Consultation Report

FMO POSITION STATEMENT ON IMPACT AND ESG FOR FINANCIAL INTERMEDIARIES

The Hague | October 2022

FMO thanks all the individuals and organizations that took part in this public consultation. This Consultation Report captures FMO's response to the feedback received during the consultation period of 2022. It is a reflection of our standpoints at this point in time. In case of any questions after the publication of the 2022 Consultation Report on the Impact and IESG for Financial Intermediaries, please contact info@fmo.nl

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1. Introduction

Impact and Environmental, Social and Governance (ESG) risk management are an important part of FMO's strategy. Focusing on Impact and ESG is in line with FMO's Sustainability Policy, which describes how FMO aims to protect people and the environment impacted by our own operations and our investments, by advancing a greener and inclusive economy and helping customers manage their environmental and social risks and improve their corporate governance. Financial Intermediaries (FIs) play an important role for FMO, as through our investments in FIs we reach MSMEs, increase access to capital, support business growth, and channel finance to businesses and end-beneficiaries that FMO cannot finance in an efficient manner directly.

Position Statements are an integral part of the FMO Sustainability Policy Framework that is steering FMO's activities. They explain FMO's choices in relation to societal challenges we operate in and describe how we select investments, work with our customers and other stakeholders, and monitor performance related to impact and ESG risk management. Position Statements are complementary to the overarching Sustainability Policy and reflect our choices and approaches in case these deviate from what is described in the Sustainability Policy. They reflect FMO's objective to apply the highest possible standard of ethics and integrity to our business activities. Position Statements are reviewed regularly to decide on revisions or updates. Throughout the development, revision, and implementation of our Position Statements, FMO engages in constructive dialogue with our stakeholders to collect valuable input and feedback and to explain our choices.

Our Position Statement on Impact and ESG for Financial Intermediaries (the Position Statement) can be considered FMO's next step in our commitment to continuously improve our Impact and ESG practices and create value at the institutional and sectoral level. It describes the choices FMO makes in structuring our customer relationships, by balancing our development mandate to deliver positive impact and improvements in practices from a level that is often not yet in line with international standards at the inception of our relationship, with the prevention and management of negative impacts that can occur from time to time. Therefore, important elements of the new Position Statement are that it clarifies FMOs structural approach to Financial Intermediary financing, including how we shape our customer relationship and subsequently how we view FMO's responsibility under the UNGPs, and FMO's risk appetite to work with the FI customer or investee towards compliance with ESG standards.

FMO conducted a formal public stakeholder consultation on the latest draft Position Statement on Impact and ESG for Financial Intermediaries between May 3rd and June 10th, 2022. This document describes the complete consultation process regarding the development of this Position Statement and presents both a summary (section 2.5) and a more detailed description (chapter 0) of the feedback received in the public consultation and FMOs response. This Consultation Report accompanies the publication of the final Position Statement and should be read in the context of that document.

FMO would like to thank all stakeholders who have participated in the consultation process and who have provided us with their feedback throughout the development of this Position Statement.

2. The stakeholder consultation process

2.1 Objective

FMO aims to be open, proactive, and transparent to all stakeholders. Through external stakeholder consultations, FMO engages proactively in an open dialogue with interested and valued stakeholders. Consultations allow us to benefit from external expertise and knowledge and to receive valuable input during the process of policymaking. In addition, consultations enable FMO to further enhance transparency and accountability around the decisions we make.

To reach these objectives, we designed the external stakeholder consultation for the draft Position Statement on Impact and ESG for Financial Intermediaries (the Position Statement) through two channels: i) targeted consultation sessions with a group of relevant stakeholders soliciting specific feedback throughout the development of the Position Statement and the ii) public consultation, allowing anyone interested in FMO's approach and investments, to share their point of view and expertise on this topic.

2.2 Targeted stakeholder consultation

FMO conducted several consultation sessions with targeted stakeholders throughout the development of the Position Statement. The objective of these sessions is to tap into the knowledge and experience of specialized stakeholders, which strengthens our Position Statement. These sessions also allow FMO to explain certain choices made. FMO invited a diverse set of stakeholders to provide their comments, suggestions, and feedback on an initial draft Position Statement in Q2 2021. The most recent targeted consultation session on the final draft Position Statement took place in May 2022. Both set of sessions were attended by representatives from, amongst others, Non-Governmental Organizations, banks, IFIs and (E)DFIs, knowledge institutes, and Dutch government.

2.3 Public consultation

On May 3rd, 2022, FMO launched the public consultation of the draft Position Statement on its website and through its own social media channels. All stakeholders and interested parties were invited to submit written contributions until June 10th, 2022. FMO has received contributions from various stakeholders, such as Non-Governmental Organizations, businesses, and industry associations, DFIs, and the Dutch Government.

2.4 Review process

FMO has reviewed all questions and comments received from stakeholders in both set of sessions and categorized each of these contributions according to topic. We have closely evaluated all comments and considered if and how to integrate these contributions or feedback into our final Position Statement. Section 2.5 below presents a summary of stakeholder comments and Chapter 3 of this report presents a more detailed description of the feedback received and our response.

2.5 Summary stakeholder comments

Our stakeholders have indicated that they appreciated the opportunity to provide feedback to the draft Position Statement. Overall, the conversations during the consultation sessions were open and constructive, allowing FMO to better understand the positions of the stakeholders and to provide more clarity about our position and reasoning. The sessions and written feedback provided us with many useful suggestions to improve clarity and refine our position vis-à-vis Impact and ESG management for our investments in Financial Intermediaries.

In general, stakeholders welcome our step to further detail our approach towards Impact and ESG management in our investments in Financial Intermediaries and confirm the need for this Position Statement. Respondents appreciate FMO’s commitment towards more clarity and transparency on this topic and express an increased importance of a policy that is specifically tailored to indirect investments.

Respondents agree that investing in FIs is an important way to increase the reach of FMO’s development activities, as it allows to fund activities that FMO might otherwise not be able to (efficiently) fund. For the purpose of transparency and risk management, it is suggested to improve transparency and disclosure on the different ESG risks that come with investing in FIs, compared to direct investments.

Furthermore, whilst it is acknowledged that the public consultation for the Position Statement on Impact and ESG for Financial Intermediaries is proof of FMO’s commitment towards transparency, stakeholders encourage FMO to further improve clarity and the level of detail within the Position Statement. Moreover, several respondents indicate that it would be in FMO’s interest to improve transparency and clarity on the matter how FMO aims to avoid human rights violations related to its indirect investments and how it interprets its responsibility under the UN Guiding Principles on Business and Human Rights when adverse human rights impacts occur. Furthermore, certain stakeholders urge FMO to increase its disclosure on its indirect activities. Lastly, some respondents indicate they would like a more detailed explanation of how FMO aims to ensure local community involvement in investment decisions that affect local livelihoods. In line with this, FMO is spurred to improve local stakeholder involvement for information gathering.

Finally, some of the respondents mention that FMO is an example for other DFIs and development finance organizations and has set the stage on other topics, such as phasing out fossil fuels. Several respondents encourage FMO to be also set an example with the Position Statement on Impact and ESG for Financial Intermediaries and be even more ambitious.

We have assessed all the feedback received. Where possible, we have adjusted and reformulated the text to improve clarity. In doing so, we have considered that this Position

Statement is a policy document, weighting the level of detail accordingly. Furthermore, the Position Statement is complementary to the Sustainability Policy and other Position Statements and will not duplicate existing policy or include topics which are outside the realm of Impact and ESG. Under section 3, both a more elaborate explanation of the comments, as well as a more detailed explanation of FMO's considerations for its response are given per topic.

2.6 Approval and implementation

The final Position Statement on Impact and ESG for Financial Intermediaries has been approved for implementation[1] by FMO's Management Board on October 4th, 2022. It will be published and effective per October 13th, 2022.

[1] The Position Statement will be implemented in FMO's investment process systematically by July 2023. From the effective date onwards, application of the Position Statement may be piloted to inform systematic and robust implementation.

3. Contributions received and FMO response

A further elaboration on the key feedback raised by our stakeholders in the consultation together with FMO's response is presented per topic below. We include only those contributions that relate specifically to the scope of this Position Statement. Specific questions for clarification and suggestions on the structure, wording and visuals have been considered for an overall review of the final Position Statement and will not be discussed in further detail.

3.1 General specificity and clarity of the language in the Position Statement

3.1.1 General lack of clarity

The overall critique is that throughout the PS, the text is at times too general and/or vague.

As a result, some respondents indicate it is not always clear what is meant – e.g., what the course of action would be under certain circumstances, which standards are being referred to, or what differences exists between lending criteria for direct and indirect investments. The feedback suggests that more detail would provide more clarity. These respondents state that doing so would be in line with market best practices, reduce the risk of misinterpretation and misunderstanding, and sends a message of commitment, which would be appreciated by certain external stakeholders.

FMO welcomes this feedback and has improved clarity in the Position Statement. We improved wording and added more detail, where considered of added value. It is important to clarify that this Position Statement is a policy document that is complementary to the Sustainability Policy. Hence the purpose of this Position Statement is to provide an overview of FMOs considerations on Impact and ESG for investments in Financial Intermediaries, and to clarify how our Sustainability Policy translates to Financial Intermediaries on policy level in case this deviates from the general approach to Impact or ESG. It is not intended to duplicate policy or to be an implementation guide. Operational details, discussing the different context specific situations and factors that FMO might encounter are therefore out of scope of this Position Statement. However, FMO is open to share more information on the implementation of our policy through different channels.

3.1.2 Clarity on EDFI collaboration and harmonized ESG practices in FIs

Certain respondents advise FMO to improve clarity on its collaboration with EDFI partners and harmonized practices in ESG risk management in FIs.

In the feedback several references are made to FMOs collaboration with its EDFI partners and mutually agreed practices in ESG risk management in FIs. The feedback states that in applying the “specific assets approach”, FMO would be departing from the agreed approach where the “portfolio approach” would be followed. While the Position Statement expresses the intention to resort to the “specific assets approach” only in exceptional instances, which still falls inside the scope of the harmonized approach, the concern is that opening this possibility may shrink the space to continue applying the “portfolio approach” going forward.

FMO understands the concern that our interpretation might be perceived as too broad and would therefore like to emphasize our commitment to our EDFI partners to collaborate based on harmonized ESG practices when working with FIs. With this Position Statement, we clarify that the “specific assets approach” is an alternative, suitable only when the instrument, amount, scope is such that a “portfolio approach” is not realistic or commensurate with the applicable leverage. Furthermore, the above assumes that applying the “specific assets approach” represents an 'easier' or more lax application of standards which is not the intention. While the eligibility criteria, categorization and risk appetite statement have not yet been designed, all discussions head in the direction of requiring a minimum standard in order to make the “specific assets approach” possible, and applying the “specific assets approach” will not translate into more simple requirements on ESG, but rather requirements that better match FMOs risk management and impact ability in that particular transaction.

3.2 Transparency and disclosure regarding FMOs Financial Intermediary financing

Respondents feel the Position Statement should be more transparent about the (additional) risks of investing in FIs and should disclose information on its FI investments accordingly.

The majority of the respondents acknowledge that investing in FIs can widen the reach of FMO’s development activities and can be a way to fund activities that otherwise might have been too costly or too complex to pursue. Additionally, it is mentioned that the public consultation for this Position Statement shows FMO’s commitment to transparency. Nevertheless, it is also commented that the Position Statement does not (sufficiently) explain the different ESG risks that come with investing in FIs, and that it would be in FMO’s best interest to improve transparency and disclosure on its FI investments.

Some of the respondents refer to the difference in lending guidelines for direct investments and investments in FIs, where the latter seems to be generally less strict. Clarity about what these differences in guidelines mean regarding risks would be appreciated. Furthermore, stakeholders expect that it would make it easier to understand the contribution of the FIs investment portfolio to FMOs different core SDGs, as well as to identify potential risks. Given the higher risks, it would be expected that FMO is transparent about its engagement with FIs and discloses the terms of these relationships – e.g., FMO’s supervisory role, the compliance procedures, eligibility criteria, accountability criteria and application process. Furthermore, stakeholders feel that FMO could be more transparent about its own evaluation of FIs, and communicate risks and challenges identified. Additionally, for full transparency FMO would ideally also disclose the details of the sub-projects financed via FIs.

FMO applies a structural approach when working with and through Financial Intermediaries, in which FMO helps the Financial Intermediaries build capacity at the institutional level to manage ESG risks that will be onboarded after the start of the relationship with FMO. FMO holds a similar risk appetite for all investments. In terms of the E&S risk analysis, the application is different due to the indirect nature of the loans provided to FIs, and the level of actual E&S risks. FMO is aware that this makes it more complex to identify all the E&S issues in the FI's (FMOs client) portfolio and has therefore developed a methodology that allows to identify the exposures that typically carry the heaviest E&S risks. In addition, a contextual risk assessment is conducted to understand potential exposure of the FI. The indirect nature warrants a different application of the E&S intervention and engagement compared to FMO's Direct investments. The lending guidelines for FIs, or, E&S requirements, are commensurate to the E&S risk profile of the FI based on the abovementioned analysis and are initially directed to the level of the FI. However, a number of these do translate through to the end-beneficiaries. FMO has added text to the Position Statement that helps clarify this point.

Disclosure and transparency are important parts of FMO's stakeholder engagement and effective management of project impacts that overarches the realm of Impact and ESG and are thus beyond the scope of this Position Statement.
FMO is currently reviewing its Customer Disclosure Policy and corresponding underlying procedures, including those for Financial Intermediaries. The review of the Customer Disclosure Policy flows from a 2020 exploration during which stakeholder expectations were assessed and a peer analysis was performed. The review encompasses the following changes (relevant to FIs) during 2022 which will be applicable to new investments from 2023 onwards:

- **The disclosure of Private Equity Funds sub-investments as per IFC –** Sub-investments (new investments) will be published, ex-post and once a year, to FMO's World Map. FMO will disclose name, sector, location of sub-project.
- **Extension of the (general) ex-ante disclosure period, in a risk-based fashion –** for high-risk investments (E&S category B+ and A for direct investments, and A for Financial Intermediaries[2]), with certain exceptions, the disclosure time will be extended from 30 to 60 days.

Furthermore, FMO has explored the disclosure of sub-projects of the Financial Institutions in which FMO holds an equity stake and/or with whom FMO has a debt relationship:

For the Financial Institutions in which FMO holds direct equity, FMO is exploring whether it can start disclosing in certain specific cases certain exposures of these investees. If deemed feasible and relevant, FMO will start following IFC's FI disclosure practice, i.e. with a limited scope. As indicative guidance, disclosure of sub-projects of more than EUR 20 million would be in line with IFC's practice today. Considerations for our exploration would include legality,

[2] FMO does not have a B+ E&S risk category for Financial Intermediaries

risk categories, market sensitivity and investment size, among other things. We aim to decide by the end of this year whether we can proceed on this point.

With its Financial Institutions debt clients, FMO's contribution under the portfolio approach would be less straightforward compared to the Private Equity investments. Financial Institutions lend to or invest their money in a larger portfolio of clients of varying and changing composition, within the boundaries established by their contract with FMO. When looking at the disclosure practices of our peers in this regard, IFC does not generally disclose the sub-projects of its financial institutions' debt customers, but instead it discloses the use of funds or purpose of its targeted credit lines. Under such an 'asset class approach', considerations of disclosure are indeed more realistic. In 2023, FMO will also start implementing the specific assets approach and may apply this approach to some of its loans as described in the Position Statement. However, under the current debt portfolio approach, exact matching of FMO's funds with a sub-project is not possible. In addition, there are other reasons that may prevent us from disclosing publicly the sub-investees of our financial institution customers, including data privacy legislation, operational considerations, security reasons or commercial sensitivities.

We have already committed to private equity fund sub-investment disclosure, and we are still considering next steps with regards to our direct equity in financial intermediaries. The disclosure of FI Debt sub-projects is something we do not consider feasible or desirable in the short term.

3.3 FMO's interpretation of the UN Guiding Principles on Business and Human Rights

The stakeholder feedback offers clarifications on the applicability of the UNGPs to Financial Institutions.

As one of the main objectives, FMO has clarified in this Position Statement how it interprets its responsibility to respect human rights under the UNGPs in its indirect financing activities. In this clarification in the draft consulted Position Statement, FMO cited part of the below paragraph from the UN OHCHR's letter to BankTrack[3]: "In practice, many of the impacts associated with a bank's financial products and services may fall into the 'direct linkage' category. 'Direct linkage' refers to situations where a bank has not caused or contributed to an adverse human rights impact, but there is nevertheless a direct link between the operations, products or services of the bank and an adverse human rights impact, through the bank's business relationships. A situation of 'direct linkage' may occur where a bank has provided finance to a client and the client, in the context of using this finance, acts in such a way that it causes (or is at risk of causing) an adverse impact. Providing a financial product or service

[3] OHCHR response to request from BankTrack for advice regarding the application of the UN Guiding Principles on Business and Human Rights in the context of the banking sector (2017) and confirmed in UNHCHR "Remedy in Development Finance. Guidance and Practice" (2022).

creates a business relationship between the bank and the client for the purposes of the UNGPs. However, the mere existence of such a business relationship does not automatically mean that there is a direct link between an adverse impact and the bank's financial product or service. For UNGP 13(b) to apply, the link needs to be between the financial product or service provided by the bank and the adverse impact itself." Further, UNGP15 explains that 'business relationships' are understood to include relationships with business partners, entities in its value chain and any other non-State or State entity directly linked to its business operations, products, or services".

It is argued in the feedback to our consultation, that FMO's relationships with FIs fall within these categories, which means FMO needs to "seek to prevent or mitigate adverse human rights impacts"[4] in of all their financed activities, including their investments through FIs. It is therefore advised to ensure that the FIs FMO works with have grievance mechanisms and means of compensation in place.

In response to this feedback, FMO stresses we understand that the reference to the opposite of 'direct' is not being 'indirect'. The level of connection that FMO may have to an adverse impact that occurs in a client's portfolio- irrespective of whether FMO is tied to the customer via direct or indirect financing- is however always context specific and situational. Therefore, our 'indirect financing activities' through Financial Intermediaries are not exempt from the possibility of being linked to an adverse human rights impact in a clients' portfolio. At the same time, FMO aims to clarify that both the nature of the business relationship and the context of how FMOs funding line is used in relationship to the adverse impacts caused by the customer are amongst several relevant contextual elements to assess and categorize the connection to an adverse impact.

FMO has made commitments to integrate human rights explicitly into its investment process, as outlined in our Position Statement on Human Rights. Nonetheless, despite our policies and practices being geared towards avoiding harm, FMO's investments in Financial Intermediaries may at times be associated with adverse impacts. As stated in the Position Statement, when a harm occurs, FMO will engage with our customer(s) and seek to build and use our relationship leverage to influence our customer(s) to work towards the cessation and mitigation of such patterns of impact and appropriate remedy. In the revised version of the Position Statement, FMO's view on direct linkage in the different approaches of our customer relationship is further clarified.

3.4 Local stakeholder engagement

Stakeholders request FMO to improve engagement of local stakeholders for information provision regarding investment decisions with respect to FIs that affect local livelihoods and set requirements for FIs regarding local stakeholder involvement and the protection of human rights.

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[4] UN Guiding Principle 13

It is mentioned by some of the respondents that using FIs for the purpose of development finance could increase the risk of cutting communication channels with local stakeholders. Only relying on information from FMO's customers is felt to increase the risk of human rights violations of local communities as it is difficult to monitor and measure the impact on local stakeholders, as this in many cases might mean that information regarding human rights and environmental risk issues does not reach FMO. Stakeholders argue that this could result in higher compensation costs sought by local communities, increase the risk of complaints filed by local communities, and ultimately increases the risk of not completing a project. Partly based on the FMO-A evaluation recommendations, respondents therefore advise that FMO sets up a mechanism through which, in addition to the information received from its customers, FMO collects information for decision-making and monitoring of its investments from other sources.

Furthermore, it is suggested that FMO should provide greater clarity and transparency on these topics, and state FMO's intention to actively engage in efforts to reach out to the local communities. Amongst others, this would require clarity and transparency about how FMO engages with local communities and individuals and the associated risks. For this to be effective, respondents believe FMO should ensure that not only the FIs and its clients are aware of FMO's policy regarding local stakeholders, but that this information also reaches the local stakeholders themselves. This would mean that the local stakeholders are aware of the possibility to give their input or file their complaint(s) and understand how they can do this. Ideally, some of the stakeholders would appreciate to see FMO disclose decisions regarding local involvement as they occur, throughout the lifecycle of a project/transaction. Doing so, would be beneficial for FMO state some of the respondents, as it decreases the chances of challenges further down the value chain, and it increases investor confidence.

Moreover, feedback indicates FMO should be clear about how it will ensure that the FIs and their clients engage with local stakeholders and have grievance mechanisms in place. In line with this, it is suggested that FMO could set minimum requirements for the FIs in which it invests, regarding minimum levels of local stakeholder engagement. In the current Position Statement, little is said to substantiate FMOs approach to "enable increased transparency" of specific assets. Examples of minimum requirements are compliance with FMO's E&S safeguards and Sustainability Policy, international and national law, as well as having effective grievance mechanisms. Respondents feel that at a minimum, FIs should be required to ensure their activities are compliant to these requirements within a specific timeframe.

In FMO's Sustainability Policy one can read that FMO feels strongly about engaging with local communities and stakeholders, as they are key partners in the development process and can often provide valuable input. Also input from various other stakeholders, like civil society organizations and media is seen as highly valuable as it can help to point to potential oversights of risk. FMO therefore aims to reach out to local stakeholders and various others whenever this is possible. Given that FMO's Sustainability Policy is applicable to all its investments, including the ones in FI's, and that this Position Statement is written complementary to the Sustainability Policy, the engagement of local communities is not individually discussed in this Position Statement. The feedback on this matter is well received and will be considered when FMO is reviewing the relevant policies and procedures.

FMO has a wide range of investments, with differing levels of impact on local communities. The extent to which local community engagement is a part of an investment is therefore dependent on the context of the project. Moreover, the influence FMO has regarding local community engagement (of projects) is limited due to the indirect nature of the relationship with the end-beneficiary. FMO will in all cases use its leverage as a funder to encourage the FIs to involve local stakeholders and support the FIs and its clients with building and strengthening their capacity development and grievance mechanisms if needed. Furthermore, in situations where the project or portfolio of an FI is considered to be high-risk, FMO might require the customer to engage with affected communities in a meaningful way and to set up local grievance mechanisms. In cases where FMO reasonably believes we cannot apply or build the leverage at the customer or investee level that would lead to the required improvements we would refrain from investing further or consider exploring solutions for responsible disengagement. The text in the Position Statement has been adjusted to incorporate this more clearly where deemed necessary.

3.5 FMO ambition and demonstration effect

Stakeholders encourage FMO to show even more ambition and use its position to set an example for other Finance Institutions.

A general feeling among the respondents is that FMO is an example for other DFIs and development finance organizations. They therefore encourage FMO to be more ambitious and thereby inspire and encourage others to do the same. Examples of suggestions are to set higher requirements for the FIs FMO invests in, to include wages and job quality as a minimum requirement both for direct and indirect investment, and to focus on ‘doing good’ in addition to ‘doing no harm’. Moreover, it is mentioned that it would be in the best interest of FMO’s own sustainability to disclose a structural approach to institutional learning, which should go beyond remedy to victims or when things go wrong.

FMO appreciates the positive encouragement of its stakeholders to be more ambitious and that we are considered a good example in the field. As such, we strive to continuously improve and reach higher impact by doing good and no harm, at a pace that can be balanced with the reality of our clients while still maintaining our competitive position in the markets. We take note of our stakeholders’ suggestions for further improvements, and these will be taken into consideration when FMO is reviewing the relevant policies and procedures.

3.5.1 FMO responsibility

Based on the above reasoning respondents feel that FMO should take greater responsibility regarding the activities the FIs FMO invests in undertake.

The general opinion of certain stakeholders is that FMO assigns too much power and responsibility to the FIs and their clients. In addition, it is argued that due to increasing scale and complexity of FI financing, there is an even larger need for a more developed and robust system. Such a system should make sure FMO is equipped to recognize, oversee and support FIs in managing its risks, as well as support the FIs clients to manage these risks. Some stakeholders indicate that doing so would require that the potential harms of FI-funded sub-projects fall into the scope of FMO's FI safeguard system and due diligence responsibilities.

Going a step further, is the stakeholder comment that a portfolio approach to FI lending might benefit DFIs like FMO. It is mentioned that DFIs who take a portfolio approach to their FI lending and offer capacity building and safeguard support across the entire portfolio of an FI, are more coherent with the UNGPs. It is commented that besides the fact that a portfolio approach is expected to improve FMO's knowledge as to what is happening within the FIs, it is also expected to build FMOs leverage. Achieving the above would require strengthening FI disclosure requirements, as concluded by the OHCHR in its draft DFI benchmarking study[5]. In all of this, stakeholders find it important FMO recognizes and communicates its own responsibility, as well as clearly communicates the steps it takes to ensure FIs have effective risk management systems in place that comply with FMO's Sustainability Policy.

Through its investments in FIs, FMO reaches MSMEs and increase access to capital, support business growth and channel finance to businesses and end-beneficiaries that FMO cannot directly finance in an efficient manner. The Financial Intermediaries in which we invest are responsible for, and make decisions on how FMO's funding is used, within the boundaries established by their contract with FMO. The relationship between FMO and the end-beneficiary of our financing via Financial Intermediaries is indirect by nature. The benefit of this is that it enables us to finance a larger number and more types of impactful beneficiaries that we could otherwise not reach. In addition, this approach often strengthens the financial sector in a country instead of smaller parallel financing structures.

FMO also recognizes the drawback - as there is no direct (contractual) relationship with those beneficiaries, there is no direct influence. Our FI customers are responsible for and make decisions on how FMO's funding is used, within the boundaries (e.g., the Exclusion List, other applicable requirements outlined in our Sustainability Policy) of our contract. For this reason, working with and through Financial Intermediaries requires a structural approach, one which helps the Financial Intermediaries build capacity at the institutional level to manage risks that will be onboarded after the start of the relationship with FMO. The Position Statement describes how FMO shapes its relationship with Financial Intermediaries and that it uses its leverage to steer the decisions of Financial Intermediaries in the right direction on a policy level.

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[5] Benchmarking Study of Development - OHCHR - Draft for consultation - June 2022

3.5.2 Fossil Fuels

Stakeholders feel that also on the topic of fossil fuels, FMO has set an example and should continue to use this position to inspire and encourage other Finance Institutions.

With its Position Statement on Coal Power Generation and Coal Mining for direct and indirect investments, as well as its Position Statement on Phasing out Fossil Fuels in Direct Investments, some respondents argue that FMO has shown leadership regarding this topic, which has helped to strengthen commitment of other countries and institutions to end direct international public finance for fossil fuels by the end of 2022 and prioritize clean energy finance adopted at COP26 in Glasgow. Nonetheless, respondents express their concern that these international commitments only cover direct finance, while indirect finance is growing. It is claimed that full alignment with the 1.5 ºC pathway would require an end to both direct and indirect finance for fossil fuels or investments that increase fossil fuel usage. Instead, some of the stakeholders feel FMO should focus its (direct and indirect) energy investments towards renewable energy solutions, or at a minimum require FI clients to commit to portfolio decarbonization plan aligned to the Paris Climate Agreement. By doing so, FMO could set the stage and inspire other institutions to move their finance away from fossil fuels entirely. To ensure transparency and correctly assess its progress towards the climate goals, it is felt that FMO should disclose its exposure to fossil fuels not only through direct, but also through indirect investments.

Because FMO has been able to restrict both direct and indirect finance within its Position Statement on Coal Power Generation and Coal Mining, respondents argue that this should also be possible for the position on Fossil Fuels. Moreover, it is advocated that as an EDFI member, FMO has committed to “cease new coal and fuel oil financing and will limit other fossil fuel financing to Paris-aligned projects until generally excluding them by 2030 at the latest”[6], thereby explicitly stating this commitment applies to both direct and indirect finance.

FMO is proud to have set such an example with its Position Statement to Phase out Fossil Fuels from its Direct investments and aims to continue to do so. We are currently reviewing the implementation of our SDG 13 ambitions and climate strategy as part of the development of our new Strategy 2030. Furthermore, FMO is active in the EDFI harmonization workstream on fossil fuels to develop a harmonized list of fossil fuel exclusions fuels, which is expected to also include indirect investments. Discussions to date regarding partner alignment on this subject have proven quite complex, although they help advance the discussion on FMOs position on the management of fossil fuel exposures and decarbonization in indirect investments. As such they are key to inform our eventual Position Statement on the subject. FMO will certainly consider the feedback we received regarding fossil fuel exclusions and portfolio decarbonization in indirect investments in the development of such a position.

[6] EDFI – News item on EDFI Climate and Energy commitment - October 2020