

Finance United:
Impact Investors, Financial Service Providers and the SDGs
Conference co-hosted by OECD and Cerise+SPTF
30 September 2020
Session Notes

<u>Name of session</u>	The Microfinance Enhancement Facility case study: using standards and social performance management tools for greater impact
<u>Time</u>	11:30 am – 1:00 pm
<u>Moderator</u>	Cécile Lapenu , Executive Director, CERISE
<u>Speakers</u>	Christelle Champetter , Senior Fund Manager, Inn pact Paul Hailey , Head of Sustainability & Impact, responsAbility Dina Pons , Managing Partner, Incofin Investment Management Jens Wirth , Division Head for Financial Inclusion and Global Funds in the Equity and Funds Department, KfW Development Bank (via video)

NOTES FROM THE PRESENTATIONS AND DISCUSSION

Question 1: How can we implement concrete standards in social and environmental performance and do those standards fit together?

Christelle's response:

- Presentation of MEF by Christelle first (see slides)
- Universal Standards for SEPM are aimed for the financial inclusion sector
- MEF has begun to use ALINUS in order to increase harmonization and transparency among its investment advisors. We will explore the strategies, benefits, constraints in this session.

Video from Jens Wirth – KfW:

- See slide for a summary of the commentary from Jens

Paul's response:

- On our side we have a clear impact thesis, which is reflected in the scoring we use for eligibility.
- We are gathering impact data through our process, and we try to learn from best practices of the sector. For example, on client protection we lean on established

practices such as the client protection standards. On governance, we know that it is a key point when it comes to SFDR.

- Sometimes what we do is also a result of some hard lessons learned. For example, in 2010 there was the Andhra Pradesh crisis. Our sector learned lessons quickly and a lot of lived experience was distilled in it. We integrated it in our processes.

Dina's response:

- Incofin is a global impact asset manager. We provide debt, equity, capital, and have an approach that includes TA. See here: <https://incofin.com/>
- For us if you value something, you need to measure it.
- We have an impact committee at Incofin level: any colleague can consult it when there is a doubt on a question of impact.
- How do we make impact governance a reality? We look at how to put standards that are actionable. We have been part of the journey of SPTF for a very long time. We had a social performance due diligence tool. Then SPTF came and we admitted that it was better to embrace the common industry tool. This is the power of the Universal Standards. So we adopted the ALINUS tool. All the investment managers are using it.
- We hope to reduce confusion with social performance by using it, to speak the same language.
- It is true that it is less easy for me to fundraise if I say I have a standardized tool than if I say I have my own proprietary tool. But it is ok. I am happy to take that risk.
- We do not need to be arrogant to say we have our own proprietary tool to analyze the social and environmental performance management (SEPM) of our investees.
- If we all use the same tool and promote the same standards, it will help the real implementation in the field.

Comment from Cécile:

A question for everyone is how can we avoid “rainbow washing” with SDG and instead really implement actions? We do observe that standardization and exchanging ideas about our shared challenges makes us stronger.

Question 2: How has the MEF used the ALINUS tool? How has it helped your reporting and strategy?

Christelle's response:

- The Microfinance Enhancement Facility (MEF) is a big fund: 700 million USD fund, one of the top 5 largest MIVs, investing worldwide, supported by 4 investment advisors
- Context in which we started to work with ALINUS: there was a quite positive vision in the microfinance sector that has reached maturity, with new topics (digitalization, gender lens) and success stories. But in parallel, we saw concerns

regarding client protection, crisis in Cambodia, over indebtedness, etc. The positive impact of microfinance has been questioned.

- In that context, we thought about the way we were measuring impact: all impact investors/funds are sending questionnaires to investees with pretty similar S&E/ESG/impact datapoints. MEF's questionnaire was composed of "standard" datapoints collected by MIVs, on which additional datapoints have been gradually added over almost ten years in order to capture specific requests from our investors and also to enable the fund to respond to surveys. We were adding questions each year every time an investor wanted to dig into one or another subject. In the end, there was a lack of coherence with redundancies and similar questions asked in slightly different manner, also increasing the difficulty for the investees to complete it.
- That's why we started to look at existing options and initiatives and pretty obviously we came to SPTF and CERISE.
- We started analyzing the content of the ALINUS questionnaire and the operational implications this would have on the data collection process as well as the reporting. In parallel, with the support of CERISE we analyzed the portfolio of the fund and we discovered that 40% of the portfolio was already using the ALINUS questionnaire, meaning that it would be something that would not be completely new to all the investees.
- We presented the results of this analysis to the Board of Directors and the Investment Committee. Following their positive feedback we engaged discussion with the investors of the MEF in order to confirm that this change would be fine for them as it would have an impact on how the fund reports and its capacity to provide some datapoints.
- Once all stakeholders gave their green lights, Inn pact and the investment advisors, with the support of CERISE, started to navigate the transition.

Question 3: What did you learn from the reports?

Christelle's response:

- We remain a microfinance investment fund. We continue to report on some traditional data points, like the percentage of women borrower, average loan size of borrowers etc.
- Even if ALINUS is a social assessment tool, we can still continue to collect the key data points we need for our reporting because they are included in there.
- On top of that we collect social performance datapoints in a structured manner. And by using an industry tool, we can benchmark our portfolio. We can benchmark our investee's results at an individual level but we can also aggregate data at the level of the portfolio and compare it to the sector (see slides with graphs presenting benchmarks).
- Now in the report of MEF, we provide analysis at the level of the portfolio and on top we also go deeper in each dimension. This is done through the support of Cerise. Data collection is done through the SPI online platform of Cerise. We

also benefit from the experience of Cerise which provide valuable comments on the results.

- It is valuable for us in the way we communicate with our investment committee. It is also interesting for Cerise because we are bringing new investees in the benchmark, since we require that all investees use ALINUS for reporting.
- It is a win-win situation: you oblige the investees to use the tool while reporting to MEF (no need to complete an additional questionnaire for some investees, opportunity to get to know this tool for others), and then you increase the size of the benchmark.

Comment from Cécile:

You can find the annual report of MEF online:

https://www.mef-fund.com/downloads/annual_reports/mef_annual_report_2021.pdf

Question 4. For investment advisors, how does the process work ? what are the challenges ? What can be the next steps in terms of speaking the same language, reducing reporting burden, etc.?

Paul's response:

- Contrast between us and Incofin was that as an organization, we were more "ALINUS agnostic".
- We were not convinced that it was something that could be systematically applicable for us. When MEF announced that it was going to apply it across the board, we had not set it up already for our own portfolio.
- Now that we have set it up, there are still institutions in our portfolio where ALINUS is not the exact best match, especially on the SME finance side. But we had some pleasant surprises when applying the tool. We had clearly underestimated our investees' ability to put this in place.
- As Dina said, one of the big steps was to train our own staff. So, there was this step of training our investment officers and teaching them how to speak about the tool because they are key point of exchange with our institutions. And fortunately for that, there is extensive training material provided by Cerise.
- I was pleasantly surprised by how it seemed logical for the investees to use this tool. But, I should not have been surprised because a lot of data that is requested in the tool is based on experience and on the kind of questions investees were getting anyway from investors like us.
- So, the investees were able to take up the tool quite easily, the platform is quite intuitive as well.
- In the long run, a clear added benefit is to push towards harmonization. Even if we are not applying ALINUS in the whole portfolio, we are still integrating key questions in our questionnaire, in order to decrease reporting burden on an investee. We have to avoid a situation where an investee is being asked a slight variation on the same questions or metrics by 20 different investors.

- This is going to be even more important with the advent of SFDR and the Principle Adverse Sustainability Indicators, where we will all be asking for the same data, and need to have a harmonized approach.
- In that respect, ALINUS is also very good in concentrating minds. Even if you are not fully applying it everywhere, you can use it as a benchmark.

Dina's response:

- Incofin was in a different position: all our financial inclusion funds are using the ALINUS questionnaire. For us it was not a challenge but a great news.
- I agree with what Paul said: ALINUS was created with a strong microfinance mindset. Our goal is to push responsible finance practices to beyond microfinance.
- However, the framework of the tool still makes sense. It depends on what type of materiality or answers you expect. For example, preventing over-indebtedness practices of clients (= assessing the repayment capacity analysis that an FSP does) applies to MF and SMEs. In this regard, the tool is relevant in its scope and what it looks for. What we need to be careful on is how we train our staff on how not to ask the questions the same way depending on where you are: e.g. rural cooperative with average loan size 1,000 USD versus urban SME with average loan size 15,000 USD. We need to tell our staff “you are not an auditor, you are an investor who is supposed to provide an opinion on a certain number of practices”.
- Second important message for us to our staff: you do not have a SEPM conversation during due diligence with a SEPM manager, but you need to have it with all managers. E.g. when you interview the CEO, you need to ask him how he takes into account the social and environmental goals in his strategy. You will probably have read the business plan before the due diligence. You can raise awareness on what you have read and you can start the conversation from that angle. And you need to have the same type of conversation with each manager to see what he thinks or maybe to raise awareness on some points.
- Another key learning : this is a standardized tool. It helps equip your people to have meaningful conversation with the data. Useful in the entire interaction with the investee. It's not just pushing on them some questions. If you just do a reporting conversation, you have lost the battle of impact.
- For us, we use ALINUS to make the investment decision. We use it to decide to disburse a loan and we ask investees to report on ALINUS after the loan is disbursed. There is a clear link for them that this assessment is used for investment decisions.

Comment from Cécile:

So for both of you the capacity building of the staff is important. It's important to note that in using this tool, you can check on practices such as promotion of women's empowerment or having a non-discrimination policy. We are also pushed by the regulators within the Sustainable Finance Disclosure Regulation (SFDR) framework with all its complexity. For example, the question of gender pay gap can bring very valuable information. What we saw in the first pilot we did, we go from minus 7 to plus 54. When

your data show plus 54, you can check the benchmarks, for example from OECD (<https://data.oecd.org/earnwage/gender-wage-gap.htm>) and try to understand where it comes from.

Question 5: How did you make decisions with the data?

Christelle's response:

- Since we started using ALINUS for data collection and reporting we had in mind to go one step further and to use the data and benchmark information for investment decision making.
- We started one year ago by asking the investment advisors to provide the ALINUS score to the investment committee as part of the investment proposal, when available.
- For Incofin, all the investees are in the process. So it was easy. This is not the case for the other investment advisors.
- When the data is not available, we have a clause in the loan agreement by which the investee commits to report on social and environmental data to the fund by completing an ALINUS questionnaire. Consequently all ALINUS score are not available for investment decision making or for the annual reporting but it is a journey.
- The idea is not to only get data but also to start engaging and create interesting debates at the level of the investment committee.

Comment by Cécile:

It is noteworthy that 40% of the portfolio was using ALINUS and aligned with the Universal Standards even before MEF decided to use ALINUS. That was our goal: to reduce burden on FSPs when we created ALINUS. The more we have investors using the same tool the more we will be aligned on this theory of change.

Questions & Answers with the Audience

Audience question 1: At the MEF, did you put the score of ALINUS in the investment committee? Are you using it for decision making? And does the investment committee know how to analyze it. For example, in our case we train our investment officers but not necessarily the board of directors.

Christelle's reply:

- Currently, the investment advisors are providing 2 sets of information:
 - Own proprietary tool: e.g, responsAbility is providing an ESG score – Symbiotics has a system out of 5 stars. For an investment committee it is not easy to compare the 82% of ResponsAbility versus the 5 stars of Symbiotics
 - ALINUS helps to improve the comparability of all the deals as it speaks the same language for all advisors.

- When we started the process with CERISE, it was clear for us and the board that some training should be put in place at the level of the investment advisors, Innpact as well as the Board and the Investment Committee, with a dedicated budget.
- There was also an important discussion about how to exchange data (direct input in the platform vs upload from the investments advisors based on Excel spreadsheet) as well as the rights attached to the data in the platform.
- We were convinced that the ALINUS tool was interesting at many levels: reporting for the fund, investment-decision making, get the investment advisors and the investees to know about the tool and its potential internal usages (out of reporting for MEF), data sharing, limit reporting burden on the investees.
- But then of course, one challenge has been to convince the investors to agree that the MEF starts using ALINUS, meaning that some specific datapoints would not be collected anymore. So we engaged discussions with KfW, the World Bank, etc.
- At the beginning it seemed super ambitious and we thought the project would be terminated after the first round of discussions with the key initiators. It turned out that despite the impact on the reporting and after presenting the tool and what it could bring the fund obtained green lights from its key investors pretty quickly and with limited additional discussions.
- Positive feedback we can share: it is possible. We did it. MEF is a big fund, with deals brought by 4 investment advisors, both public and private investors. After engaging discussions with all stakeholders and since the tool is the result of an industry work and it makes sense, the stakeholders were pretty quickly convinced that maybe it an interesting way to start thinking of social and environmental performance and also to reshape how data are collected worldwide.

Cécile's reply:

For me the value of the tool is that it is a bottom-up approach with the Universal Standards. It is aligned on Impact Standards from OECD and UNDP. The question was on the financial inclusion side: what are the practices in the field and what data do we need? The data that come from the field and that are collected in the field are probably the most interesting ones. This is maybe one of the point that simplified the discussion with KfW and IFC.

Audience question 2: Any discussions with regulators?

Cécile's reply:

Yes. Regulators in different countries are considering, or have already, implemented the Universal Standards in their own regulation. They use them to push the sector a step forward: governance, transparency, confidentiality of data and protection of customers are key issues that are taken into account by the regulation. We see more and more this. Yesterday we had the examples of Egypt, Nicaragua, Cambodia, Philippines.

Comment from Jurgen' Hammer, Director of SPTF Europe:

For regulators, it is important that what they consider integrating in the regulation is stable. The maturity that we have achieved and in particular in client protection now makes the discussion with regulation much more active than it used to be. The regulators are realizing that social performance and client protection are related to risks in the financial markets, so this is why they think about integrating it. Many regulators are approaching us right now because they need to update their regulatory framework. They saw that there is something available that has been tested, that is practical and that covers aspects of the regulator risk supervision of financial market stability. In addition, it has been tested by the dozens of investment officers of the funds who use it for due diligence. What we heard in the panel yesterday with regulators is that they will not necessarily take the entire SPI, but there are elements in SPI that make a lot of sense for regulators and supervisors. We need to be aware that things in the end do not happen without regulation. We do not have transparency in any market if there is no regulation. So regulation is necessary.

Audience question 3: From my experience, it is very difficult for investors and DFIs to give up their own tools and use another. Paul, how did you succeed in convincing the board or your credit department to accept ALINUS?

Paul's reply:

It is less of an issue when it comes to financial inclusion. The majority of our private investors have tended to accept that, given our track record, when we propose a framework, this is the one that is based on industry best practice. Where it can be harder is in the other sectors, e.g., agriculture or energy, where potential E&S risk can be higher and there can be less consensus around what industry best practice is. But typically in these discussions, when you look at what is really material, what is well founded, what makes sense for us to gather, you can end up with a very interesting framework. For us it was less a question of convincing our own board or management but more a question of convincing the investors.

Christelle's reply:

The structure and the way the questions are organised around the 7 dimensions makes sense. Most of the aspects that we were trying to capture with our questionnaire were covered in the tool. We presented the tool and our arguments to the portfolio managers that are in charge of the MEF at the level of our key investors. We showed them the lack of coherence of the MEF questionnaire, the low response rates for some datapoints, the redundancies, also highlighting the impact of their individual demands on the overall coherence of the questionnaire and the difficulty for the investees to complete it. After that it was easy to convince them to move to an ALINUS questionnaire to talk the same language with the investees. Following these initial discussions, they each led the internal discussions within their respective institutions.

Audience question 4: We do not do reporting for reporting. We do it for actions. Can you give an example of an action that was taken based on ALINUS scores?

Christelle's reply:

We are currently trying to embed ALINUS in the investment decision process. We are not yet there but we are moving forward. We want to do more with the data. But this is one of the limits that we see in the tool. An ALINUS questionnaire is normally valid for 18 months which is disconnected to the life circle of an investment fund (annual reporting). In an ideal world we would be able to get updated on a yearly basis, both the quantitative data and the inputs for the 7 dimensions. This cannot be achieved for now which does not mean that the MEF cannot use and benefit from the tool. An important aspect was for the board and the investment committee to be reassured that the MEF is successful in building a portfolio of MFIs with strong social performance. And it is the case: the ALINUS results of the MEF are above the benchmarks on all dimensions, These results can be considered as an external validation that the processes put in place over the last 10 years were actually well implemented, combined with the robust processes of the four investments advisors. There is so much more we would like to do with the date but over the past 12 months, instead of doing more on integrating the social aspects in the processes, we are using a lot of energy and time to try to tackle SFDR issues, like all actors in the industry.

Dina's reply:

For us we have a minimum score that is a key threshold. In fact, we never have a deal that is rejected at the level of the investment committee because it is the work of the debt director to guide his team to not spend time on deals that have a very low social and environmental performance, so low scores are identified before the investment committee. Also, we have an internal investment committee which assesses every file and only the approved files are presented to the MEF IC. This gives MEF the insurance that a file with a too low ES score would not be presented to them. I can give you another example on how we use ALINUS score to make investment decision: because of concern of aggressive growth in the Cambodian microfinance market, we have set a minimum score expected on client protection which is specific to Cambodia. By having the ALINUS score + by having set up the minimum CP standards in this market, it helps us screen the right investees. And we have trained our people on that.