



Environmental and Social Risk Policy

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1 BACKGROUND

Alterfin (“the Cooperative”) is a Belgian financial cooperative created in 1994. The Cooperative raises capital to invest in smallholder farming in developing countries via microfinance institutions (“MFIs”), Sustainable Agriculture Organisations (SAOs) including small and medium enterprises (SMEs) and producer’s organisations. Alterfin’s goal is to improve the livelihoods and living conditions of socially and economically disadvantaged people and communities, predominantly in rural areas in low and middle-income countries across Latin America, Africa, and Asia. This is driven by the mobilisation of funds from individual investors and socially responsible institutions, the structuring and promoting of sustainable investments and by collaboration with like-minded organisations.

Alterfin’s Environmental & Social Performance Management (ESPM) Framework guides the Cooperative’s operations in this effort. The ESPM Framework has a dual approach based on two principles: “doing no harm” and “doing good”. Doing no harm means that Alterfin seeks to mitigate and/or avoid the negative effects on the natural environment (i.e., air, water, soil) or communities of people (e.g., employees, customers, residents) that result directly or indirectly from its financing. Doing good means that Alterfin aims to maximise the environmental and social benefits of its transactions to pursue deeper impact.

This document focuses on the “doing no harm” component of Alterfin’s ESPM Framework version 1.0 dated 09.07.2021, to ensure that the Cooperative incorporates industry best practice and adheres to international standards in daily operations. As such, Alterfin implements a set of standards requirements and tools which are in turn structured in an Environmental & Social Risk Policy (“E&S Risk Policy”).

2 OBJECTIVE AND SCOPE

To adequately address the E&S risks of its transactions with partners, Alterfin requires MFIs and SAOs respectively to mitigate the negative environmental and social effects of their lending operations and improve their environmental and social risk management practices. This E&S Risk Policy (“the Policy”) lays the ground for that integrated E&S management approach.

The purpose of this Policy is to define Alterfin’s principles and standards for E&S risk management and to define the requirements for its partners.

The scope of this Policy extends to all microfinance and sustainable agriculture activities Alterfin finances as well as funds or third parties funds it manages. As a cooperative, Alterfin commits to applying the Policy consistently across its activities. All staff involved in the Cooperative’s operations is expected to know the Policy and to act accordingly.

3 STANDARDS

Alterfin commits to industry best practices in terms of environmental and social risk management by applying the following standards:

- Alterfin does not finance - nor directly or indirectly - companies with activities or characteristics mentioned on its Exclusion List (Annex A).
- Alterfin requires partners to achieve compliance with the legal and regulatory environmental and social requirements that are applicable in the regions where they operate.
- For MFI, Alterfin also applies the Universal Standards for Social Performance Management (“the Universal Standards”) and the Client Protection Principles (“CPP”).

- For SAOs, Alterfin applies FAO's Environment and Social Management Standards¹ as relevant to the different commodities being financed; as well as a combined selection of various voluntary certification standards such as Fairtrade, Organic, Rainforest Alliance/UTZ and Global G.A.P.
- When relevant, Alterfin applies international standards such as the IFC Performance Standards ("IFC PS") and the ILO Core Labour Conventions to its transactions on a best practice basis.

In case of discrepancy between the applicable national legislations in the partner's country of operation and these international standards, the Cooperative will apply the stricter of the two standards.

4 RISK PROFILES

To evaluate the E&S risk of a transaction in an adequate fashion, Alterfin classifies the E&S risk level on an ex-ante basis. To that end, the Cooperative has defined its own risk profiling method which is based on the characteristics of the involved partners and their value chains. This method helps determine the expected E&S risk level of the transaction and define the E&S risk management requirements for the involved partner.

As a *standard*, Alterfin assumes that its transactions mostly carry limited E&S risk due to:

- a. the nature and scale of its partners' customers, being either smallholder farmers in the case of sustainable agriculture organisations or micro entrepreneurs in the case of MFIs.
- b. the small size of its transactions.

Exceptions to this assumption apply if (i) a sustainable agriculture organisation operates in a high-risk sector or geography or if (ii) an MFI provides large loan tickets to its beneficiaries. In these cases, Alterfin assumes an *increased* E&S risk profile for the transaction and raises the requirements for the involved partner.

Table 1 Risk profiles definitions

RISK PROFILES	MICROFINANCE INSTITUTIONS	SUSTAINABLE AGRICULTURE ORGANISATIONS
STANDARD	MFIs with average disbursement to end clients < 20.000 USD	All sectors and countries except those mentioned under Increased risk
INCREASED	MFIs with average disbursement to end clients > 20.000 USD	High risk sectors and countries to be defined

5 REQUIREMENTS

To mitigate the negative environmental and social risks and impacts associated with the transaction, Alterfin has defined a set of requirements. Those requirements differ based on whether the transaction has been defined with a standard or increased risk profile.

Requirements for microfinance institutions

Alterfin requires the MFIs it finances to be responsible employers and responsible lenders. To ensure this is achieved in practice, the Cooperative requires MFIs to comply with the requirements presented in Table 2.

¹ <https://www.fao.org/3/i4413e/i4413e.pdf>

Table 2 Requirements for MFIs

REQUIREMENTS FOR MICROFINANCE INSTITUTIONS	E&S RISK PROFILES	
	STANDARD	INCREASED
- Complies with Alterfin's Exclusion List	√	√
- Complies with applicable laws and regulation in host countries	√	√
- Ensures Client Protection (<i>Universal Standard</i>)	√	√
- Ensures Responsible Human Resource Development (<i>Universal Standard</i>)	√	√
- Ensures Environmental Performance Management (<i>Universal Standard</i>)	-	√

All MFIs are required to comply with Alterfin's Exclusion List and applicable laws and regulations in host countries.

In addition to this, Alterfin applies the *Universal Standards* that are relevant to direct and indirect environmental and social risk management. The selected standards are appropriate for the MFIs' risk exposure and are in line with IFC's Interpretation Note on Financial Intermediaries.²

Next to that, Alterfin requires all MFIs to offer good practice working conditions to their workforce by applying the *Universal Standard: Responsible Human Resource Development* which also ensures that MFIs keep their working conditions in accordance with relevant aspects of Performance Standard 2 on Labour and Working Conditions.

Only for those MFIs with *increased risk*, Alterfin requires the organisation to evaluate and mitigate environmental and social risks in portfolio. Those MFIs must implement a basic risk management mechanism by applying *Universal Standard: Environmental Performance Management*. In the exceptional case of MFIs with high E&S risk exposure, Alterfin may decide to increase the requirements to a more elaborate E&S risk management mechanism by applying IFC Performance Standard 1.

Requirements for sustainable agriculture organisations

To mitigate the E&S risks of the direct financing, the Cooperative defines requirements for a SAO with regards to its internal operations and its supply chain. Those requirements differ based on whether the transaction has been defined with a standard or increased risk profile. To determine the increased risk profiles, a list will be composed of high-risk crops & products, linked to specific countries and/or regions. This list will be validated by Alterfin's management on a yearly basis based on a fixed set of the following FAO standards that can be used to identify increased risk profiles³:

- ESS 1: Natural Resource Management
- ESS 2: Biodiversity, Ecosystems and Natural Habitats
- ESS 3: Plant Genetic Resources for Food and Agriculture
- ESS 4: Animal - Livestock and Aquatic - Genetic Resources for Food and Agriculture
- ESS 5: Pest and Pesticide Management
- ESS 6: Involuntary Resettlement and Displacement
- ESS 7: Decent Work
- ESS 8: Gender Equality
- ESS 9: Indigenous Peoples and Cultural Heritage

² https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/publications/publications_policy_interpretationnote-fi

³ <https://www.fao.org/3/i4413e/i4413e.pdf>

Alterfin requires the SAOs it finances to be responsible employers and responsible service providers to their members or associated farmers. To ensure this is achieved in practice, the Cooperative requires SAOs to comply with the requirements presented in Table 3.

Table 3 Requirements for sustainable agriculture organisations

REQUIREMENTS FOR SUSTAINABLE AGRICULTURE ORGANISATIONS	E&S RISK PROFILES	
	STANDARD	INCREASED
- Compliance with Alterfin's Exclusion List	√	√
- Compliance with applicable laws and regulation in host countries	√	√
- Ensures responsible employee treatment	√	√
- Ensures environmentally sustainable production		√
- Ensures proper member/associated farmer protection		√

All SAOs are required to comply with Alterfin's Exclusion List, applicable laws, and regulations in host countries.

In addition to this, Alterfin applies FAO's Environment and Social Management Standards that are relevant to direct and indirect environmental and social risk management. Alterfin requires all SAOs to offer good practice working conditions to their workforce by applying FAOs ESS 7 which also ensures that SAOs keep their working conditions, or by adhering to a relevant voluntary certification standard.

Only for those SAO's with *increased risk*, Alterfin requires the organisation to evaluate and mitigate environmental risks and proper protection of member and/or associated farmers. Those SAOs must implement a basic risk management mechanism by either adhering to the relevant externally audited voluntary standards such as Global GAP, Fairtrade, Rainforest Alliance/UTZ, organic, SAI, SAN, or by another standard that can mitigate the relevant increased risk. In the exceptional case of SAOs with high E&S risk exposure, Alterfin may decide to increase the requirements to a more elaborate E&S risk management mechanism in accordance with its crop & country specific standards.

Compliance

It is expected that not every partner will follow the requirements at the time a transaction closes. In such cases, the Cooperative and the partner will agree on an E&S Action Plan defining the corrective measures to bring the partner into compliance within an achievable timeframe. It should be noted that Alterfin takes a realistic approach and requires partners to improve E&S management practices through means that are appropriate to the nature and scale of their operations and commensurate with the E&S risk associated with their operations.

6 APPLICATION

The figure below describes the internal steps that need to be taken by Alterfin to ensure E&S risk management along its investment process. The steps are further defined in *Alterfin's E&S procedure documentation*.



Figure 1 Overview of Alterfin's E&S procedure

Alterfin applies a risk-based E&S management approach which means it enhances the resources it deploys to assess and mitigate a transaction's E&S risk. To ensure a consistent application of E&S risk management across operations, the Cooperative embeds it throughout the investment cycle which means that Alterfin commits to the following tasks:

- Screening a potential transaction for eligibility against the Exclusion List.
- Profiling a potential transaction on the E&S risk level triggered by the partner.
- Identifying requirements to avoid or minimise E&S impacts to a risk level acceptable to the Cooperative's standards and risk appetite.
- Considering the findings and recommendations from the E&S due diligence as a key factor in the Investment Committee's decision-making.
- If appropriate and when TA resource is available, agreeing on an E&S Action Plan describing clear and realistic measures to mitigate the partner's direct and indirect E&S risks.
- Monitoring the partner's compliance with Alterfin's standards in general and the activities from the mutually agreed Action Plan (if any).

To ensure this process is resource-efficient and benefits from the existing relationship with the partner, Alterfin puts forward an engagement approach for transactions that are renewed within 12 months. This means that for those transactions, Alterfin does not require a full E&S risk assessment during due diligence but rather focuses on changes that have occurred during the last 12 months.

7 ROLES AND RESPONSIBILITIES

To effectively manage E&S risks, Alterfin allocates the right resources and tools that will allow timely intervention. All team members involved in the investment process must participate in the implementation of the E&S Framework. The responsibilities for the framework are divided between 5 key roles.

Investment Managers

The Investment Managers are responsible for applying the ESPM standards to the transactions and engage with partners on Alterfin's E&S standards and requirements. Throughout the investment cycle, Investment Managers carry responsibility for a transaction's E&S due diligence, agree on corrective measures with the partners in case it does not comply with Alterfin's E&S standards and requirements, and they monitor performance over time. If needed, the Investment Managers can involve the E&S Impact Manager in case of questions or specific issues.

E&S Impact Manager

The E&S Impact Manager is responsible for ensuring that all transactions financed by Alterfin comply with applicable standards and requirements by assisting the Investment Team with the screening, assessing, and monitoring E&S risk associated with transactions as well as the E&S risk management capacity of the involved partner when needed.

Next to that, the E&S impact manager carries responsibility for the development and maintenance of the ESPM including all policies, procedures, and tools.

Legal & Compliance team

Our Legal & Compliance team ensures that the applicable E&S standards and requirements are adequately included in a transaction's legal agreement. This should fortify the Investment Managers Team's leverage to keep a partner to the commitments and mitigation measures and to act in case of any breaches of law or activities contrary to Alterfin's E&S Policy.

Investment Committee

The Investment Committee ("IC"), IC Normal Quorum or IC Special Quorum as applicable, carries final responsibility for ratifying the E&S risk assessment from the due diligence assessment and any corrective measures in the E&S Action Plan. The IC can overrule conclusions and recommendations from the Investment Team or the E&S Impact manager and define additional requirements up to and including declining the suitability of the investment.

Monitoring Committee

The Monitoring Committee will play an active role during the monitoring phase as it will ensure partners comply with E&S covenants and implement the agreed E&S action plan. In case of poor E&S risk management performance, the monitoring committee will support investment managers in taking adequate decisions. The Monitoring Committee reports directly to the Investment Committee.

8 DOCUMENT REVIEW

This E&S Risk Policy is approved by the Board and comes into force as of 1st April 2022. The policy will be reviewed and revised as necessary to reflect any changes to the Cooperative's policies, standards, and operations. At a minimum, this policy will be reviewed and possibly revised on a bi-annual basis. The next review is scheduled on 1st April 2024.

ANNEX A EXCLUSION LIST

Alterfin will not finance any activity, production, use, distribution, business, or trade involving the below sectors and activities:

- Forced labour⁴ or child labour⁵
- 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 more than 2.5 km in length).
- Cross-border trade in waste and waste products, unless compliant with the Basel Convention and the underlying regulations.
- Destruction⁶ of High Conservation Value areas⁷.
- Radioactive materials⁸ and unbounded asbestos fibres.
- Pornography and/or prostitution.
- Racist and/or anti-democratic media.
- If any of the following products form a substantial part of a project's primary financed business activities⁹:
 - a) Alcoholic Beverages (except beer and wine).
 - b) Tobacco.
 - c) Weapons and munitions; or
 - d) Gambling, casinos, and equivalent enterprises.

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.

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 of outstanding significance or critical importance (See <http://www.hcvnetwork.org>).

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.