DEG's Disclosure Statement for the

Operating Principles for Impact Management

KFW DEG

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Photo: stock.adobe.com/arrowsmith2

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IN A NUTSHELL: DEG's alignment to the Operating Principles for Impact Management

The Operating Principles for Impact Management are a milestone, bringing together DFIs, asset managers, and asset owners on a robust framework to foster greater discipline, transparency, and accountability in impact investing. The Impact Principles continue to grow as a global standard among impact investors and their evolving regulatory environments.

At the beginning of 2021, BlueMark, the leading independent provider of impact verification services, verified DEG's alignment with the Operating Principles for Impact Management. Their verifier statement is available online[1].

Their findings showed that we are leading in Environmental, Social Risk and Corporate Governance Management (Principle 5). Our Development Effectiveness Rating (DERa) and impact target as part of our strategic objectives and incentive system brings us to the top of peers (Principle 2). During 2021 we continued our work in these areas.

At the same time, the verification also identified potential for improvement, from managing exits and implementing learning loops (Principle 7 and 8) to documenting and strategically managing the different channels through which DEG supports its clients (Principle 3). The recommendations were timely, as DEG was in the process of developing a new strategy for the period 2022 onwards. The implementation plan for 2022 covers several suggestions from the verification and will be addressed in next year's disclosure statement.

Graph 1 – Findings from BlueMark's verification of DEG's extent of alignment to the Principles, Feb 2021

Principle	Alignment
1. Define strategic impact objective(s), consistent with the investment strategy	HIGH
2. Manage strategic impact on a portfolio basis	ADVANCED
3. Establish the Manager's contribution to the achievement of impact	MODERATE
4. Assess the expected impact of each investment, based on a systematic approach	HIGH
5. Assess, address, monitor, and manage potential negative impacts of each investment	ADVANCED
6. Monitor the progress of each investment in achieving impact against expectations and respond appropriately	HIGH
7. Conduct exits considering the effect on sustained impact	LOW
8. Review, document, and improve decisions and processes based on the achievement of impact and lessons learned	MODERATE

[1] https://www.deginvest.de/DEG-Documents-in-English/About-us/Responsibility/DEG-BlueMark_Verifier-statement_2021.pdf

DISCLOSURE STATEMENT
OPERATING PRINCIPLES FOR IMPACT MANAGEMENT

DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH
April 2022

DEG – Deutsche Investitions- and Entwicklungsgesellschaft mbH (DEG) hereby affirms its status as a Signatory to the Operating Principles for Impact Management (the "Impact Principles").[2]

This Disclosure Statement applies to the following assets or business lines (the "Covered Assets"): Investment Finance and Equity Participation.[3]

The total Covered Assets in alignment with the Impact Principles is US$ 10.5 billion[4] as of December 31, 2021 portfolio under management in alignment with the Impact Principles.

Please find detailed information on the Impact Principles on its webpage: ww.impactprinciples.org

On our website you also find the 2021 verifier statement by BlueMark.

Roland Siller
DEG Chief Executive Officer
April 2022

[2] 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.

[3] Investment Finance: EUR 5.8 billion and Equity Participation: EUR 3.4 billion as of December 31, 2021.

[4] EUR 9.2 billon; Oanda: EUR/USD = 1.1324 as per 31.12.2021.

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.

  - In 2021, DEG still applied a three-dimensional strategic system, targeting sustainable returns, development impact, and the promotion of German business in emerging markets. During 2021, DEG worked on the development of a new strategy from 2022 onwards with committments for climate, impact, and transformation[5]. Impact and sustainable financial returns will be both equally important strategic targets for DEG. In addition, DEG will enter a reduction pathway in alignment with the Paris Agreement's 1,5° C target, achieving a net-zero portfolio by 2040. DEG commits to supporting its clients on their transformative journeys towards positive impact and more climate resilience.

- 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 clients accelerate sustainable development in line with the 2030 Agenda through their entrepreneurial success and their environmental and social responsibility. DEG helps its clients 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.

  - As part of the new strategy, DEG commits to increasing its clients' contributions to economic, social, and environmental objectives as indicated by the Sustainable Development Goals (SDGs), thereby improving the positive impacts of its investments continuously. This is to be achieved by supporting its "clients to provide more and better jobs, to increase local income and to drive transformation in developing markets while acting in a sustainable manner and creating benefits for local communities".

[5] https://www.deginvest.de/DEG-Documents-in-English/About-us/Responsibility/DEG-Impact-Climate-Commitment-2022.pdf

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.

- DEG applies its Development Effectiveness Rating (DERa)[6] 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.

- 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. DEG's Development Effectiveness Rating system ("DERa") offers a consistent framework to systematically consider impact throughout the investment process through clearance in principle, due diligence, and portfolio management.

- 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.

- The annual bonus of DEG is linked to the achievement of a portfolio-level DERa target which creates a staff incentive system connected to impact. Further, DERa targets offer an informal performance and discussion mechanism within investment teams.

[6] For more information on the DERa, please refer to https://www.deginvest.de/Our-impact/Wir-messen-Wirksamkeit/

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.

- DEG tracks its Business Support Services via an extensive, SAP based documentation. The status of the activity is reported as well as the intention, interim results, success level and related results.

- DEG's Development Effectiveness Rating (DERa) tracks – in addition to the development effects of DEG's clients – DEG's added value. To be able to analyse the role of DEG and its Business Support Services, indicators both on financial as well as value additionality are included in the DERa.

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 impact[2] 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 standards[4] 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 HIPSO (https://indicators.ifipartnership.org/about/); IRIS (iris.thegiin.org); GIIRS (http://b-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.

- DERa is fully aligned to HIPSO and partially to IRIS+. In case these frameworks do not cover relevant indicators, other standard frameworks are used. The alignment to a standard is documented for each indicator of the DERa.

- 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 imp acts 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/library/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.[7]
- 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.
- 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, the IFC Performance 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 Environmental and Social Action Plan with its clients, which is regularly monitored. If necessary, DEG assists its clients 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 them in its Environmental and Social Indicator System (EaSI) in a systematic manner.
- DEG publishes investment-related information on the investments financed using DEG funds on the website https://deginvest-investments.de/. This includes information on the environmental and social category (A, B+, B, C) and. in case of in the case of land-related investments. a link to the company's website providing a summary of the environmental and social action plan.
- 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 clients to develop, implement and maintain an E&S Risk management system adequate to their respective potential risk

[7] https://www.deginvest.de/Impact-climate-focus/A-guide-to-our-standards/DEG-Guideline-for-environmental-and-social-sustainability/

levels. DEG offers Business Support Services to support its clients 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 clients, which results in a benchmarking against national standards and international best practice as well as specific recommendations, which clients 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.

- DEG's DERa further includes a neutral annually updated view on the clients performance. This shows negative effects, e.g. decreasing quantities of jobs or local incomes as well as issues in qualitative aspects such as job quality or the management of environmental and social risks. The operations level such as fatalities or other matters with high response urgency are not covered by DERa as the E&S department and market colleagues have a rapid notification and response system in place to deal with this issues in a much faster manner. This notification is contractually agreed with DEG clients.

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 (http://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.
- DEG internally provides all colleagues with a DERa Dashboard that allows aggregated and disaggregated views of a single client's development effectiveness performance as well as views on departments, client cluster, countries, regions etc. This information is updated once a year based on fully checked official data.
- DERa data is further tracked throughout the year and client information on development effectiveness is accessible to all investment related colleagues.
- 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.

- The Annual Review documents of DEG investments includes the risk side on ESG as well as the more opportunity focused development effectiveness aspects along the five DERa categories.
- Based on DERa results, DEG publishes an impact report annually[8]. DEG also contributes to KfW's Sustainability Report[9] 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 evaluation studies of selected topics and investments. Further department internal learning, such as lessons from the special operations departments with clients in difficult situations, are discussed with responsible departments and management.

[8] https://www.deginvest.de/International-financing/DEG/Download-Center/Jahresberichte/

[9] https://www.kfw.de/microsites/Microsite/nachhaltigkeitsbericht.kfw.de/en.html

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

The Manager shall publicly disclose, on an annual basis, the alignment of its impact management systems with the Impact 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.

- In February 2021, DEG's alignment with the Operating Principles for Impact Management was verified by Bluemark, a Tideline Company. The Covered Assets reviewed totalled €8.5 billion for the year ending December 2020. The Verifier Statement identified both areas of strength and areas for improvement.

  About BlueMark: BlueMark, a Tideline company, is a leading provider of impact verification services in the impact investing market. BlueMark was founded with a mission to "strengthen trust in impact investing" and to help bring more accountability to the impact investment process. BlueMark is a wholly owned subsidiary of Tideline Advisors, LLC. and headquartered at 915 Battery St, San Francisco, CA 94111, USA. For more information, please visit www.bluemarktideline.com.

  About BlueMark Qualifications: BlueMark has conducted this verification with an independent and unconflicted team experienced in relevant impact measurement and management issues. BlueMark has implemented a Standard of Conduct requiring employees to adhere to the highest standards of professional integrity, ethics, and objectivity in their conduct of business activities.

  About the Assessment Methodology and Scope: BlueMark's full assessment methodology, based on its professional judgment, consisted of:
  1. Assessment of the IM system in relation to the Impact Principles, using BlueMark's proprietary rubric, and examining processes and policies against the following criteria:
     - *Compliance* of the IM system with a threshold level of practice;
     - *Quality* of the IM system's design in terms of its consistency and robustness;
     - *Depth* of sub-components of the system, focused on completeness
  2. Interviews with DEG staff responsible for defining and implementing the IM system;
  3. Testing of selected DEG transactions to check the application of the IM system; and
  4. Delivery of detailed assessment findings to DEG, outlining areas of strong alignment and recommended improvement, as well as BlueMark's proprietary benchmark ratings on the extent of alignment to each of the Impact Principles.

- DEG plans regular external verification to support further learning, in a 3 year verification cycle. In future DEG plans to align this to other official validation cylces, which DEG implements for DERa and other management tools and systems.