

Disclosure Statement Operating Principles for Impact Management

**DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH
April 2020**

DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH (DEG) hereby affirms its status as a founding signatory to the Operating Principles for Impact Management (“the Principles”).¹

This Disclosure Statement applies to the following assets (the “Covered Assets”): Investment Finance and Equity Participation.²

This Disclosure Statement applies to DEG’s EUR 9.0 billion³ as of December 31, 2019 portfolio under management in alignment with the Principles.



Christiane Laibach
DEG Chief Executive Officer
April 2020

¹ The information contained in this Disclosure Statement has not been verified or endorsed by International Finance Corporation, the World Bank or any member of the World Bank Group or the Secretariat or Advisory Board. All statements and/or opinions expressed in these materials are solely the responsibility of the person or entity providing such materials and do not reflect the opinion of International Finance Corporation, the World Bank or any member of the World Bank Group. None of International Finance Corporation, the World Bank or any member of the World Bank Group shall be responsible for any loss, claim or liability that the person or entity publishing this Disclosure Statement or its investors, Affiliates (as defined below), advisers, employees or agents, or any other third party, may suffer or incur in relation to this Disclosure Statement or the impact investing principles to which it relates. For purposes hereof, “Affiliate” shall mean any individual, entity or other enterprise or organization controlling, controlled by, or under common control with the Signatory.

² Investment Finance: EUR 5.8 billion and Equity Participation: EUR 3.2 billion as of December 31, 2019.

³ Equivalent to USD 10 billion; Oanda: EUR/USD = 1.11986 as per 31.12.2019.

Principle 1: Define strategic impact objective(s), consistent with the investment strategy.

The Manager shall define strategic impact objectives for the portfolio or fund to achieve positive and measurable social or environmental effects, which are aligned with the Sustainable Development Goals (SDGs), or other widely accepted goals. The impact intent does not need to be shared by the investee. The Manager shall seek to ensure that the impact objectives and investment strategy are consistent; that there is a credible basis for achieving the impact objectives through the investment strategy; and that the scale and/or intensity of the intended portfolio impact is proportionate to the size of the investment portfolio.

- DEG, wholly-owned subsidiary of KfW, was founded in 1962 to promote private sector development thus contributing to sustainable local development.
- Accordingly, DEG has defined a three-dimensional strategic system: sustainable returns, development impact, and the promotion of German business in Emerging Markets.
- In order to realize the ambitious “2030 Agenda for Sustainable Development” and to achieve the 17 global Sustainable Development Goals (SDGs), the private sector plays a crucial role. DEG’s customers accelerate sustainable development in line with the 2030 Agenda through their entrepreneurial success and their environmental and social responsibility. DEG helps its customers to enhance their sustainability and impact performance by combining long-term financing with a broad range of business support services and a clear focus on promoting international environmental, social and corporate governance standards.
- DEG defines its impact objective as follows: *“What DEG wants to achieve is for our clients to provide more and better jobs, increase local income and support transformation in developing markets while acting in a sustainable manner and creating benefits for local communities”*.
- DEG applies its Development Effectiveness Rating (DERa)⁴ in order to measure the development effectiveness of its individual clients and their contributions to the SDGs. With regard to funds, it also measures development effectiveness at investee level. During due diligence, a baseline for each client and a forecast (5 years after investment) is established, which allows DEG to track impact performance during portfolio management.

Principle 2: Manage strategic impact on a portfolio basis.

The Manager shall have a process to manage impact achievement on a portfolio basis. The objective of the process is to establish and monitor impact performance for the whole portfolio, while recognizing that impact may vary across individual investments in the portfolio. As part of the process, the Manager shall consider aligning staff incentive systems with the achievement of impact, as well as with financial performance.

⁴ For more information on the DERa, please refer to <https://www.deginvest.de/International-financing/DEG/Übers/Uns-wir-bewirken/Wir-messen-Wirksamkeit/>

- DEG's strategy pursues a portfolio approach focusing on a target portfolio with a 5-year horizon, which is adjusted on an annual basis in accordance with market trends. In establishing the target portfolio all three strategic goals – sustainable return, impact and promotion of German business in Emerging Markets - are adequately considered. Management and staff incentives are linked to all three strategic goals.
- DERA is an integral tool for DEG to pursue this portfolio approach with a focus on impact. DEG's impact is measured as a 3-year-average portfolio DERA score based on an annual DERA score for every single portfolio client. The overall average DERA score is audited by an external Auditor on an annual basis.

Principle 3: *Establish the Manager's contribution to the achievement of impact.*

The Manager shall seek to establish and document a credible narrative on its contribution to the achievement of impact for each investment. Contributions can be made through one or more financial and/or non-financial channels.¹ The narrative should be stated in clear terms and supported, as much as possible, by evidence.

¹ For example, this may include: improving the cost of capital, active shareholder engagement, specific financial structuring, offering innovative financing instruments, assisting with further resource mobilization, creating long-term trusted partnerships, providing technical/market advice or capacity building to the investee, and/or helping the investee to meet higher operational standards.

- DEG offers a range of financial and non-financial products and services aimed at contributing to the achievement of impact. In addition, to long-term finance at market-oriented terms and risk capital that is needed in Emerging Markets, DEG offers a variety of business support services to promote e.g. good environmental, social and corporate governance international practice, gender equality, SMEs, resource efficiency.

Principle 4: *Assess the expected impact of each investment, based on a systematic approach.*

For each investment the Manager shall assess, in advance and, where possible, quantify the concrete, positive impact² potential deriving from the investment. The assessment should use a suitable results measurement framework that aims to answer these fundamental questions: (1) What is the intended impact? (2) Who experiences the intended impact? (3) How significant is the intended impact?³ The Manager shall also seek to assess the likelihood of achieving the investment's expected impact. In assessing the likelihood, the Manager shall identify the significant risk factors that could result in the impact varying from ex-ante expectations.

In assessing the impact potential, the Manager shall seek evidence to assess the relative size of the challenge addressed within the targeted geographical context. The Manager shall also consider opportunities to increase the impact of the investment. Where possible and relevant for the Manager's strategic intent, the Manager may also consider indirect and systemic impacts. Indicators shall, to the extent possible, be aligned with industry standards⁴ and follow best practice.⁵

² Focus shall be on the material social and environmental impacts resulting from the investment. Impacts assessed under Principle 4 may also include positive ESG effects derived from the investment.

³ Adapted from the Impact Management Project (www.impactmanagementproject.com)

⁴ Industry indicator standards include HPSO (<https://indicators.ifi-partnership.org/about/>); IRIS (iris.thegiin.org); GIIRS (<http://analytics.net/giirs-funds>); GRI (www.globalreporting.org/Pages/default.aspx); and SASB (www.sasb.org), among others

⁵ International best practice indicators include SMART (Specific, Measurable, Attainable, Relevant, and Timely), and SPICED (Subjective, Participatory, Interpreted & communicable, Cross-checked, Empowering, and Diverse & disaggregated), among others.

- Guided by the Sustainable Development Goals (SDGs), DERA uses five impact categories: decent jobs, local income, market and sector development (“What are the contributions”); environmental stewardship, and community benefits (“How are they achieved”). Based on the various indicators included in the DERA, a cumulative score is created, which rates each transaction from “exceptional” to “unsatisfactory”.
- DERA reflects country and sector context in an individual category (providing a higher score for less developed countries and sectors which are a bottleneck for development) as well as the contribution of the investment project to market and sector development (e.g. if the investment is changing market structures, promoting innovation such as new technology and enhancing competition).
- DERA is applied over the entire project duration of each DEG investment. An initial DERA is created before a project is approved. This consists of a) a baseline with current values prior to the DEG investment and b) an ex-ante estimate of the expected effects of the investment with a time horizon of five years (forecast). After commitment, DERA is updated annually by recording current values.
- Comparisons between baseline, forecast and actual score for individual clients, but also for portfolio clusters and the overall clusters over years provide useful trends and lessons.

Principle 5: Assess, address, monitor, and manage potential negative impacts of each investment.

For each investment the Manager shall seek, as part of a systematic and documented process, to identify and avoid, and if avoidance is not possible, mitigate and manage Environmental, Social and Governance (ESG)⁶ risks. Where appropriate, the Manager shall engage with the investee to seek its commitment to take action to address potential gaps in current investee systems, processes, and standards, using an approach aligned with good international industry practice.⁷ As part of portfolio management, the Manager shall monitor investees’ ESG risk and performance, and where appropriate, engage with the investee to address gaps and unexpected events.

⁶ The application of good ESG management will potentially have positive impacts that may or may not be the principal targeted impacts of the Manager. Positive impacts resulting from ESG matters shall be measured and managed alongside with, or directly embedded in, the impact management system referenced in Principles 4 and 6.

⁷ Examples of good international industry practice include: IFC’s Performance Standards (www.ifc.org/performancestandards); IFC’s Corporate Governance Methodology (www.ifc.org/cgmethodology); the United Nations Guiding Principles for Business and Human Rights (www.unglobalcompact.org/librav/2); and the OECD Guidelines for Multinational Enterprises (<http://mneguidelines.oecd.org/themes/human-rights.htm>).

- DEG’s operations are guided by its Guideline for Environmental and Social Sustainability.⁵
- DEG requires and promotes compliance with international environmental and social standards as well as environmentally relevant safety, health and technical standards in production and products. A dedicated Sustainability team is in charge of the environmental and social management from due diligence to monitoring. In addition, corporate governance risks are addressed during structuring of the investment and in portfolio management, both by a dedicated team as well as by the investment managers themselves.

⁵ <https://www.deginvest.de/International-financing/DEG/Über-uns/Was-wir-tun/DEG-Umwelt-und-Sozialrichtlinie/>

- DEG manages the ESG risks of its investments in line with the IFC Performance Standards (IFC PS). The companies DEG finances contractually agree to comply with the Exclusion List, national regulations, with the IFC PS as environmental, social standards, as well as the core labour standards and Fundamental Principles of the International Labour Organization (ILO). In case of current deviations from these standards, DEG contractually agrees on an E&S Action Plan with its customers, which is regularly monitored. If necessary, DEG assists its customers in implementing adequate measures to meet these standards through tailored advisory services.
- DEG regularly monitors the Environmental and Social (ES) risks of each investment and documents it in its Environmental and Social Indicator System (EaSI) in a systematic manner.
- DEG publishes a summary of the project including the ES category is published on the website (<https://deginvest-investments.de/>)
- For investments in financial institutions (FI) and funds, DEG's E&S due diligence comprises a review of the existing portfolio and portfolio forecast of the FI or fund to identify ESG risks at sub-borrower or sub-investee level. DEG requires all FI and fund customers to develop, implement and maintain an E&S Risk management system adequate to their respective potential risk levels. DEG offers business support services to support its customers in developing and implementing such a system.
- DEG's Corporate Governance (CG) assessment tool considers a company's commitment to corporate governance, the structure and functioning of its board, its internal and external controls, treatment of minority shareholders as well as transparency and disclosure. As part of its business support services, DEG offers a Corporate Governance Assessment to its customers, which results in a benchmarking against national standards and international best practice as well as specific recommendations which customers can implement themselves or with further support from DEG.
- To ensure individuals, groups, communities or other parties who believe to be adversely affected by a project financed or planned by DEG the right to be heard and the right to complain, DEG has established an Independent Complaints Mechanism. An Independent Expert Panel, consisting of a group of three persons with environmental, social, legal and financial expertise, decides whether a complaint is admissible, responds to the complainant, is responsible for a dispute resolution or a compliance review and reports on individual complaints.

Principle 6: Monitor the progress of each investment in achieving impact against expectations and respond appropriately.

The Manager shall use the results framework (referenced in Principle 4) to monitor progress toward the achievement of positive impacts in comparison to the expected impact for each investment. Progress shall be monitored using a predefined process for sharing performance data with the investee. To the best extent possible, this shall outline how often data will be collected; the method for data collection; data sources; responsibilities for data collection; and how, and to whom, data will be reported. When monitoring indicates that the investment is no longer expected to achieve its intended impacts, the Manager shall seek to pursue appropriate action.⁸ The Manager shall also seek to use the results framework to capture investment outcomes.⁹

⁸ Actions could include active engagement with the investee; early divestment; adjusting indicators/expectations due to significant, unforeseen, and changing circumstances; or other appropriate measures to improve the portfolio's expected impact performance

⁹ Outcomes are the short-term and medium-term effects of an investment's outputs, while the outputs are the products, capital goods, and services resulting from the investment. Adopted from OECD-DAC (www.oecd.org/dac/).

- DEG requires its clients to regularly report data on E&S management and performance as well as DERA relevant indicators, in addition to annual reports and other relevant information.
- DERA indicators are aligned with the Harmonized Indicators for Private Sector Operations (HIPSO) and IRIS.
- DERA is designed along five outcome categories. Each category consists of a set of indicators that capture a customer's contribution to each category. These indicators are mostly quantitative in nature or are qualitative expert judgements. Some indicators are more static while others are dynamic, which allows the valuation of absolute, realized effects and growth processes. These indicators likewise differentiate between mitigating risks and proactive development contributions.
- Regular feedback to the clients includes ESG and impact performance. DEG also offers various business support services (technical assistance) to support clients in improving their ESG and impact performance.

Principle 7: Conduct exits considering the effect on sustained impact.

When conducting an exit,¹⁰ the Manager shall, in good faith and consistent with its fiduciary concerns, consider the effect which the timing, structure, and process of its exit will have on the sustainability of the impact.

¹⁰ This may include debt, equity, or bond sales, and excludes self-liquidating or maturing instruments.

- DEG considers the effect on maintaining impact when making exit decisions in its equity portfolio. This can affect the timing, structure, and choice of who to sell to.
- Most debt investments are self-liquidating without exit decisions. Nevertheless, DEG's long-term investment horizon allows for impactful change while DEG is on board, and good practices incorporated into policies and processes are likely to be sustained beyond the term of DEG's investment.

Principle 8: Review, document, and improve decisions and processes based on the achievement of impact and lessons learned.

The Manager shall review and document the impact performance of each investment, compare the expected and actual impact, and other positive and negative impacts, and use these findings to improve operational and strategic investment decisions, as well as management processes.

- Based on DERA results, DEG publishes an impact report annually⁶. DEG also contributes to KfW's Sustainability Report⁷ every year.
- A DEG-internal dashboard provides transparent and easy access to all impact data allowing feedback to different departments, comparisons between different sectors, regions etc.
- DEG also undertakes independent evaluation studies of selected topics and investments. Lessons learned from these studies are discussed with responsible departments and management.

Principle 9: Publicly disclose alignment with the Principles and provide regular independent verification¹¹ of the alignment.

The Manager shall publicly disclose, on an annual basis, the alignment of its impact management systems with the Principles and, at regular intervals, arrange for independent verification of this alignment. The conclusions of this verification report shall also be publicly disclosed. These disclosures are subject to fiduciary and regulatory concerns.

¹¹ The independent verification may be conducted in different ways, i.e., as part of a financial audit, by an independent internal impact assessment committee, or through a portfolio/fund performance evaluation. The frequency and complexity of the verification process should consider its cost, relative to the size of the fund or institution concerned, and appropriate confidentiality.

- DEG's Impact Measurement and Management system DERA and DERA data 2018 has been externally verified by "Define" in accordance with KfW's risk model validation policy. DEG impact data is also independently verified within each Annual Report, also DEG's sustainability work is covered by the externally audited Sustainability Report of KfW Group.
- We are currently assessing different options for including an independent verification of DEG's alignment with the Principles according to Principle 9 within our impact and sustainability reporting procedures, and we aim to provide an independent verification by the time of next Disclosure Statement, April 12, 2021.

⁶ <https://www.deginvest.de/International-financing/DEG/Download-Center/Jahresberichte/>

⁷ <https://www.kfw.de/microsites/Microsite/nachhaltigkeitsbericht.kfw.de/en.html>