

## Sustainability-related disclosure: statement on integration of sustainability risks



### Introduction

This statement is published by the SANAD Fund for MSME (SANAD, “the Fund”) on its website in accordance with Article 3 of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR, “the Regulation”). Its purpose is to provide transparency on the Fund’s policies for integrating sustainability risks into its investment decision-making process. ‘Sustainability risk’ as defined by the Regulation means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment. Other documents that are related to this statement include:

- [SANAD statement on adverse sustainability impacts](#) (March 2021) in accordance with Article 4 of the Regulation
- [SANAD statement on the promotion of sustainable investment objectives](#) (March 2021) in accordance with Article 10 of the Regulation
- SANAD Responsible Investment Policy
- Other periodic reports, fact sheets and information published on the [SANAD website](#)

This statement is made on 9<sup>th</sup> March 2021 in reference to the calendar year 2020.

Sustainability risks are defined as an overarching risk of environmental, social or governance events or conditions which have or can have significant negative impacts on the assets, financial and earnings situation, or reputation of the Fund. SANAD’s risk management processes (particularly in relation to credit risk management) incorporate – or are closely integrated with – the evaluation, ongoing monitoring and control of sustainability risks to ensure proper assessment of the risk profile of the counterparties.

Sustainability risks are also addressed within the overall framework of reputational, legal and ESG risk management, benefiting from the Fund’s strong focus on delivering positive environmental and social impact and supporting good governance practices of the investees.

## Context

The SANAD Fund is an impact investment fund that promotes employment and entrepreneurship in the Middle East, North Africa and select countries in sub-Saharan Africa. The investment strategy of the Fund focuses on financing micro, small and medium enterprises (MSMEs), agricultural businesses and low-income households via debt provided to qualified local financial intermediaries and equity financing to qualified local financial intermediaries and fintech companies. The Fund's financing instruments include senior loans, mezzanine and equity instruments.

Investees of the Fund are referred to as "Partner Institutions" (PIs). Eligibility requirements and investment criteria include negative and positive screening, monitoring and active management based on internationally recognized environmental, social, and governance (ESG) standards for the identification, avoidance and mitigation of adverse impacts and ESG-related risks.

The combined effect of these product features is that the Fund inherently has limited exposure to potentially material sustainability risks given its sector focus and selection of PIs. Nevertheless, national ESG regulations and enforcement in the emerging and transitional economies targeted by the Fund are sometimes weaker compared to developed markets and may be subject to change and reform. Moreover, at the time of investing, the Fund's PIs may also have limited ESG management capacity and expertise in which case the Fund, via its [Technical Assistance Facility](#), can provide support to meet its ESG management requirements.

The Fund therefore integrates ESG considerations (including sustainability risks and potential adverse impacts) into decision-making and investee engagement throughout the investment process, including ongoing monitoring and portfolio management once an investment has been made.

## Environmental, Social and Governance Risks

SANAD's Responsible Investment Policy (RI Policy) places a priority on effectively managing – i.e. avoiding, minimizing and mitigating – E&S risks and impacts associated with its investments. Key factors include, but are not necessarily limited to, pollution prevention and control; protection of biodiversity; natural habitats and cultural heritage; occupational and community health & safety; labor standards and working conditions; indigenous peoples rights; involuntary resettlement and human rights.

The Fund's Board of Directors has overall responsibility for setting the RI Policy and overseeing its implementation, both directly and via the Fund's Board-appointed Investment Committee. Remuneration of Directors shall not favor excessive risk taking, not limited to but explicitly with respect to sustainability risks. Primary responsibility for day-to-day implementation of the RI Policy rests with the SANAD's Advisor<sup>1</sup>.

The Fund requires its PIs to carry out their activities (for equity investments) or to use proceeds (for financial intermediaries) in compliance with the SANAD Exclusion List. The SANAD Exclusion List

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<sup>1</sup> The Fund's Advisor is the impact asset manager Finance in Motion.

prohibits financing activities with inherent or elevated sustainability risk, such as activities involving child and forced labour, pesticides/herbicides subject to international bans, activities related to coal, oil and gas sectors, and those involving destruction of high conservation value areas, among others. Equally, PIs have to carry out activities in compliance with national law and in a manner consistent with the key principles of the relevant IFC Performance Standards and International Labor Organization's core labor standards.

At investee level, PIs are subject to E&S screening, and categorization. SANAD's E&S categorization system is closely aligned with those employed as standard by IFC, the Association of European Development Finance Institutions (EDFI) and others.

The investment evaluation includes a thorough E&S due diligence (ESDD), customized according to the initial E&S risk categorization of the investment. The due diligence process includes the use of data intelligence for E&S screening and media reports to identify high-risk factors, which may impact the reputational and/or credit risk. Results of the ESG due diligence form an integral part of the investment proposal and are presented to the Investment Committee, whose investment decision includes the review of E&S factors. Where E&S risks cannot be mitigated to a satisfactory extent, the investment will not proceed.

For direct investments (equity or debt investments in technology companies, typically fintech and agri-tech companies), categorized as medium or medium-high risk, the Fund requires an E&S assessment to be undertaken commensurate to the level of E&S risks of the investment. Typically, such assessments will be used to draw up an appropriate E&S action plan (ESAP). The Fund does not provide financing to direct investments categorized as high risk.

The Fund requires that all its PIs establish or maintain a satisfactory E&S management system (ESMS). PIs and – in the case of investments to financial intermediaries – projects, financed with proceeds of the Fund must comply with the SANAD Exclusion List. The Fund assesses that the PI's in-house employment practices conform with IFC Performance Standard 2 on labour conditions. For equity transactions, the Fund also requires that the PI's in-house employment practices conform with key principles of IFC Performance Standard 2 on labor conditions. Responsible Finance aspects, such as consumer protection, are integrated into the PI due diligence process.

The Fund monitors the E&S performance of its PIs on a continuous basis and requires each PI to self-report to the Fund at least every 12 months. Where appropriate, third party consultants may be engaged to support the E&S monitoring of investments and/or to provide independent E&S monitoring reports.

Engagement with Partner Institutions is an integral component of the Fund's investment process and contribution to positive development impact. This engagement often includes (but is not necessarily limited to) ESG matters. Where appropriate, e.g., when a PI does not meet the required standards of

ESG management, technical assistance or capacity building is provided as part of the engagement with a PI.<sup>2</sup>

In addition, the Fund operates a [communications and complaint mechanism](#) to allow project affected persons or other stakeholders to raise concerns or grievances about the E&S aspects of the Fund's PIs and investments.

Potentially material sustainability risks identified as a result of the Fund's E&S monitoring of a PI are escalated to the Investment Committee and/or Board of Directors according to the nature of the identified risk. Potential sustainability risks are also given systematic consideration before the Fund's Board approves the use of new financial instruments, the creation of new sub-funds, or entry into new countries of operation.

The Fund, with support of its Advisor, maintains a formal and documented E&S Management System to implement the policies and procedures described above. This includes clear requirements for E&S-related functional clearances and the documentation and retention of information on internal decision-making. E&S procedures and decision-making are also subject to internal and (at certain intervals) external review and oversight. Investment staff of the Advisor receive formal induction and periodic refresher training on the Fund's E&S policies and procedures and are supported by the Advisor's in-house team of experienced E&S experts.

The Fund's objective is to identify, mitigate, monitor or refrain from investments with investee-specific governance risk in order to protect the Funds' stakeholders against reputational risk, financial loss or non-compliance with relevant regulatory standards.

Assessment of the investees' governance, i.e. its market position, ownership structure, composition, quality and independence of the Board of Directors and Management, and the effectiveness of control standards are therefore integrated into the counterparty creditworthiness assessment. Equally, the investees' approach to consumer protection, the availability of complaints mechanisms, the assessment of unethical business practices, involvement in crime (including bribery and corruption), associations with acts of violence, and imposed sanctions are an integral part of the investee due diligence process. Governance-related risk management is further supported through the Fund's risk-based AML/CFT framework. The AML/CFT Policy for Investees defines the minimum standards and principles for investee eligibility, as well as detailed KYC procedures and ML/TF due diligence requirements for all potential investees, the scope of which is determined on a risk-sensitivity basis.

Enhanced due diligence is performed for every high-risk investee. Where deemed necessary, an additional external independent background study is commissioned.

Monitoring and reporting of these governance factors is performed regularly based on the investees' risk profile – e.g., high-risk investees are monitored more intensively.

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<sup>2</sup> SANAD focuses on private debt transactions and has only very limited exposure to publicly traded securities or listed companies and as such does not undertake investor engagement within the meaning and context provided by Article 3(g) of Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies.