

FMO SUSTAINABILITY BOND

April, 2015

FRAMEWORK SUMMARY AND SECOND OPINION



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1. PREFACE

Sustainalytics has been 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. 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 two sections: Sustainability Bond Framework Overview – a summary of FMO's Sustainability Bond framework; and Sustainalytics' Opinion – an opinion on the framework.

2. INTRODUCTION

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 60 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, food and water.

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

The footprint objective is translated into an operational objective to double the proportion of new green commitments to 40% in 2020 (versus the 20% target in 2014). As part of this endeavour, FMO plans to issue a Sustainability Bond to fund both its green and inclusive finance commitments.

3. FMO'S ESG PERFORMANCE AND POLICIES

3.1 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. The company's total ESG score places FMO in the first position in the diversified financials industry, an industry leading position that it has maintained over the last three years. FMO is also placed in the first position on environment, social, and governance indicators. Sustainalytics has found no evidence of any significant ESG controversies involving FMO, which provides a clear indication of the company's strong ESG preparedness and policies.

3.2 ESG Policies

FMO has an Environmental and Social Policy¹ and a Corporate Governance policy in place, defining ESG criteria for direct and indirect investments. All FMO’s direct investment clients (including those in which it takes equity stake) are required to comply with national E&S laws as a minimum standard, and with the stricter of Environmental and Social Performance Standards and applicable IFC Environmental Health and Social Guidelines, as developed by the International Finance Corporation (IFC), member of the World Bank Group. 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 sustainability 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 sustainability team is comprised of 27 members, four 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.

4. SUSTAINABILITY BOND FRAMEWORK OVERVIEW

4.1 Use of Proceeds

FMO plans to use the Sustainability Bond proceeds to fund environmental (“green”) and inclusive finance projects to support its vision. FMO’s definition of green projects focuses on climate-related projects while the inclusive finance projects primarily focus on microfinance. Further, FMO states that all green projects 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: climate change mitigation and climate change adaptation, and one category under inclusive finance. FMO’s definition of these categories are provided in Table 1 below.

Table 1

Category	Definition
Climate Change Mitigation	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.

¹ <http://www.fmo.nl/esg-policy>

Climate Change Adaptation	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
Inclusive Finance²	Inclusive finance includes but not limited to microfinance, and focuses on expanding access to affordable and responsible financial products and services to the poor and vulnerable populations. This also includes organizations that are often unable to gain access to financial products and services such as micro- and small-enterprises.

4.1.1 Eligibility Criteria

4.1.1.1 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"³. 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 during the year on a rolling basis when FMO partners with MDBs on climate deals, and 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;
- Waste and wastewater;
- Non-energy GHG reductions; and
- Cross-sector activities.

4.1.1.2 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:

² <http://www.unpri.org/areas-of-work/implementation-support/piif/what-is-inclusive-finance/>

³ <http://www.ebrd.com/downloads/sector/sei/climate-finance-2012.pdf>

- 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.

4.1.1.3 Inclusive Finance Eligibility Criteria

FMO provides funds to microfinance institutions (MFIs) to provide loans to micro-enterprises. FMO plans to use the Sustainability Bond 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: 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.

4.1.2 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 labour⁴ or child labour⁵.
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:
 - 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 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.

⁵ 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.

4. Destruction⁶ of High Conservation Value areas⁷.
5. Radioactive materials⁸ 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 activities⁹:
 - a) Alcoholic Beverages (except beer and wine);
 - b) Tobacco;
 - c) Weapons and munitions;
 - d) Gambling, casinos and equivalent enterprises; or
 - e) Nuclear energy.

4.1.3 Eligible projects

Projects eligible for Sustainability Bond proceeds include projects that meet the eligibility criteria described above and these 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.

4.2 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.

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 meets 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 consults the Climate Business Knowledge Street (CBKS) Green Team for advice.

⁶ 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.

⁷ High Conservation Value (HCV) areas are defined as natural habitats where these values are considered to be of outstanding significance or critical importance

⁸ 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.

⁹ 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.

- 3) Based on the outcome of the CBKS Green Team discussion, 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 CBKS Green Team composition consists of members from different departments who have expertise in sustainability, and is chaired by the manager of the sustainability department. If required the CBKS green team may engage external experts to make a decision on green credentials of complex deals. The mandate of the CBKS Green Team 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 (microfinance):

- 1) The deal team checks whether the project meets the inclusive finance eligibility criteria as described in paragraph 4.1.1.3;
- 2) When the project meets the inclusive finance criteria, it is then labelled as microfinance 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 4.1.1 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

4.3 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 2 years from the issue date.

4.4 Impact Measurement & Reporting

4.4.1 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 CO₂eq 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 CO₂eq per year (i.e., 10% of total GHG savings).

In addition, FMO is working to develop metrics that would help it measure and capture positive outcomes from inclusive finance funding.

4.4.2 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.

In addition, FMO plans to move towards a fully integrated annual report with financial and non-financial information including GHG emissions. FMO will have the integrated report audited by its auditors providing (limited) assurance. FMO already published two Sustainability Bond [newsletters](#) in 2014 on its website. More detailed project information can be found on FMO's website, including a [world map](#) indicating location of the projects, the sector, client information, the funding objective, and the rationale for funding.

4.5 Compliance Review

On the first anniversary of the 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.

5. SUSTAINALYTICS OPINION

Industry Leader in ESG performance: FMO takes the number one spot within the diversified financials industry in Sustainalytics' Global Platform. The company ranks at the top of its industry based on its overall ESG rating as well as its performance in each of the areas of environmental, social, and governance performance. Furthermore, FMO has not been involved in any major controversies or incidents relating to environmental, social or governance issues. Given its mission, vision and programmes aimed at creating positive sustainability outcomes, and given its industry leading ESG performance among its peers, Sustainalytics is of the opinion that FMO is well positioned to issue its second Sustainability Bond.

Use of proceeds: 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.”¹⁰ 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.

With regard to Inclusive Finance, FMO is diligent in its selection of MFIs that support lending to micro enterprises. While lending to micro enterprises 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 undertaking an annual review of MFI's to ensure that their lending practices are compliant with FMO's policies and exclusionary criteria mentioned in section 4.1.2, will help FMO to mitigate this risk.

Strong internal expertise: FMO is developing strong internal expertise in the identification, evaluation and assessment of green 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 4.2 above, before it is approved as a green project. This practice will enable FMO to allocate Sustainability Bond funds to high-quality green 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

¹⁰ <http://www.ebrd.com/downloads/sector/sei/climate-finance-2012.pdf>

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.

Excellent reporting: FMO's reporting on the Sustainability Bond is very detailed and includes a description of each project along with the information regarding location and amounts allocated. FMO published two Sustainability Bond newsletters in 2014, providing project allocation details for its previous Sustainability Bond. It plans to continue to report in a similar fashion for its second Sustainability Bond.

Conclusion: FMO is well positioned to issue its second Sustainability Bond with the bond proceeds directed towards climate change mitigation activities, climate change adaptation activities and towards microfinance institutions aimed at improving inclusive finance. FMO's reporting will be very detailed and transparent, which will provide investors clarity about the bond investments. FMO will be able to quantify GHG reductions for direct energy-related projects for which the bond funds were allocated and is continuously trying to build its expertise in assessing greenness of projects, which will likely result in high-quality green assets being funded by the bond. In addition, FMO has engaged Sustainalytics to provide a compliance review on the first anniversary of the bond, which will provide additional assurance that the bond is fully compliant with use-of-proceeds criteria. Based on the above points, Sustainalytics considers FMO's Sustainability Bond to be robust, credible and transparent.

6. APPENDICES

APPENDIX 1: FMO Environmental and Social 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
FI Criteria for Categorization	Portfolio > 20% in high risk sectors	Portfolio < 20% in high risk sectors, as well as Microfinance Institutions	Consumer finance (under review)
FI Requirements	<ul style="list-style-type: none"> - Apply Exclusion List - Client has or develops an ESMS, to apply IFC PS to their high risk portfolio clients - ESAP to develop ESMS 	<ul style="list-style-type: none"> - Apply Exclusion List - ESAP to develop ESMS based on client type (see below) 	<ul style="list-style-type: none"> - Apply Exclusion List - National Law

		- Client to be compliant with local laws and regulations for their entire portfolio.	
For FI-B client type & requirements:	<p>Within FI-B there are 3 client types and are subject to different requirements in the development of an ESMS. The client types and their requirements are:</p> <ol style="list-style-type: none"> 1. Willing and able clients: ESMS is optional and based on clients willingness 2. Partners (example IFC) ESMS to be implemented according to IFC PS to their high risk portfolio clients and according to local laws and regulations for the rest of the portfolio. 3. Clients with identified increased risk profile**: These clients will be treated as an A-client and have the same requirements as A-clients <p>**Condition under which a FI-B client has an increased risk profile will include, but not limited to:</p> <ul style="list-style-type: none"> • Invested sectors • Type of product offering • E+S Country risk, referring to degree of enforcement of local laws and regulations • Reputational risk for FMO 		
Indirect Investments: Private Equity Funds	PEF-A	PEF-B	PEF-C
Risk / impact	High	Medium	Low
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	-Apply exclusion list - Commit to E&S Investment Code before first investment - ESMS based on IFC PS for high risk clients -ESMS ready before first investment	- Apply exclusion list - Commit to E&S Investment Code before first investment - ESMS based on IFC PS for high risk clients -ESMS ready before first investment	- Apply exclusion list - Commit to E&S Investment Code before first investment - ESMS based on IFC PS for high risk clients -ESMS ready before first investment
Investee Company Requirements	- National Law and ILO core conventions. - Work to ultimately comply with IFC PS (for high risk investee companies only) - Policy for continuous improvement	- National Law and ILO core conventions. - Work to ultimately comply with IFC PS (for high risk investee companies only) - Policy for continuous improvement	- National Law and ILO core conventions. - Work to ultimately comply with IFC PS (for high risk investee companies only)

			- Policy for continuous improvement
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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. For FI clients in category FI-B and FI-C, opportunities will be actively explored on how FMO can assist these clients with development of an ESMS for their portfolio, on a voluntary basis. Through this, FMO identifies potential value creation that can be achieved with these clients.

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

Renewable Energy

Electricity generation	<ul style="list-style-type: none"> • Wind power • Geothermal power, if net emission can be demonstrated • Solar power (concentrated solar power, photovoltaic power) • Biomass or biogas power that does not decrease biomass and soil carbon pools • Ocean power (wave, tidal, ocean currents, salt gradient, etc.) • Hydropower plants only if net emission reduction can be demonstrated
Transmission systems, greenfield	<ul style="list-style-type: none"> • 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
Heat production or greenfield	<ul style="list-style-type: none"> • Solar water heating and other thermal applications of solar power in all sectors • Thermal applications of geothermal power in all sectors • Thermal applications of sustainably-produced bioenergy in all sectors, including

Transport

Vehicle energy efficiency fleet retrofit	<ul style="list-style-type: none"> • Existing vehicles, rail or boat fleet retrofit or replacement (including the use of lower-carbon fuels, electric or hydrogen technologies, etc.)
Urban transport modal change	<ul style="list-style-type: none"> • Urban mass transit • Non-motorized transport (bicycles and pedestrian mobility)
Urban development	<ul style="list-style-type: none"> • 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 • 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)
Inter-urban transport and freight transport	<ul style="list-style-type: none"> • Improvement of general transport logistics to increase energy efficiency of infrastructure and transport, e.g. reduction of empty running • 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) • 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)

Agriculture, forestry and land use

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

or degradation of ecosystems	
Sustainable forest management	<ul style="list-style-type: none"> • Forest management activities that increase carbon stocks or reduce the impact of forestry activities
Agriculture	<ul style="list-style-type: none"> • 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.)
Livestock	<ul style="list-style-type: none"> • Livestock projects that reduce methane or other GHG emissions (manure management with biodigestors, etc.)

Waste and wastewater

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

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

Cross-sector activities

Policy and regulation	<ul style="list-style-type: none"> • National mitigation policy/planning/institutions • Energy sector policies and regulations (energy efficiency standards or certification schemes; energy efficiency procurement schemes; renewable energy policies) • Systems for monitoring the emissions of greenhouse gases • Efficient pricing of fuels and electricity (subsidy rationalization, efficient end-user tariffs, and efficient regulations on electricity generation, transmission, or distribution)
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	<ul style="list-style-type: none"> • Education, training, capacity building and awareness raising on climate change mitigation/sustainable energy/sustainable transport; mitigation research
Energy audits	<ul style="list-style-type: none"> • Energy audits to energy end-users, including industries, buildings, and transport systems
Supply chain	<ul style="list-style-type: none"> • Improvements in energy efficiency and GHG reductions in existing product supply chains
Financing instruments	<ul style="list-style-type: none"> • 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. • Renewable energy and energy efficiency financing through financial intermediaries or similar (e.g. earmarked lines of credit; lines for microfinance institutions, cooperatives, etc.)
Low-carbon technologies	<ul style="list-style-type: none"> • Research and development of renewable energy or energy efficiency technologies • Manufacture of renewable energy and energy efficiency technologies and products
Activities with greenhouse gas accounting	<ul style="list-style-type: none"> • 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

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

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