

10.02.2022

## Impact/Climate Commitments

# Promoting Private Sector Development in Emerging Markets: DEG's pathway to higher SDG contributions and a GHG neutral portfolio

For close to 60 years, we at DEG have been investing in sustainable development by providing financing and advice to private companies in developing and emerging markets. With our global reach and international network, we feel the pulse and urgency of the time. In the midst of a global pandemic and its economic and social impact, with a rapidly warming climate and rising global inequality, major challenges lie ahead of us. At DEG, we firmly believe that the private sector can deliver on addressing global challenges for a sustainable future. With this belief at our core, we support our clients in creating positive impact with decent jobs, inclusive economic growth, and the sustainable social-ecological transformation of their value chains.

As reflected in the Paris Agreement, there is an urgent need to act on promoting a rapid transition to net-zero and climate resilience. Green economic transformation has started worldwide, and our clients increasingly seek tailored advice and financing to manage their own transition, navigate climate risks, and future-proof their operations for sustainable business success. At the same time, societal challenges are exacerbated by the climate crisis. For us, acting on climate change is thus also an essential component of delivering on impact.

To promote future-oriented companies in developing and emerging markets, we have updated our business model. We provide our clients—often medium-sized companies in Infrastructure & Energy, Industries & Services, and Banking—with superior impact and climate solutions geared towards fostering sustainable, resilient business models. For the first time, impact and sustainable financial returns are both equally important strategic targets for DEG. A new steering approach at portfolio level ensures an effective allocation of our equity and resources, including our internal carbon budget, to achieve these targets.

For these reasons, we present three commitments, which form the backbone of our business in the coming years:

1. Our commitment to **impact** – increasing our clients' positive impact on society and the environment, and thus strengthening our contribution to the Sustainable Development Goals (SDGs).
2. Our commitment to combating **climate change** – we will enter a reduction pathway in alignment with the Paris Agreement's 1,5°C target, achieving a net-zero portfolio by 2040.
3. Our commitment to **transformation** – achieving our goals together: supporting our clients on their own transformative journeys towards positive impact and more climate resilience.

To achieve our ambitious impact, climate, and transformation goals, we will also implement some organisational changes and further enhance our expertise. We will monitor, review, and report on our progress annually. We will adhere to KfW Banking Group guidelines and EDFI (European Development Finance Institutions) harmonised approaches as well as other relevant international standards as defined below and will contribute to their continuous development.

## 1. Our commitment to impact

Goals:	We commit to increasing our clients' contributions to economic, social, and environmental objectives as indicated by the Sustainable Development Goals (SDGs), thereby improving the positive impacts of our investments continuously.
Measures:	<ul style="list-style-type: none"><li>• We are adapting our origination strategy to only finance clients who already have strong net-positive impact in line with the SDGs and/or clients who are willing to transform towards higher impact. By 2025, all new investments will either be high-impact already, or explicitly transforming towards high-impact.</li><li>• We are updating our impact measurement system, the internationally recognised Development Effectiveness Rating (DERa) to address both positive and negative impacts. We aim for the new DERa to be in place by 2023.</li><li>• We will continue to promote the implementation of international environmental and social standards in our investments as a precondition for sustainable business development.</li><li>• We are also continuously improving internal impact management in line with the Operating Principles Management (OPIM). We disclose our performance annually with independent verification taking place at regular intervals.</li></ul>
Standards:	<ul style="list-style-type: none"><li>• <a href="#">Operating Principles for Impact Management</a></li><li>• <a href="#">IFC Performance Standards</a>, <a href="#">ILO conventions</a> covering core labour standards and the basic terms and conditions of employment, <a href="#">World Bank Group EHS Guidelines</a>, Human Rights</li></ul>
Measuring progress:	<ul style="list-style-type: none"><li>• On the client level, we track impact performance annually using the DERa and share our assessment with clients for their own use and to inform our tailored approach to transformation.</li><li>• On the portfolio level, we track impact performance using an average DERa score that takes into account the performance of all of our clients. To measure success, this average score is compared to a predefined DERa scoring target.</li><li>• We communicate our impact performance in our annual development report.</li></ul>

## 2. Our commitment to combating climate change<sup>1</sup>

<sup>1</sup> DEG's banking operations (= scope 1+2) are largely climate-neutral in the areas of energy (buildings) and business trips, as part of KfW Banking Group's activities. KfW has been offsetting emissions that remain despite the conversion to renewable energy sources and the use of more environmentally friendly transportation since 2006. This statement is focussing on DEG's portfolio emissions (= scope 3), i.e. the GHG emissions related to our clients' activities.

Goals:	<p>We commit for all our decisions throughout the investment lifecycle that we will consider the total climate impact of our clients, including their supply and value chain.</p> <p>Today, all our client's scope 1 and 2<sup>2</sup> emissions that are attributable to DEG amount to a portfolio greenhouse gas (GHG) footprint of 1.4 million tons of CO<sub>2e</sub> (modelled estimate). We commit to achieving net-zero emissions on portfolio level by 2040, aligned with the Paris Agreement's 1.5<sup>3</sup> C goal. Starting this year, DEG's portfolio emissions will enter a science-based reduction pathway, reducing the carbon intensity of our investments by two-thirds until 2040.</p> <p>Remaining scope 1 and 2 emissions of our clients, attributed to DEG, will be neutralised by investing in carbon sink projects certified by internationally recognised standards.</p>
Measures:	<p>Our measures are guided by a hierarchy of (1) avoiding GHG emissions, (2) reducing GHG emissions and adapting to climate change <u>by implementing transformation pathways with our clients, and (3) neutralising remaining GHG emissions.</u></p> <ul style="list-style-type: none"> <li>• To achieve our reduction pathway, we will start in 2022 to reduce the carbon intensity of our attributed portfolio emissions (gradually starting in 2022 reaching annually 4.2% in 2025<sup>3</sup>) to achieve a two-thirds reduction by 2040.</li> <li>• Next to more climate-conscious client selection (<i>avoid</i>), our reduction pathway is primarily achieved by supporting transformation pathways of our clients, particularly for high emitters. For this, and to help our clients adapt to climate change, we will significantly expand our advisory and promotion services (<i>reduce and adapt</i>).</li> <li>• By piloting the allocation of carbon budgets to DEG's internal business units, we incentivise ownership and decision-making in line with our reduction pathway. These carbon budgets serve as complements to the impact and return metrics within our internal steering system. In addition, we will develop an internal carbon pricing mechanism by 2024.</li> <li>• We are building a diverse portfolio of afforestation and reforestation investments according to internationally recognised standards (<i>neutralise</i>).</li> </ul>
Standards:	<ul style="list-style-type: none"> <li>• <u>Science-based targets initiative (SBTi)</u> to guide our definition of Paris alignment</li> <li>• <u>Task Force on Climate-Related Financial Disclosures (TCFD)</u> for disclosure</li> <li>• <u>Partnership for Carbon Accounting Financials (PCAF)</u> for accounting and reporting</li> <li>• <u>Verified Carbon Standard (VERRA), Gold Standard and the Climate, Community and Biodiversity Standards (CCB Standards)</u> for carbon sink certifications</li> <li>• KfW Paris-compatible sector guidelines, KfW TranSForm Initiative and EDFI harmonised approaches</li> </ul>
Measuring progress:	<ul style="list-style-type: none"> <li>• We will account for clients' GHG emissions in the DERa.</li> <li>• We are committed to high data quality in our reporting according to PCAF. We will publicly disclose our attributed portfolio emissions annually starting 2023.</li> <li>• We model portfolio emissions using the Joint Impact Model, and measure &amp; model our clients' emissions based on real data wherever possible.</li> </ul>

<sup>2</sup> For companies: Scope 1 – Direct Emissions from owned or controlled sources; Scope 2 – Indirect emissions from the generation of purchased electricity; Scope 3 – all indirect emissions (excluding scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

<sup>3</sup> This percentage results from the necessary reductions to reach the Paris Agreement's 1.5°C goal

### 3. Our commitment to transformation

Goals:	<p>Recognising the need for a tailored approach, we commit to working with our clients to achieve sustainable transformation and climate resilient business in line with the SDGs – within their internal operations, their supply chains, and the environments they operate in. This way, we are able to achieve our impact and climate goals together with our clients.</p>
Measures:	<ul style="list-style-type: none"> <li>• We embark on tailored transformation journeys that span the entire investment cycle together with selected clients. After assessing transformation potential, we define individual objectives for transformation together with our clients, and monitor progress. To facilitate successful transformation, we offer tailored advisory services on topics ranging from climate mitigation and adaptation to gender equality and link our clients with innovative solutions and best-in-class technologies.</li> <li>• We are updating the DERA to include metrics relevant to transformation. It will soon track each client’s transformation progress as well as DEG’s contribution.</li> <li>• We will set up a subsidiary that is focused exclusively on advisory (DEG Impulse) and significantly increase funds for transformation support.</li> </ul>
Measuring progress:	<ul style="list-style-type: none"> <li>• Using the updated DERA, we track progress on transformation in line with the objectives defined for each client.</li> <li>• On the portfolio level, we track the DERA sub-score on transformation, which provides an aggregated overview of clients’ progress.</li> </ul>

## Our approach to achieve these commitments

Goals: We will implement the required organisational and processual changes, and strengthen our expertise to realise our ambitious impact, climate, and transformation goals.

Measures:

- At portfolio level: A new steering approach ensures that we maximise impact and returns by effectively allocating our equity and resources, including our internal carbon budget.
- We are adjusting our internal processes from origination until responsible exit to systematically integrate impact and climate considerations and build relevant capacity.
- We are enhancing impact and climate expertise across all our business units through dedicated learning and development programs.