards -ESAP (if necessary)	-IFC Performance Standards -ESAP (on request)	-National Law -No ESAP

### Methodology: Environmental and Social Action Plans



Based on the outcomes of the assessment carried out, an Environmental and Social Action Plan (ESAP) will be agreed upon as necessary, with clear and practical milestones to be achieved within a certain period of time. The ESAP would normally allow clients a three-year period at the maximum to reach full compliance with the requirements. For clients in category B and C, no in-depth assessment is required. However, on a voluntary basis FMO tries to identify potential value creation that can be achieved with these clients.

The ESAP is, in cooperation with the client, made “SMART”, i.e. Specific, Measurable, Achievable, Realistic and Time-Bound, and included in the loan documentation. Non-compliance with key milestones of the ESAP constitutes an event of default under the loan documentation. For FMO’s direct equity transactions, the ESAP shall be firmly agreed and the E&S principles to be applied by the company shall be firmly constituted in the Shareholders Agreement. The ESAP shall be under implementation before disbursement of FMO’s funds.

Effective implementation of the ESAP adds value to the client, it mitigates E&S risks and it contributes to E&S development impact that FMO achieves through its financing.

### Indirect Investments

For financial institution (FI) clients and private equity funds (PEF) in which FMO invests, it focuses on how they address the environmental and social risk in their portfolios. Depending on the risk category, FMO expects the FIs and PEFs to apply certain environmental and social standards when financing or investing in their clients. This entails that, FIs and PEFs will be required to establish and maintain an E&S Management System to ensure that their investments meet (or over time become compliant with) FMO’s requirements. The level of detail and sophistication of this management system and of the monitoring approach will depend on the E&S risk profile of the FI / PEF and the type of financing that they provide. In the table below, the risk categorisation for FIs and PEFs is presented, together with the applicable requirements.

Indirect Investments: Financial Institutions	FI-A	FI-B	FI-C
Risk / impact	High	Medium	Low
BASIC CRITERIA	High E&S risk sector exposure is > 20%	High E&S risk sector exposure is < 20%	Retail or micro businesses exposure is > 80%
UP- OR DOWNGRADE CRITERIA	<u>Upgrade category</u> if one of the criteria below is applicable: <ul style="list-style-type: none"> <li>– Exposure to IFC PS-triggered transactions is &gt; 10% of total loan portfolio or &gt; USD 300mln</li> <li>– Specific E&amp;S challenges increase the FI-Clients E&amp;S risk profile</li> </ul> 		
	<u>Downgrade category</u> if one of the criteria below is applicable: <ul style="list-style-type: none"> <li>– Short-term (&lt; 12 months) financing is &gt; 75%</li> <li>– Average loan size or financial engagement of the FI-Client is &lt; EUR 25.000</li> </ul> 		
Footnotes:			
<ol style="list-style-type: none"> <li>1. <i>Portfolio</i>: Percentages refer to total loan portfolio volume</li> <li>2. <i>High E&amp;S Risk Sector</i>: determined based on EDFI High E&amp;S Risk Sector List</li> <li>3. <i>IFC PS-triggered transactions</i>: Project finance and corporate loans related to project finance (total project size USD ≥ 10m / ≥36 months tenor)</li> <li>4. <i>E&amp;S challenges</i>: country specific E&amp;S issues (Indigenous people / Land rights / Water / Deforestation), negative NGO / Media attention</li> </ol>			

Indirect Investments: Financial Institutions	FI-A	FI-B	FI-C
BASIC REQUIREMENTS	<ul style="list-style-type: none"> <li>- Apply Exclusion List to FI-Client’s loan and investment portfolio (Annex 3)</li> <li>- Compliance with IFC PS 2 – Labour and Working Conditions (material issues)</li> <li>- Compliance of FI-Client and its clients (loan portfolio) with local E&amp;S regulation</li> <li>- Annual portfolio sector overview / composition</li> </ul>		
CATEGORY-BASED REQUIREMENTS	<i>Scope</i> <ul style="list-style-type: none"> <li>- ESMS covering at minimum IFC PS-triggered transactions, high E&amp;S risk sectors and country-specific sensitive issues</li> </ul> <i>Application</i> <ul style="list-style-type: none"> <li>- IFC PS framework is applied to IFC PS-triggered transactions</li> <li>- Transactions with country-specific sensitive issues will</li> </ul>	<i>Scope</i> <ul style="list-style-type: none"> <li>- ESMS covering IFC PS-triggered transactions and country-specific sensitive issues</li> </ul> <i>Application</i> <ul style="list-style-type: none"> <li>- IFC PS framework is applied to IFC PS-triggered transactions</li> <li>- Transactions with country-specific sensitive issues will be addressed through IFC</li> </ul>	<ul style="list-style-type: none"> <li>- CPP Requirements</li> </ul>

	<p>be addressed through IFC PS or an approach tailor-made to address risks in the local context</p> <ul style="list-style-type: none"> <li>- Clients in the high E&amp;S risk sectors will adhere to local E&amp;S regulation</li> </ul> <p><i>Additional</i></p> <ul style="list-style-type: none"> <li>- E&amp;S tracking Management Information System</li> <li>- Annual E&amp;S Monitoring Report</li> </ul>	<p>PS or an approach tailor-made to address risks in the local context</p> <p><i>Additional</i></p> <ul style="list-style-type: none"> <li>- E&amp;S tracking Management Information System</li> <li>- Annual E&amp;S Monitoring Report</li> </ul>	
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<b>Indirect Investments: Private Equity Funds</b>	<b>PEF-A</b>	<b>PEF-B</b>	<b>PEF-C</b>
<b>Risk / impact</b>	<b>High</b>	<b>Medium</b>	<b>Low</b>
PEF Criteria for Categorization	>15% Investee companies in high risk sectors	<15% Investee companies in high risk sectors	In principle Investments in low risk sectors only
Fund Requirements	<ul style="list-style-type: none"> <li>-Apply exclusion list</li> <li>- Commit to E&amp;S Investment Code before first investment</li> <li>- ESMS based on IFC PS for high risk clients</li> <li>-ESMS ready before first investment</li> </ul>	<ul style="list-style-type: none"> <li>- Apply exclusion list</li> <li>- Commit to E&amp;S Investment Code before first investment</li> <li>- ESMS based on IFC PS for high risk clients</li> <li>-ESMS ready before first investment</li> </ul>	<ul style="list-style-type: none"> <li>- Apply exclusion list</li> <li>- Commit to E&amp;S Investment Code before first investment</li> <li>- ESMS based on IFC PS for high risk clients</li> <li>-ESMS ready before first investment</li> </ul>
Investee Company Requirements	<ul style="list-style-type: none"> <li>- National Law and ILO core conventions.</li> <li>- Work to ultimately comply with IFC PS (for high risk investee companies only)</li> <li>- Policy for continuous improvement</li> </ul>	<ul style="list-style-type: none"> <li>- National Law and ILO core conventions.</li> <li>- Work to ultimately comply with IFC PS (for high risk investee companies only)</li> <li>- Policy for continuous improvement</li> </ul>	<ul style="list-style-type: none"> <li>- National Law and ILO core conventions.</li> <li>- Work to ultimately comply with IFC PS (for high risk investee companies only)</li> <li>- Policy for continuous improvement</li> </ul>

### **Methodology: Environmental and Social Action Plans**

For those FIs where an ESMS is required, an action plan can be agreed upon with timelines for the various elements (policy, training, procedures and full implementation). The Environmental and Social Action Plan (ESAP) is to be agreed upon as necessary, with clear and practical milestones to be achieved within a certain period of time.

## APPENDIX 2: Eligible activities under climate change mitigation and adaptation (Source MDB)

### 2a: Eligible activities under climate change mitigation

#### Energy efficiency

Commercial and residential buildings	<ul style="list-style-type: none"> <li>• Energy-efficiency improvement in lighting, appliances and equipment</li> <li>• Substitution of existing heating/cooling systems for buildings by cogeneration plants that generate electricity in addition to providing heating/cooling</li> <li>• Retrofit of existing buildings: Architectural or building changes that enable reducing energy consumption</li> <li>• Waste heat recovery improvements</li> </ul>
Public services	<ul style="list-style-type: none"> <li>• Energy-efficiency improvement in utilities and public services through the installation of more efficient lighting or equipment</li> <li>• Rehabilitation of district heating systems</li> <li>• Utility heat loss reduction and/or increased waste heat recovery</li> <li>• Improvement in utility scale energy efficiency through efficient energy use, and loss reduction.</li> </ul>
Agriculture	<ul style="list-style-type: none"> <li>• Reduction in energy use in traction (e.g. efficient tillage), irrigation, and other agriculture processes</li> </ul>
Industry	<ul style="list-style-type: none"> <li>• Industrial energy-efficiency improvements through the installation of more efficient equipment, changes in processes, reduction of heat losses and/or increased waste heat recovery</li> <li>• Installation of cogeneration plants</li> <li>• More efficient facility replacement of an older facility (old facility retired)</li> </ul>
Transmission and distribution systems	<ul style="list-style-type: none"> <li>• Retrofit of transmission lines or substations to reduce energy use and/or technical losses, excluding capacity expansion</li> <li>• Retrofit of distribution systems to reduce energy use and/or technical losses, excluding capacity expansion</li> <li>• Improving existing systems to facilitate the integration of renewable energy sources into the grid</li> </ul>
Power plants	<ul style="list-style-type: none"> <li>• Renewable energy power plant retrofits</li> <li>• Energy-efficiency improvement in existing thermal power plant</li> <li>• Thermal power plant retrofit to fuel switch from a more GHG-intensive fuel to a different, less GHG-intensive fuel type</li> <li>• Waste heat recovery improvements</li> </ul>
Construction of new buildings	<ul style="list-style-type: none"> <li>• Use of highly efficient architectural designs or building techniques that enable reducing energy consumption for heating and air conditioning, exceeding available standards and complying with high energy efficiency certification or rating schemes</li> </ul>

## Renewable Energy

Electricity generation	<ul style="list-style-type: none"> <li>• Wind power</li> <li>• Geothermal power, if net emission can be demonstrated</li> <li>• Solar power (concentrated solar power, photovoltaic power)</li> <li>• Biomass or biogas power that does not decrease biomass and soil carbon pools</li> <li>• Ocean power (wave, tidal, ocean currents, salt gradient, etc.)</li> <li>• Hydropower plants only if net emission reduction can be demonstrated</li> </ul>
Transmission systems, greenfield	<ul style="list-style-type: none"> <li>• New transmission systems (lines, substations) or new systems (e.g., new information and communication technology, storage facility, etc.) to facilitate the integration of renewable energy sources into the grid</li> </ul>
Heat production or greenfield	<ul style="list-style-type: none"> <li>• Solar water heating and other thermal applications of solar power in all sectors</li> <li>• Thermal applications of geothermal power in all sectors</li> <li>• Thermal applications of sustainably-produced bioenergy in all sectors, including</li> </ul>

## Transport

Vehicle energy efficiency fleet retrofit	<ul style="list-style-type: none"> <li>• Existing vehicles, rail or boat fleet retrofit or replacement (including the use of lower-carbon fuels, electric or hydrogen technologies, etc.)</li> </ul>
Urban transport modal change	<ul style="list-style-type: none"> <li>• Urban mass transit</li> <li>• Non-motorized transport (bicycles and pedestrian mobility)</li> </ul>
Urban development	<ul style="list-style-type: none"> <li>• Integration of transport and urban development planning (dense development, multiple land-use, walking communities, transit connectivity, etc.), leading to a reduction in the use of passenger cars</li> <li>• Transport demand management measures to reduce GHG emissions (e.g., speed limits, high-occupancy vehicle lanes, congestion charging/road pricing, parking management, restriction or auctioning of license plates, car-free city areas, low-emission zones)</li> </ul>
Inter-urban transport and freight transport	<ul style="list-style-type: none"> <li>• Improvement of general transport logistics to increase energy efficiency of infrastructure and transport, e.g. reduction of empty running</li> <li>• Railway transport ensuring a modal shift of freight and/or passenger transport from road to rail (improvement of existing lines or construction of new lines)</li> <li>• Waterways transport ensuring a modal shift of freight and/or passenger transport from road to waterways (improvement of existing infrastructure or construction of new infrastructure)</li> </ul>

## Agriculture, forestry and land use

Afforestation (plantations) on non-forested land	<ul style="list-style-type: none"> <li>• Afforestation (plantations) on non-forested land</li> <li>• Reforestation on previously forested land</li> </ul>
Reducing emissions from the deforestation	<ul style="list-style-type: none"> <li>• Biosphere conservation projects (including payments for ecosystem services)</li> </ul>

or degradation of ecosystems	
Sustainable forest management	<ul style="list-style-type: none"> <li>• Forest management activities that increase carbon stocks or reduce the impact of forestry activities</li> </ul>
Agriculture	<ul style="list-style-type: none"> <li>• Agriculture projects that do not deplete and/or improve existing carbon pools (Reduction in fertilizer use, rangeland management, collection and use of bagasse, rice husks, or other agricultural waste, low tillage techniques that increase carbon contents of soil, rehabilitation of degraded lands, etc.)</li> </ul>
Livestock	<ul style="list-style-type: none"> <li>• Livestock projects that reduce methane or other GHG emissions (manure management with biodigestors, etc.)</li> </ul>

## Waste and wastewater

Waste and wastewater	<ul style="list-style-type: none"> <li>• Solid waste management that reduce methane emissions (e.g. incineration of waste, landfill gas capture, and landfill gas combustion)</li> <li>• Treatment of wastewater if not a compliance requirement (e.g. performance standard or safeguard) as part of a larger project</li> <li>• Waste recycling projects that recover or reuse materials and waste as inputs into new products or as a resource</li> </ul>
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## Non-energy GHG reductions

Industrial processes	<ul style="list-style-type: none"> <li>• Reduction in GHG emissions resulting from industrial process improvements and cleaner production (e.g. cement, chemical)</li> </ul>
Air conditioning and cooling	<ul style="list-style-type: none"> <li>• Retrofit of existing industrial, commercial and residential infrastructure to switch to cooling agent with lower global warming potential</li> </ul>
Fugitive emissions and carbon capture	<ul style="list-style-type: none"> <li>• Carbon capture and storage projects (including enhanced oil recovery)</li> <li>• Reduction of gas flaring or methane fugitive emissions in the oil and gas industry</li> <li>• Coal mine methane capture</li> </ul>

## Cross-sector activities

Policy and regulation	<ul style="list-style-type: none"> <li>• National mitigation policy/planning/institutions</li> <li>• Energy sector policies and regulations (energy efficiency standards or certification schemes; energy efficiency procurement schemes; renewable energy policies)</li> <li>• Systems for monitoring the emissions of greenhouse gases</li> <li>• Efficient pricing of fuels and electricity (subsidy rationalization, efficient end-user tariffs, and efficient regulations on electricity generation, transmission, or distribution)</li> </ul>
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	<ul style="list-style-type: none"> <li>Education, training, capacity building and awareness raising on climate change mitigation/sustainable energy/sustainable transport; mitigation research</li> </ul>
Energy audits	<ul style="list-style-type: none"> <li>Energy audits to energy end-users, including industries, buildings, and transport systems</li> </ul>
Supply chain	<ul style="list-style-type: none"> <li>Improvements in energy efficiency and GHG reductions in existing product supply chains</li> </ul>
Financing instruments	<ul style="list-style-type: none"> <li>Carbon markets and finance (purchase, sale, trading, financing, guarantee and other technical assistance). Includes all activities related to compliance-grade carbon assets and mechanisms, such as Clean Development Mechanism (CDM), Joint Implementation (JI), Assigned Amount Units (AAUs), as well as well-established voluntary carbon standards like the Verified Carbon Standard (VCS) or the Gold Standard.</li> <li>Renewable energy and energy efficiency financing through financial intermediaries or similar (e.g. earmarked lines of credit; lines for microfinance institutions, cooperatives, etc.)</li> </ul>
Low-carbon technologies	<ul style="list-style-type: none"> <li>Research and development of renewable energy or energy efficiency technologies</li> <li>Manufacture of renewable energy and energy efficiency technologies and products</li> </ul>
Activities with greenhouse gas accounting	<ul style="list-style-type: none"> <li>Any other activity not included in this list for which the results of an ex-ante greenhouse gas accounting (undertaken according to commonly agreed methodologies) show emission reductions that are higher than a commonly agreed threshold</li> </ul>

## 2b: A few examples of climate change adaptation activities

Adaptation Category	Potential Risk	Adaptation Activity
Water resources	Water resources reduction in river water levels due to reduced rainfall	Improved catchment management planning and regulation of abstraction
Urban development	Increased urban flooding from extreme rainfalls	Asset review to identify assets vulnerable to increased flooding, then prioritise protection works
(Waste) water infrastructure	Increased groundwater salinity due to sea level rise and/or coastal flooding	Provision of microfinance for domestic rainwater harvesting equipment and storage

### APPENDIX 3: Process to select green and inclusive finance projects

Function	Activity	Frequency and Output
Treasury officer	<ul style="list-style-type: none"> <li>▪ Runs a project disbursement report (e.g. Dashboard) based on the green and inclusive finance labels in ACBS (stage 1)</li> <li>▪ Provides Director Financial Markets (FM), Director Risk Management (RM) and Manager Sustainability (SUS) with the report</li> </ul>	<p><b>Frequency</b> Semi-Annually</p> <p><b>Output</b> Report on eligible green and financial inclusion disbursements</p>
Director FM	<ul style="list-style-type: none"> <li>▪ Organizes a meeting together with Manager SUS, Director RM and relevant Front-Office Directors.</li> <li>▪ Determines based on report which green and inclusive finance projects are eligible for the sustainability bond.</li> </ul>	<p><b>Input</b> Report on eligible green and inclusive disbursements</p> <p><b>Output</b> List of disbursements to be tagged to the Sustainability Bond</p>
Treasury Officer	<ul style="list-style-type: none"> <li>▪ Sends list of projects to be tagged to the Sustainability bonds (ISIN codes) outstanding to the Mid-Office.</li> </ul>	<p><b>Input</b> List of disbursements to be tagged to the Sustainability Bond</p> <p><b>Output</b> Identification of eligible assets in ACBS</p>
Mid-Office Officer	<ul style="list-style-type: none"> <li>▪ Enters the ISIN code in ACBS for the disbursements to applicable disbursements</li> </ul>	
Treasury officer	<ul style="list-style-type: none"> <li>▪ Provides report with earmarked green and inclusive projects to Asset and Liability Committee (ALCO) for information.</li> <li>▪ Prepares newsletter with earmarked projects for investors together with Marketing &amp; Communications on a semi-annual basis.</li> </ul>	<p><b>Output</b> Report for ALCO on earmarked projects</p>
M&C Officer	<ul style="list-style-type: none"> <li>• Ensures detailed project disclosure for earmarked projects on the external website in line with FMO's disclosure policy</li> <li>• Publishes Sustainability Bond newsletter on the external website</li> </ul>	<p><b>Output</b> Semi-Annual newsletter for investors (progress report)</p>

## APPENDIX 4: Documents reviewed

The table below provides an overview of all documents on which this second opinion is based.

Document #	Title	Comments
1	Approved Green Definition Proposal (dated 2 October 2014)	Outlines FMO's definition of "green", and criteria and eligible projects related to climate change adaptation and mitigation
2	Eligible Projects for Other Footprint Category (dated 20 August 2014)	Outlines eligible projects that would qualify as "green" that fall outside of climate change mitigation and adaptation projects
3	Inclusive Finance	Outlines FMO's definition of inclusive finance and criteria and eligible inclusive finance projects
4	IFC Special Climate Definition	
5	Sustainability Bond newsletters	Sustainability Bond newsletters provided on the website
6	Strategy documentation	
7	FMO Environmental and Social Policy	
8	MDB Climate Finance report Nov 2013	
9	Final terms Sustainability Bond	Transaction details of FMO's inaugural Sustainability Bond
10	Annual Report 2016	
11	FMO's website	
12	FMO Sustainability Policy	
13	FMO Investment Criteria (February 2017)	
14	IFC's Fact sheet: SME Loan Size Proxy	Definition of Micro, Small, and Medium-size Enterprises

**APPENDIX 5: ICMA’s External Review Form**

**Green Bond Programme  
External Review Form**

**Section 1. Basic Information**

**Issuer name:** FMO

**Green Bond ISIN or Issuer Green Bond Framework Name, if applicable:** FMO SUSTAINABILITY BOND

**Review provider’s name:** Sustainalytics

**Completion date of this form:** May 9<sup>th</sup> 2017

**Publication date of review publication:**

**Section 2. Review overview**

**SCOPE OF REVIEW**

The review assessed the following elements and confirmed their alignment with the GBPs:

- |  |  |
|--|--|
| <input checked="" type="checkbox"/> Use of Proceeds        | <input checked="" type="checkbox"/> Process for Project Evaluation and Selection |
| <input checked="" type="checkbox"/> Management of Proceeds | <input checked="" type="checkbox"/> Reporting                                    |

**ROLE(S) OF REVIEW PROVIDER**

- |   |  |
|---|--|
| <input checked="" type="checkbox"/> Consultancy (incl. 2 <sup>nd</sup> opinion) | <input type="checkbox"/> Certification |
| <input type="checkbox"/> Verification   | <input type="checkbox"/> Rating        |
| <input type="checkbox"/> Other ( <i>please specify</i> ):                       |  |

**EXECUTIVE SUMMARY OF REVIEW and/or LINK TO FULL REVIEW (if applicable)**

Please refer to FMO’s Sustainability Bond Framework and Second Opinion Document above.

## Section 3. Detailed review

### 1. USE OF PROCEEDS

#### Overall comment on section (if applicable):

FMO plans to use the proceeds of its Sustainability Bonds to fund environmental (“green”) and inclusive finance projects. FMO’s definition of green projects focuses on climate-related projects, that should be value added, and go beyond complying with regulatory standards in order to initiate and/or enable a market shift. FMO’s use of proceeds will finance climate change mitigation and climate change adaptation projects, as well as inclusive finance projects, which includes MFI financing as well as SME financing in developing and emerging economies. The eligible categories align well with project categories recognized by the GBP as addressing key areas of environmental and social concern. Notably, FMO has also an extensive list of exclusionary criteria to avoid involvement in controversial sectors. Overall, Sustainalytics considers that FMO’s Sustainability Bonds use of proceeds to be impactful and to provide a positive contribution to the organization’s vision to become a leading impact investor, and to advancing the Sustainable Development Goals.

#### Use of proceeds categories as per GBP:

- |  |  |
|--|--|
| <input checked="" type="checkbox"/> Renewable energy   | <input checked="" type="checkbox"/> Energy efficiency                                  |
| <input checked="" type="checkbox"/> Pollution prevention and control   | <input checked="" type="checkbox"/> Sustainable management of living natural resources |
| <input checked="" type="checkbox"/> Terrestrial and aquatic biodiversity conservation  | <input checked="" type="checkbox"/> Clean transportation                               |
| <input checked="" type="checkbox"/> Sustainable water management   | <input checked="" type="checkbox"/> Climate change adaptation                          |
| <input checked="" type="checkbox"/> Eco-efficient products, production technologies and processes  | <input checked="" type="checkbox"/> Other ( <i>please specify</i> ): Inclusive finance |
| <input type="checkbox"/> Unknown at issuance but currently expected to conform with GBP categories, or other eligible areas not yet stated in GBPs |  |

### 2. PROCESS FOR PROJECT EVALUATION AND SELECTION

#### Overall comment on section (if applicable):

FMO has outlined a clear decision-making process for its bond’s project evaluation and selection process, supported by a thorough social and environmental assessments prior to providing (direct or indirect) financing to all its projects. Notably, FMO aligns its requirements with IFC’s Environmental and Social Performance Standards, recognized as best practice internationally. Sustainalytics considers this due diligence level of particular importance given FMO’s involvement in developing and emerging markets, where the environmental and social risks associated with the projects are potentially greater. Despite extensive environmental and social assessments, FMO has recently seen two of its investments involved in social disputes. FMO communicates transparently on how it addressed both cases (one

dispute is being addressed following an agreement between the government of Panama and indigenous groups and for the other case FMO is in discussion with involved stakeholder to realize a responsible exit). Overall, Sustainalytics considers that FMO's policies and due diligence efforts, in line with international best practices, strengthen the bank's ability to address and mitigate social and environmental risks in its portfolio.

### Evaluation and selection

- |  |   |
|--|---|
| <input checked="" type="checkbox"/> Defined and transparent criteria for projects eligible for Green Bond proceeds | <input checked="" type="checkbox"/> Documented process to determine that projects fit within defined categories |
| <input checked="" type="checkbox"/> Summary criteria for project evaluation and selection publicly available       | <input type="checkbox"/> Other ( <i>please specify</i> ):   |

### Information on Responsibilities and Accountability

- |   |   |
|---|---|
| <input type="checkbox"/> Evaluation / Selection criteria subject to external advice or verification | <input checked="" type="checkbox"/> In-house assessment |
| <input type="checkbox"/> Other ( <i>please specify</i> ):   |   |

### 3. MANAGEMENT OF PROCEEDS

#### Overall comment on section (*if applicable*):

The net proceeds of the Sustainable Bond issue are held within FMO's Treasury in a special sub-portfolio that is linked to FMO's lending operations in the fields of green finance and inclusive finance. As long as the Sustainability Bond is outstanding, the balance of the sub-portfolio will be reduced by amounts matching the disbursements to the eligible projects. Pending such disbursement, the net proceeds of the Sustainability Bond will be held in FMO's liquidity portfolio and may temporarily be used for different purposes in case of liquidity stress situations. Sustainalytics considers this is well aligned with the GBP recommendations.

#### Tracking of proceeds:

- |   |
|---|
| <input checked="" type="checkbox"/> Green Bond proceeds segregated or tracked by the issuer in a systematic manner            |
| <input checked="" type="checkbox"/> Disclosure of intended types of temporary investment instruments for unallocated proceeds |
| <input type="checkbox"/> Other ( <i>please specify</i> ):   |

#### Additional disclosure:

- |   |   |
|---|---|
| <input type="checkbox"/> Allocations to future investments only | <input checked="" type="checkbox"/> Allocations to both existing and future investments |
| <input type="checkbox"/> Allocation to individual disbursements | <input type="checkbox"/> Allocation to a portfolio of disbursements                     |

- Disclosure of portfolio balance of unallocated proceeds
- Other *(please specify)*:

#### 4. REPORTING

##### **Overall comment on section *(if applicable)*:**

FMO's reporting on the Sustainability Bond is very detailed and includes a description of each project along with the information regarding location, amounts allocated and relative ESG risk level. FMO publishes two Sustainability Bond newsletters per year, providing detailed and insightful project allocation information. Sustainalytics considers FMO's reporting to be aligned with best practices.

##### **Use of proceeds reporting:**

- Project-by-project
- On a project portfolio basis
- Linkage to individual bond(s)
- Other *(please specify)*:

##### **Information reported:**

- Allocated amounts
- GB financed share of total investment
- Other *(please specify)*:

##### **Frequency:**

- Annual
- Semi-annual
- Other *(please specify)*:

##### **Impact reporting:**

- Project-by-project
- On a project portfolio basis
- Linkage to individual bond(s)
- Other *(please specify)*:

##### **Frequency:**

- Annual
- Semi-annual
- Other *(please specify)*:

##### **Information reported *(expected or ex-post)*:**

- GHG Emissions / Savings
- Energy Savings
- Other ESG indicators *(please specify)*:  
*Number of (in)direct jobs supported*

**Means of Disclosure**

- Information published in financial report
- Information published in sustainability report
- Information published in ad hoc documents
- Other (please specify): Information published in a dedicated Sustainability Bond Newsletter
- Reporting reviewed:  
*Annual Compliance Review of eligible projects by Sustainalytics and allocation per use of proceeds by EY.*

Where appropriate, please specify name and date of publication in the useful links section.

**USEFUL LINKS** (e.g. to review provider methodology or credentials, to issuer’s documentation, etc.)

<https://www.fmo.nl/sustainability-bonds>  
<https://www.fmo.nl/impact/how-we-measure-impact>

**SPECIFY OTHER EXTERNAL REVIEWS AVAILABLE, IF APPROPRIATE**

**Type(s) of Review provided:**

- Consultancy (incl. 2<sup>nd</sup> opinion)
- Certification
- Verification / Audit
- Rating
- Other (please specify):

**Review provider(s):**

**Date of publication:**

**ABOUT ROLE(S) OF REVIEW PROVIDERS AS DEFINED BY THE GBP**

- (i) Consultant Review: An issuer can seek advice from consultants and/or institutions with recognized expertise in environmental sustainability or other aspects of the issuance of a Green Bond, such as the establishment/review of an issuer’s Green Bond framework. “Second opinions” may fall into this category.
- (ii) Verification: An issuer can have its Green Bond, associated Green Bond framework, or underlying assets independently verified by qualified parties, such as auditors. In contrast to certification, verification may focus on alignment with internal standards or claims made by the issuer. Evaluation of the environmentally sustainable features of underlying assets may be termed verification and may reference external criteria.
- (iii) Certification: An issuer can have its Green Bond or associated Green Bond framework or Use of Proceeds certified against an external green assessment standard. An assessment standard defines criteria, and alignment with such criteria is tested by qualified third parties / certifiers.
- (iv) Rating: An issuer can have its Green Bond or associated Green Bond framework rated by qualified third parties, such as specialised research providers or rating agencies. Green Bond ratings are separate from an issuer’s ESG rating as they typically apply to individual securities or Green Bond frameworks / programmes.

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