ESG reporting and ESG assurance

How to prepare for ESG (data) assurance and lessons learned

Webinar part 3 (of 3)
September 23, 2020

DUFAS

EY
Building a better working world

Program webinar part 3 - 23 september 2020

1

12.00-12.05
Welcome & introduction
- Iris van de Looij & Remco Bleijs (Dufas and EY)

2

12.05-12.25
ESG (readiness) assurance - Why, how and when
- Remco Bleijs and Jan Germs (EY)

3

12.25-12.50
ESG validation and assurance - Case study
- Martine van Aalst & Erik Smeets (FMO Investment Management)
- Mark Baak (Privium Fund Management)

4

12.50 - 13.00
Q&A, wrap up webinars & closing
- Iris van de Looij & Remco Bleijs

EY

1. Welcome & introduction

Iris (Dufas) & Remco (EY)

EY

2. ESG (readiness) assurance - why, when, what and how

Remco Bleijs & Jan Germs (EY)

EY

WHY? Investors say there is significant value in independent, third-party ESG assurance

- Strong ESG strategies and frameworks will likely be important for companies recovering from the economic impacts of the COVID-19 global health pandemic and demonstrating their resilience to thrive.
- For investors to understand the strength of a company's resilience, they should have insight into the ESG risks that companies face and how they intend to manage them:
  - Credible and trusted ESG disclosures are therefore important, and the research finds significant appetite among investors to build trust in the credibility of ESG disclosures through independent assurance.

From your perspective, how valuable is it to have a third-party firm provide independent assurance of the following data / information?

Percentage of respondents who see independent assurance as "valuable" or "very valuable"

Source: EY Global Investor Survey 2020

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WHY is assurance needed?

to address key risks…including GREEN WASHING

Reputational

- Lack of consistency in defining **what constitutes ‘green’** has led to increased scrutiny on firms marketed products as ESG aligned;
- Increasing pressure from **changing social expectations** to support the transition to a sustainable world
- Customer disengagement
- Shareholder activism

Financial

- Loan / trading book losses
- **Penalties / fines as a result of breaches**
- Litigation costs
- Competitive disadvantage and loss of market share
- **Physical and transition risks**
- **Regulatory Capital**

Regulatory

- **Increasing regulatory requirements and expectations (EU Sustainable Finance plan (Taxonomy, SFDR**) / EU Green Bond Standards)
- **Loss of competitive advantage** by not aligning to regulatory requirements and benchmarks
- **Conduct Risk**

….and increase transparency to support the flow of capital to green behaviour and green products

WHY? Importance and trends in ESG data validation and assurance

1. Non-financial information is increasingly being used in decision-making by stakeholders including investors
2. Risk reduction leading to a lower cost of capital
3. Balanced assurance level on financial and non-financial information
4. Scope and level of assurance influence rating on ESG benchmarks
5. In-depth assurance findings enable further enhancement of reporting reliability & maturity of disclosures
6. Accelerating change and differentiation with competitors

HOW? EY 5 step approach in ESG reporting and ESG assurance

Introduction

The world is facing major global challenges. These can be categorized into **Environmental** challenges taking into consideration climate change, loss of biodiversity and reduction of raw materials; **Social** challenges, addressing issues such as human rights violations and pandemics; and challenges with **Governance** matters such as money laundering, corruption and other ethical issues. Actors within financial institutions, such as **investors** and **financiers**, play crucial roles in helping to solve these **"ESG" challenges**. Together with stakeholders, financial institutions are increasingly making an important contribution to this topic.

Financial institutions are dealing with the ESG aspects of the **"EU action plan on Sustainable Finance"** of the European Commission. This leads to many obligations in the field of Sustainable Finance and ESG. Some of these are:

- The **EU Taxonomy** that will lead to a classification of economic activities of companies in sustainability categories. This should help investors assess how sustainable financial products are (1st alignment reporting mandatory on the situation as of December 31, 2021);
- The **EU Sustainable Finance Disclosure Regulation** (SFDR) which, among other things, leads to the mandatory publication of sustainability policy and information about integration of sustainability risks and information about sustainability of products (from March 10, 2021);
- Amendments to **Ucits, AIFMD and Mifid II** guidelines in the field of sustainability (expected application 2021/2022).

In the environmental field, the Dutch financial sector has further committed itself to comply with the **Dutch Climate Agreement**. This means that the financial institutions involved will report on the climate impact of loans and investments for the 2020 financial year. By 2022 at the latest, institutions will publish their action plans, disclosing their contribution to the reduction of CO_2 emissions. The above leads to more reporting and assurance issues.

ESG topics

The topics below play an important role with regard to EGS for financial institutions and their investments and financing activities:

Environmental (E)

- **Climate change:**
  How are climate risks evaluated for the business and are greenhouse gas reduction targets adequate?
- **Environmental impacts:**
  Are pollution controls sufficiently robust and e.g. biodiversity impacts mitigated? Ie. nitrogen issue, biodiversity.
- **Water scarcity:**
  Water is essential to all forms of life and various processes and is heavily impacted by current economic activities.
- **Resource scarcity/efficiency:**
  Does the issuer's resource management address the right risks?

Social (S)

- **Human / Labor Rights**
  Are there breaches to international conventions and is there an effective human capital development strategy?
- **Health and safety / Vitality:**
  Does the issuer have effective rules in place in order to ensure health and safety? How does the firm look at employee vitality in the long term?
- **Supply chain:**
  Does the issuer have a comprehensive supplier management system in place and are the suppliers abiding by ESG standards?
- **Other topics:**
  The current Covid-19 pandemic shifts attention to topics such as resilience, vitality et cetera.
  The question of paying fair taxes in the countries where companies operate is another prevailing topic.

Governance (G)

- **Board governance:**
  Are governance structures robust and does the Board exercise effective oversight?
- **Business ethics:**
  Is there evidence of effective procedures and processes to mitigate business ethics risks (briber, corruption, etc.)?
- **Other ethical topics such as anti-money laundering and corruption:**
  Does the company have sufficient policies and practices in place against money-laundering, bribery and corruption?

Demand for ESG reporting and ESG assurance

The developments within the financial sector described above entail that, in addition to financial accountability, reporting on ESG information and performance is becoming more and more important. The increased interest from stakeholders for this type of information has led to an enormous increase in the demand for ESG reporting and ESG assurance.

We have designed a 5-step plan for ESG reporting and assurance for ESG information.

EY has developed a 5-step approach for ESG reporting and assurance over ESG information:

01 Identify stakeholders' needs

02 Set up and/or renew policies

03 Define KPIs, collect data and measure results and risks

04 Reporting

05 Assurance readiness check/assurance

EY

05

5) Assurance

HOW? EY 5 step approach - step 5

5A

Assurance readiness check

The reliability of internal reports increases enormously in value when assurance is provided.

1. The starting point can be to have an independent assurance readiness assessment performed, so that better insight is obtained into the quality and verifiability of data systems, the KPIs and (external) reporting processes.
2. This also offers the possibility to critically review the chosen criteria for KPIs and to have the reliability of information pre-verified.

KPI elements	KPI 1	
	After phase 1 and 2	After phase 3
KPI ownership		
Process design		
Process existence		
Internal controls framework		
IT application and controls		
Definition (suitable criteria)		
Sufficient and appropriate evidence and data availability		

5B

Assurance

When the data systems, KPIs and reporting processes are sufficiently in order, the reported information can be verified by an external accountant.

1. During an assurance engagement, points 1 to 4 from the brochure will be included in the assurance procedures. An assurance engagement is aimed at gathering evidence in order to obtain assurance that the report does not contain any material inaccuracies and demonstrating the reliability of the reporting to stakeholders.
2. The assurance engagement may be aimed at a reasonable degree of assurance or a limited degree of assurance.

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HOW? ESG assurance related to standards / norm based

Trending

- PCAF
- TCFD
- SDG's/ SDI's
- GIIN/ IMP

Reporting frameworks

- Global Reporting Initiative
- IR framework (IIRC)
- Sustainability Accounting Standards Board (SASB)

Law and regulation

- EU-Directive for non-financial information
- EU Sustainable Finance Plan
- Richtlijnen voor de Jaarverslaggeving

Benchmarks

- Transparancy benchmark
- Tax Transparancy benchmark
- Dow Jones Sustainability Index & other ESG indices

Guidelines

- ISO 26000
- UN Global Compact
- OECD guidelines

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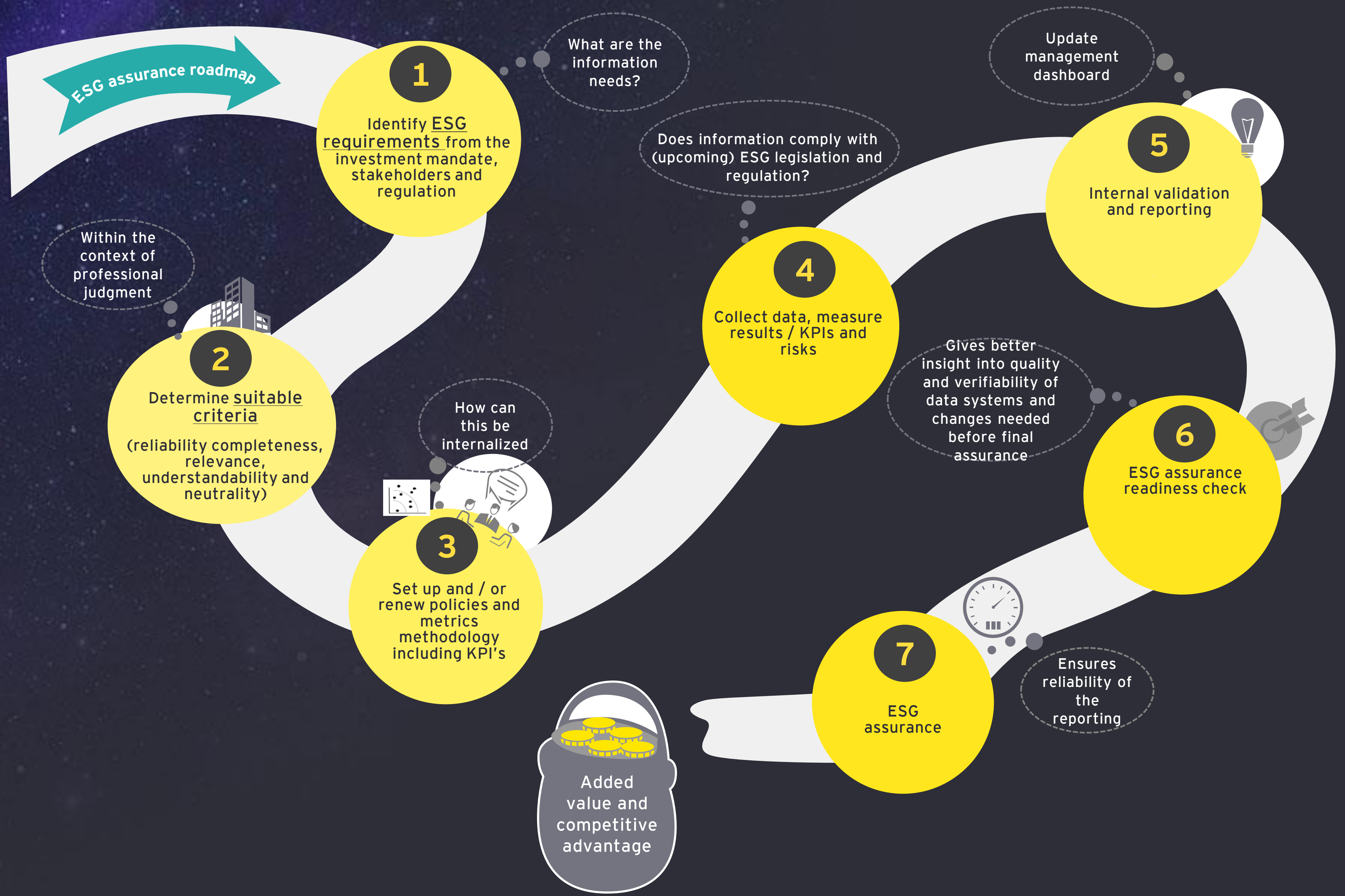
HOW AND WHEN? Good ESG assurance roadmap - *HOW to prepare as a client + pitfalls*



WHAT? Types of assurance standards on ESG info

1. COS 3810N (assurance on -integrated- societal reports / KPI's)
   a) Responsible Investment/ESG reports
   b) (Integrated) Reports with ESG aspects
   c) ESG KPI's

2. COS/ISAE3000 (assurance other than audit or review of financial info)
   a) Green/social impact bonds based on agreed criteria
   b) TCFD / climate reporting
   c) EU Taxonomy/SFDR alignment

3. COS/ISAE 3410 (assurance on emissions)
   a) Carbon / CO_2 accounting
   b) PCAF

4. Other COS/ISAE or reviewprocedures on ESG info

Standard to draft report

Standard to check report

EY methodology

Reporting Standards

A company uses reporting standards and frameworks to draft their report.

Assurance Standards

The auditor uses the assurance standards to verify whether the report is reliable and prepared in accordance with the reporting standards.

EY SAM

The Sustainability Audit Methodology (SAM) is the EY methodology to apply the assurance standards.

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WHAT? 2 flavors of assurance: Limited versus Reasonable

Limited Assurance	Reasonable Assurance
Objective: to conclude that ***nothing*** came to the auditors attention that could lead to the conclusion that the ESG reporting is ***not*** materially misstated (negative assurance statement / review	**Objective:** to conclude that the ESG reporting is free from material misstatement (positive assurance statement)
Procedures: review / little emphasis on effectiveness of internal controls	**Procedures:** audit / emphasis on design and effectiveness of internal controls and extent of testing data dependent on auditors' risk assessment
Business value: 1. Initial step in enhanced reporting reliability& maturity on sustainability disclosures. 2. High-level management letter review findings. 3. Keep in par with competitors.	**Business value:** 1. Balanced assurance level on financial and non-financial information. 2. Scope and level of assurance influences rating on e.g. DJSI. 3. More in-depth recommendations to enable further enhancement of reporting reliability & maturity of disclosures. 4. Accelerating change and differentiation with competitors.

EY

WHAT? 2 flavors of assurance: Limited versus Reasonable

Procedure	Limited Assurance	Reasonable Assurance
Information / data supplied by third parties	External information is deemed sufficient as long as the auditor can gain an understanding of the data and that there is a conflict of interest between third parties and the company.	External information is not deemed sufficient without actually establishing that the process of the supplier data is reliable. There needs to be a conflict of interest regarding the data delivered, i.e. a monetary incentive is present to deliver accurate data (for example a payment structure based on relevant activity).
IT environment	Gain an understanding of the relevant IT processes and perform procedures aimed at assessing the plausibility of the information derived from IT systems.	Gain an understanding of the IT systems, test the IT General controls and the relevant IT-dependent manual and application controls relating to the reported data which is derived from IT systems.
Estimates and assumptions	The auditor shall evaluate whether the company has appropriately applied the requirements of the applicable criteria relevant to estimates and whether the methods for making estimates are appropriate and have been applied consistently and, if any, in changes in reported estimates or in the method for making them from the prior period are appropriate in the circumstances.	In addition to the procedures for a limited assurance engagement, one or more of the following procedures: (a) Test how the entity made the estimate and the data on which it is based. (b) Test the operating effectiveness of the controls over how the entity made the estimate, together with other appropriate procedures. (c) Develop a point estimate or a range to evaluate the estimate. (d) Perform back-testing procedures to establish the reliability of the estimate in prior year.
Internal audit	Not necessary for achieving limited assurance, but will save time and costs of external auditor when they can rely on work performed by IA.	Reliance on internal audit procedures is highly recommended for performance of an effective and efficient reasonable assurance engagement.

3. ESG validation and assurance - Case study

- Martine van Aalst & Erik Smeets (FMO Investment management)
- Mark Baak (Privium Fund Management)

FMO

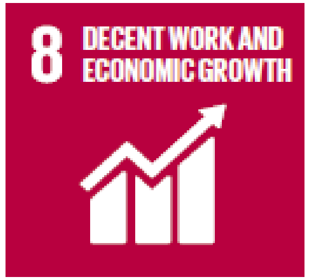
Entrepreneurial Development Bank

A ROAD TO IMPACT

Measurement & Reporting

Agricola Pampa Baja, Peru

IMPACT STEERING ON THE SDGS



We contribute to SDG 8, decent work and growth, by:

- Supporting economic growth and jobs in our markets
- Ensuring working conditions at clients are decent
- Steered through volume and catalyzing, sector and geographic allocation, instead of a label

We contribute to SDG 10, reduced inequalities, by:

- Investing in the very poorest countries
- Investing in inclusive businesses

REDUCING INEQUALITIES LABEL

We contribute to SDG 13, climate action, by:

- Targeting GHG avoidance
- Investing in climate mitigation and adaptation

GREEN LABEL

HISTORY OF IMPACT & ESG IN FMO (~2005 – 2018 and continues)

FMO Entrepreneurial Development Bank

Create value

Avoid eroding value

Compliance:

- Legal compliance
- ESG Standards
- Exclusion list
- ‘Cover everything’ action plans in contracts
- Rule-based approach
- Risk to FMO

Advanced risk management

- Client engagement
- Prioritize ESG action plans
- Risk-based approach Credit ESG integration
- Internal accountability for client performance

Where we are

FMO Entrepreneurial Development Bank

Leadership

- Financing transitions to green and more inclusive economy
- Innovation
- Catalyzing other financiers
- Transparency & accountability
- Reputation and social license to operate
- Harmonization
- Impact measurement Framework Document

Compliance → **Risk Management** → **Value-Add**

FMO Privium
IMPACT
FUND

FMO Privium Impact Fund

Invest for impact & return

Don’t take any unnecessary risks.

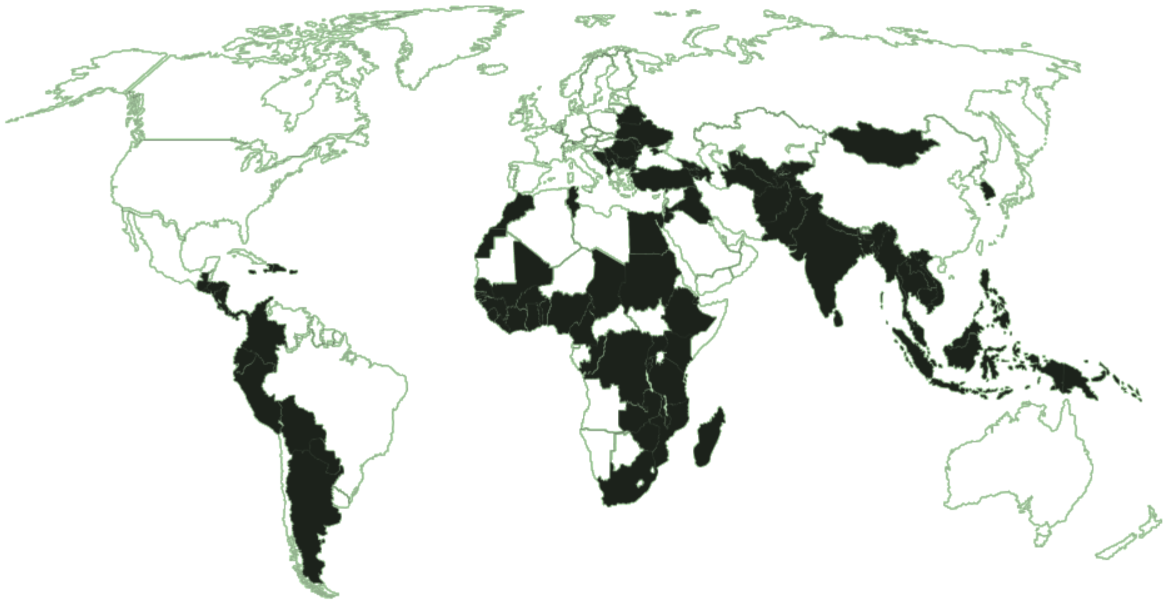
Read the Key Investor Information Document.

THIS IS A MANDATORY ANNOUNCEMENT

www.fmopriviumimpactfund.com

FMO Privium Impact Fund | Investment Strategy

- ✓ - Co-financing with FMO
- ✓ - Diversification across 3 sectors and 4 regions
- ✓ - USD / EUR denominated loans
- ✓ - Senior loans – amortizing with floating interest mostly

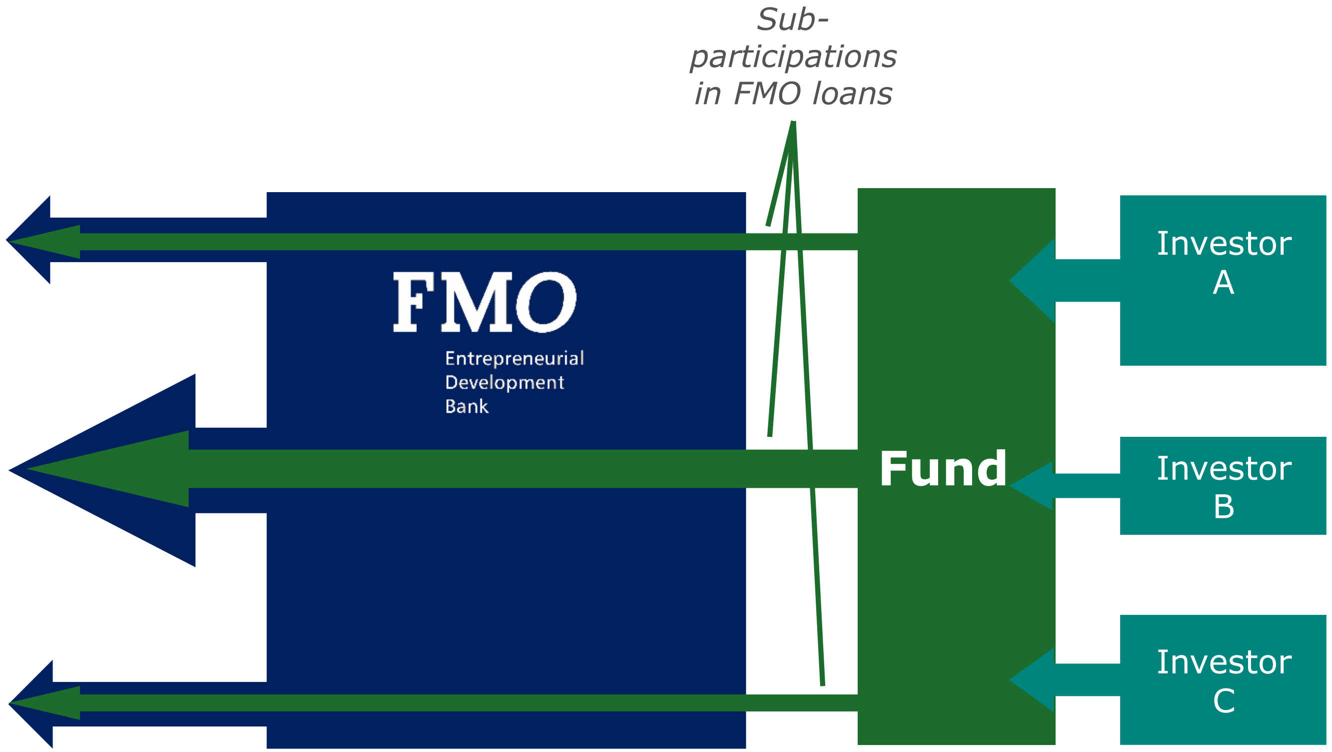


Financial Institutions

Agribusiness, Food & Water

Renewable Energy

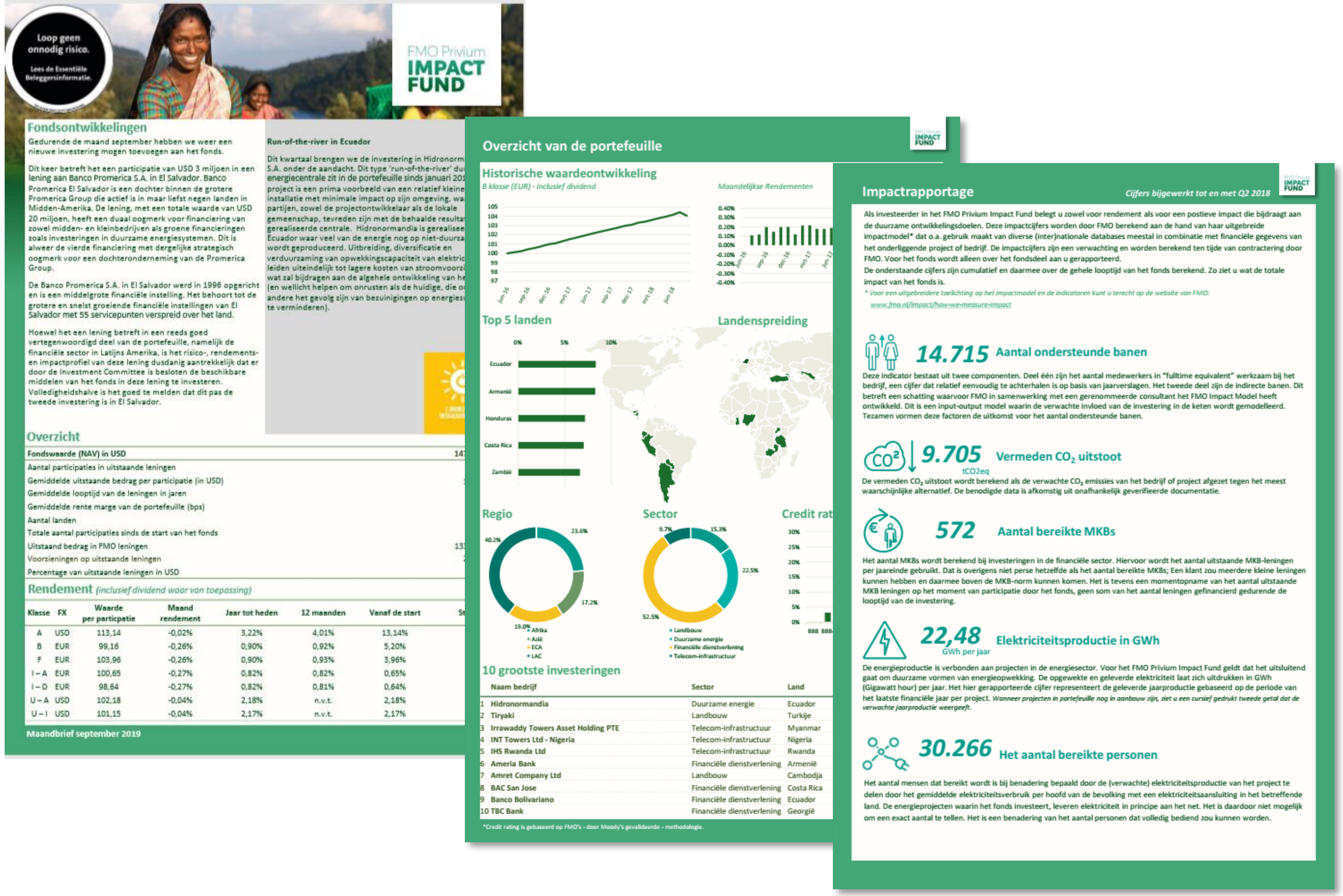
Fund flow



Co-investing with FMO through fund structures is easy

How we reported: cumulative

Quarterly Report



Annual Report

Key Figures

Totals for the Fund		2019	2018	2017	2016
Net Asset Value at 31 December	USD	156,575,599	130,883,698	76,342,756	44,296,69
Number of outstanding units at 31 December		1,410,025.7179	1,163,926.97	656,701.20	426,100.00
Investment result					
Direct result	USD	7,389,470	5,623,079	8,002,912	-911,262
Revaluation	USD	-5,814,769	-5,094,980	-3,169	73,693
Costs	USD	-1,854,401	-1,567,968	-986,904	-305,993
Total investment result for the period	USD	-279,700	-1,039,869	7,012,839	-1,143,562

Investment result per unit[2]					
Direct result	USD	5.24	4.83	12.19	-2.14
Revaluation	USD	-4.12	-4.38	-0.01	0.17
Costs	USD	-1.31	-1.34	-1.5	-0.71
Total investment result per unit	USD	-0.20	-0.89	10.68	-2.68

Total for the Fund – Impact				
Number of jobs supported	27,198	22,953	12,324	6,705
Greenhouse gas avoided (tCO2eq)	20,600	16,040	8,855	1,320
Number of SME loans	1,548	707	457	293
GWh electricity produced per annum	50.77	41.36	16.31	8.24
People served	64,171	41,946	17,522	8,057

General overview at 31 December				
Number of loans on the portfolio	70	56	32	18
Average exposure per loan (in USD)	1,909,292	2,247,459	2,104,475	2,243,401
Average maturity of the loans (years)	5.41	5.75	8.02	7.68
Average interest margin of the portfolio (bps)	485	486	480	515
Number of countries	31	26	21	15
Total number of loans in the portfolio, since launch	75	59	33	18
Total exposure in FMO loans	143,196,905	117,660,765	68,160,424	39,360,043
Total provision on the loans in the portfolio	4,250,000	1,250,000	n/a	n/a
Percentage of loans in the portfolio, denominated in USD	100%	100%	100%	100%

1: The results cover the period from commencement of operations of the Fund at 20 June 2016 through 31 December 2016.

2: The result per unit is calculated using the total number of outstanding unit as per the end of the period.

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More is available at: *www.fmopriviumimpactfund.com*

How we report now: portfolio status

Quarterly Report

(Semi) Annual Report

Key figures

Total for the Fund		30-06-2020	2019	2018
Net Asset Value at reporting date	USD	156,727,505	156,575,599	130,883,698
Number of outstanding units at reporting date		1,421,081.171	1,410,025.717	1,163,926.969
Investment result				
Direct result	USD	896,941	7,389,470	5,623,079
Revaluation	USD	1,188,454	-5,814,769	-5,094,980
Costs	USD	-3,031,859	-1,854,401	-1,567,968
Total investment result for the period	USD	-946,464	-279,700	-1,039,869

Investment result per unit[1]		30-06-2020	2019	2018
Direct result	USD	0.63	5.24	4.83
Revaluation	USD	0.84	-4.12	-4.38
Costs	USD	-2.13	-1.31	-1.34
Total investment result per unit	USD	-0.67	-0.20	-0.89

Total for the Fund – Impact	30-06-2020	2019	2018
Number of jobs supported	49,850	n/a	n/a
Greenhouse gas avoided (tCO2eq)	172,071	n/a	n/a
Financed emission	538,119	n/a	n/a

General overview at reporting date	30-06-2020	2019	2018
Number of loans on the portfolio	72	70	56
Average exposure per loan (in USD)	1,965,403	1,909,292	2,247,459
Average maturity of the loans (years)	5.10	5.41	5.75
Average interest margin of the portfolio (bps)	474	485	486
Number of countries	31	31	26
Total number of loans in the portfolio, since launch	81	75	59
Total exposure in FMO loans	141,509,049	143,196,905	117,660,765
Total provision on the loans in the portfolio	8,737,830	4,250,000	1,250,000
Percentage of loans in the portfolio, denominated in USD	100%	100%	100%

[1] The result per unit is calculated using the total number of outstanding unit as per the end of the period.

More is available at: *www.fmopriviumimpactfund.com*

Lessons learned from assurance procedures on our impact figures in our annual report

Development impact indicators

The Fund Manager reports on a quarterly and annual basis on the impact development of the Fund on the basis of its five impact indicators. Two of these indicators – "number of jobs supported" and "greenhouse gas emissions avoided" – are indicators which FMO also uses in its audited financial statements for impact reporting on its portfolio. The other three indicators – "number of SMEs financed", "Gigawatt- hours of energy generated" and "Equivalent number of people served via power generation" – serve to further illustrate the development goals and impact of the Fund.

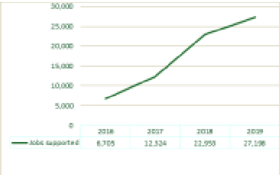
The values of the impact indicators are the outcome of calculations from FMO's impact model[1] – a model that FMO specifically developed (together with consultant Steward Redqueen) to implement its strategy to become the leading impact investor in 2020. The model is designed to paint a picture as accurately as possible of the expected impact; its calculation makes use of macro-economic and greenhouse gas databases. This allows the model to look beyond the impact at the level of the direct underlying investment; it also looks at the impact through the local value chain. The results are always calculated by taking into account the ratio between the funding from the FMO Privium Impact Fund and the total value of the company or project. Only the share attributable to the Fund is reported. To enable you as an investor in the FMO Privium Impact Fund to interpret the impact figures, there is a short explanation of each indicator below. The overview below also reports the impact attributed to all new investments made by the Fund year on year on a cumulative basis towards its five impact indicators. Certain indicators may be (partially) based on projections and expectations. We do not decrease the impact figures because of (early) repayment of a loan as the impact is expected to remain in place and remains (partially) attributable to the Fund's investments.

Since the second half of 2017 we started experimenting with calculating the expected impact per million USD invested in relevant sectors. The purpose was to create further insight into which investments were expected to achieve more impact per million USD invested than others. As this calculation was intended to support us in our search for investments that combine risk, return and impact in the best way, creating the impact where it matters most, we intended to use the figure in the decision-making process. In practice though, comparing the expected impact per million USD was usually not that simple and more like comparing apples to oranges. We have found that we have often taken a more comprehensive look at comparing potential investments and slowly but surely abandoned this practice of using the impact per invested USD million as a metric. As the effect on the decision-making process is in practice absent, we will no longer show a figure per invested USD million. This obviously does not mean that we do not consider the impact for each and for every potential investment.

Number of jobs supported

This indicator comprises two components: 1) The number of employees (FTEs) working at the company – a figure that is relatively easy to come by via the annual reports; 2) Indirect jobs created – this is based on the outcome of FMO's Impact Model. This is an input-output model in which the expected impact of the investment on the chain is modelled. Together, these components form the outcome of the number of jobs supported.

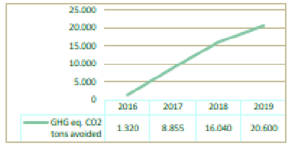
Applicable sectors: Financial Institutions, Renewable Energy, Agribusiness, Telecom Infrastructure



Greenhouse gas emissions avoided

The greenhouses gas emissions[2] avoided are calculated as the company's or project's anticipated CO_2 emissions compared against the most likely alternative. The required data is taken from independently verified documentation and is calculated as tons of CO_2 equivalents per year.

Applicable sectors: Financial Institutions (e.g. when a green line is provided), Renewable Energy



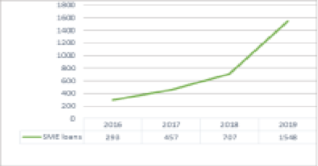
[1] For more information on the impact model and methodologies visit

[2] Greenhouse Gas (GHG, measured in CO2 equivalent) is the most frequently used environmental sustainability indicator, which has a global reporting standard

Number of SME loans

This number is measured for investments in the financial sector, by taking the number of outstanding SME loans at year end. This is not per se the same as the number of SMEs reached – a client could have multiple loans, but has proven to be a reliable proxy. It is a snapshot of the number of outstanding SME loans, not a sum of the number of loans funded during the term of the investment. Loans are considered an SME loan if the outstanding value lies between USD 10,000 and USD 1,000,000.

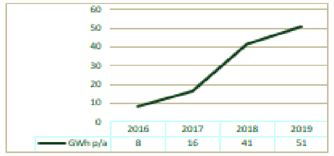
Applicable sector: Financial Institutions



GWh electricity produced

Energy production in the case of the FMO Privium Impact Fund only relates to renewable forms of energy. The electricity generated and supplied is expressed in GWh (Gigawatt hours) per year. A project has a certain amount of Wattage installed and therewith a maximum capacity. This is not the same as the reported figure as a project will never be able to use its installed capacity to 100% of its potential due to internal and external circumstances. This applies to any form of energy project, be it renewable or not. The figure reported here represents the actual annual production of electricity, based on the period of the last financial year per project.
So far there are no projects in the portfolio that are still under construction.

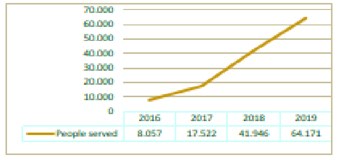
Applicable sector: Renewable Energy



People served

The number of people served via power generation projects is estimated by dividing the annual amount of electric energy delivered to off takers during the reporting period by the power consumption per connected capita. The power consumption per connected capita is calculated as the electric power consumption per capita divided by the electrification rate (source: World Bank / IEA data).

Applicable sector: Renewable Energy



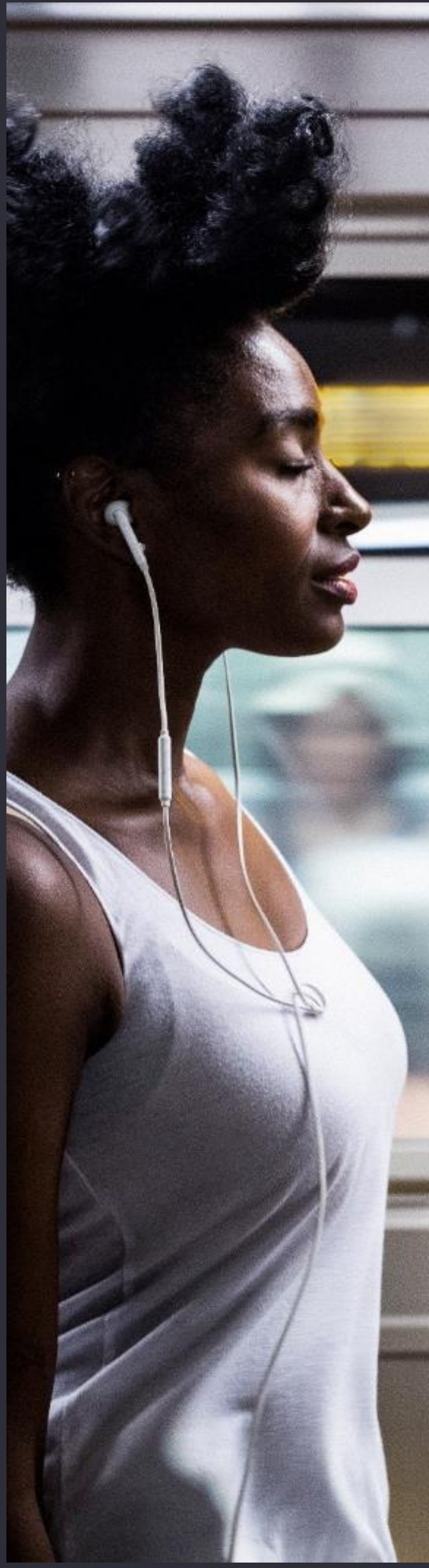
4. Q&A, wrap up webinars and closing

Iris & Remco

Call for action based on our 3 ESG webinars / key takeaways

1. Start today with the impact assessment of EU Sustainable Finance plan (SFDR, EU Taxonomy + Mifid II/AIFMD/Ucits) – see also AFM letter July 3, 2020
2. Apply the 5 step approach for ESG reporting and ESG assurance
3. Be patient for the upcoming harmonization of ESG / NFI reporting standards and start now/continue your journey. Many good examples available
4. Prepare for ESG assurance: 50 shades of Green versus 2 flavors of assurance
5. Be aware and careful for Greenwashing

Happy to support!



Thanks for joining!

Dufas and EY