

Disclosure statement Operating Principles for Impact Management

Norfund
DATE, 2021

Norfund is a founding signatory to the Operating Principles for Impact Management (the Impact Principles). The Impact Principles provide a reference point against which the impact management systems of funds and institutions may be assessed. They draw on emerging best practices from a range of asset managers, asset owners, asset allocators, and development finance institutions. This Disclosure Statement affirms Norfund investments and operations are managed in alignment with the Impact Principles. Total committed capital under management in alignment with the Impact Principles is US\$ 3 322.8 million as of December 31st, 2020.

Principle 1 - Strategy

“Define strategic impact objective(s), consistent with the investment strategy: The Manager shall define strategic impact objectives for the portfolio or fund to achieve positive and measurable social or environmental effects, which are aligned with the Sustainable Development Goals (SDGs), or other widely accepted goals. The impact intent does not need to be shared by the investee. The Manager shall seek to ensure that the impact objectives and investment strategy are consistent; that there is a credible basis for achieving the impact objectives through the investment strategy; and that the scale and/or intensity of the intended portfolio impact is proportionate to the size of the investment portfolio.”

- Norfund is fully funded over the Norwegian government development budget and the fund's operations and mandate are set out in the “Norfund act” (Act nr. 26 of 9th of May 1997). In accordance with this law, Norfund invests with a development objective and is assessed based on development impacts achieved. Norfund aims to achieve impact on all investments and report on its operations to the Ministry of Foreign Affairs.
- According to its parliamentary mandate Norfund operates to “assist in developing sustainable business and industry in developing countries” by taking on high-risk investments through equity, loans or guarantees.
- Norfund's Board of Directors (BoD) has approved the fund's strategy for 2019-2022 with clear targets for portfolio impact performance. These targets are aligned with specific SDGs and SDG targets. Norfund's investment areas and priority markets are selected based on where we are likely to have the most development impact.
- In accordance with the strategy, Norfund has four investment areas; namely Clean Energy, Financial Institutions, Scalable Enterprises and Green Infrastructure (as of 2019). These have been chosen based on development rationales formalised in sectoral theories of change for each investment area. Each investment area is then tracked against specific impact targets, as well as other impact KPIs tracking cross portfolio impacts, all aligned with the SDGs.
- In order to ensure investments are conducted in areas with the highest expected impact, Norfund also targets its investments geographically, having defined core countries, extended reach countries and vulnerable states, with specific investment criteria/modalities based on country grouping.
- Norfund has set targets for portfolio shares invested in specific sectors, geographic regions and instruments, defined through assessments of additionality and impact expectations.

While not absolute, these targets act as signposts to ensure that allocations are made in line with strategic priorities.

- Finally, in order to deliver on our mandate to support sustainable businesses, Norfund also operates with a self-determined target return of 5% at portfolio level for the strategy period. This reflects that profitability of investees is considered key for impact sustainability and to deliver on our mandate; a business that runs deficits will not survive. All returns are reinvested.
- The Norfund project cycle includes multiple stages of assessments and approvals. Investment departments undertake all activities, screenings and analysis related to the investment, but require approval at key stages for projects they deem promising. After initial screening, Clearance in Principle (CIP) by the Investment Committee (IC) is required to proceed to due diligence, deeper analysis and negotiations. Final Approval (FA) by the IC is then required before an agreement can be signed. Investments exceeding certain limits and investments not fully within the fund's strategy require, in addition, approval by the BoD. At the other end, an exit approval by the IC is required for equity sales and a post-exit analysis is submitted after completion of an exit as lessons learned documentation.
- The IC is constituted by Norfund Management staff members, an ESG officer and external members, whose objective is to ensure the quality of Norfund investments and exchange of experience within Norfund. The IC is headed by the Chief Executive Officer (CEO). The committee considers financial, impact and ESG aspects of investments.
- The BoD consists of members appointed by the General Assembly, which is constituted by the Minister of International Development, and in addition two members elected among and by Norfund's employees.
- For each proposed direct investment, project managers are required to present a baseline and target for primary KPIs before the investment decision is taken, allowing for subsequent progress tracking on project and portfolio level against target impact.
- For investments through funds, the requirement of a baseline and target is currently waived due to the inherent uncertainty regarding exact fund investments. Once invested, development impact of fund investees is tracked in the same way as direct investments. The development impact achieved through fund investments are included in strategic goals for the aggregate portfolio under the Scalable enterprises department.

Principle 2 – Management of Impact

“Manage strategic impact on a portfolio basis: The Manager shall have a process to manage impact achievement on a portfolio basis. The objective of the process is to establish and monitor impact performance for the whole portfolio, while recognizing that impact may vary across individual investments in the portfolio. As part of the process, the Manager shall consider aligning staff incentive systems with the achievement of impact, as well as with financial performance.”

- Norfund operates with a development mandate, with investment strategies developed based on this mandate. Impact considerations guide the choice of investment areas, geographical allocations and choice of priority instruments. This is designed to optimise impact at portfolio level through allocation and instrument choice.
- Norfund performs primary data collection on development impact annually for the entire portfolio. This allows for tracking of developments in individual investments and aggregate to the portfolio level.

- Development impact data is published yearly in the report on operations, presenting each investment area's financial and development impact results.
- Norfund maintains a limited bonus policy with 2.5 percent of total salary budget available for bonus considerations. Bonuses are awarded based on qualitative assessments of outstanding performance by individuals to resolve specific cases or longstanding issues. This is to incentivise efforts to improve quality in Norfund's processes and is not connected to financial return.

Principle 3 – Additionality

“Establish the Manager's contribution to the achievement of impact: The Manager shall seek to establish and document a credible narrative on its contribution to the achievement of impact for each investment. Contributions can be made through one or more financial and/or non-financial channels. The narrative should be stated in clear terms and supported, as much as possible, by evidence.”

- When Norfund considers investments, all investments must demonstrate expected additionality.
- Norfund invests using an additionality framework that establishes expected additionality based on indicators relating to context, investment modality and project characteristics. The framework is based on the OECD definition of additionality and includes both financial and value (non-financial) additionality.
- For investment committee notes for Clearance in Principle (CIP) and Final Approval (FA), project managers must include the investment additionality score, generated with Norfunds additionality calculator. The calculator scores the project based on framework indicators.
- In addition to the framework score, the project manager must include a written description of Norfund's additionality, highlighting any aspects not captured by the framework.
- Norfund has developed sectoral theories of change, based on reviews of relevant literature, that outline the mechanisms and channels from action to impact, based on literature reviews. These outline the narratives and rationales that guide Norfund operations.

Principle 4 – Assess Impact

“Assess the expected impact of each investment, based on a systematic approach: For each investment the Manager shall assess, in advance and, where possible, quantify the concrete, positive impact potential deriving from the investment. The assessment should use a suitable results measurement framework that aims to answer these fundamental questions: (1) What is the intended impact? (2) Who experiences the intended impact? (3) How significant is the intended impact? The Manager shall also seek to assess the likelihood of achieving the investment's expected impact. In assessing the likelihood, the Manager shall identify the significant risk factors that could result in the impact varying from ex-ante expectations.

In assessing the impact potential, the Manager shall seek evidence to assess the relative size of the challenge addressed within the targeted geographical context. The Manager shall also consider opportunities to increase the impact of the investment. Where possible and relevant for the Manager's strategic intent, the Manager may also consider indirect and systemic impacts. Indicators shall, to the extent possible, be aligned with industry standards and follow best practice.”

- Investment committee notes for CIP and FA include a section wherein the project manager states the expected development impacts of the proposed investment.
- Since October 2018, the template for preliminary approval has also included a requirement of a baseline and target on primary KPIs.
- KPIs are set, monitored and reported using the Harmonised Indicators for Private Sector Operations (HIPSO) where possible and indicators aligned with standardised metrics when not available in the catalogue of HIPSO. Indicators are tracked on an annual basis.
- Risk factors of an investment are rated, and necessary mitigating measures are mapped in investment committee notes for preliminary and final approval
- Where specific opportunities are identified, Norfund can utilise a business support facility to co-finance complimentary impact-enhancing measures with grant funding (e.g. leadership training program for female employees, investment-related community development initiatives, etc.).

Principle 5 - ESG

“Assess, address, monitor, and manage potential negative impacts of each investment: For each investment the Manager shall seek, as part of a systematic and documented process, to identify and avoid, and if avoidance is not possible, mitigate and manage Environmental, Social and Governance (ESG) risks. Where appropriate, the Manager shall engage with the investee to seek its commitment to take action to address potential gaps in current investee systems, processes, and standards, using an approach aligned with good international industry practice. As part of portfolio management, the Manager shall monitor investees’ ESG risk and performance, and where appropriate, engage with the investee to address gaps and unexpected events.”

- [Norfund’s ESG policy](#) describes the sustainability commitments of Norfund when we finance projects and how we commit the companies we are directly invested in to responsible business practices.
- The policy covers our direct investments in the form of equity and loans to investees as well as investment through subsidiaries, in private equity funds, financial institutions and designated platform companies. We adapt our approach to best assess the ESG risks connected to the type of investment we make.
- The IFC Performance Standards for environmental and social sustainability (“[IFC Performance Standards](#)”) and the [World Bank Environmental, Health and Safety Guidelines](#) are the main standards for operationalising Norfund’s sustainability commitments. We are also committed the [Harmonised EDFI Exclusion list](#), EDFI Principles for Responsible Financing and the Corporate Governance Development Framework. In 2020 Norfund developed a [Climate Position](#) and adopted the EDFI Fossil Fuel exclusion list.
- The policy also outlines the key elements of our E&S work:
 - o We incorporate appraisal of Environmental & Social risks into our analysis and decision-making processes
 - o We require the companies we invest in to adhere to high standards
 - o We monitor and promote environmental and social performance throughout our investment period
 - o We work to improve capacity and competence
 - o We promote transparency and disclosure of performance
- Each investment department has dedicated ESG specialists.

- Project Managers, investment staff and the management team also receive ESG training.
- Project Managers are responsible for initial ESG risk assessments during the investment exploration phase, with level of ESG specialist involvement based on the initial risk rating.
- Norfund uses the EDFI harmonised categorisation system (e.g. A, B+, B, C: FIA, FIB, FIC) to reflect the potential magnitude of E&S risks of its investments and allocate resources according to risk.
- When co-investing with other development finance institutions with trusted ESG systems, Norfund collaborates on ESG assessments.
- For financial institution (FI) investments, due diligence requires the review of the investee's existing portfolio to identify high risk sectors and the appropriateness of the FI's ESG management system and ability to mitigate risks.
- ESG incidents are reported and tracked, with annual or quarterly E&S reporting depending on risk rating.
- Norfund is a signatory to the corporate governance development framework ([CGDF](#)) and utilises this framework for its corporate governance risk assessment when deemed necessary.
- Every investment decision is taken based on two investment committee notes (Clearance in Principle and Final Approval), wherein the investment team includes their ESG assessment in a separate section, ensuring that ESG considerations are highlighted at both stages of the decision-making process.
 - o An assessment using available data is undertaken for the initial screening process before seeking Clearance in Principle.
 - o An ESG Due Diligence is undertaken and reflected in the note for submission for Final Approval decisions, including outlines of mitigating measures if necessary
- Finally, an ESG officer is a member of the investment committee, enabling ESG concerns to be raised and considered in the committee itself during the decision-making process.

Principle 6 – Monitor the progress of each investment in achieving impact against expectations and respond appropriately

“Monitor the progress of each investment in achieving impact against expectations and respond appropriately: The Manager shall use the results framework (referenced in Principle 4) to monitor progress toward the achievement of positive impacts in comparison to the expected impact for each investment. Progress shall be monitored using a predefined process for sharing performance data with the investee. To the best extent possible, this shall outline how often data will be collected; the method for data collection; data sources; responsibilities for data collection; and how, and to whom, data will be reported. When monitoring indicates that the investment is no longer expected to achieve its intended impacts, the Manager shall seek to pursue appropriate action. The Manager shall also seek to use the results framework to capture investment outcomes.”

- As part of investment agreements, Norfund requires investee reporting on key development impact indicators, in line with Norfund's yearly reporting schedule.
- Norfund utilises impact monitoring indicators based on relevant HIPS0 definitions, to monitor the development impact performance of investments. Disaggregated by gender wherever possible.

- Norfund collects development impact data on all investments on an annual basis through its development impact reporting system. All used and reported numbers are actual reported numbers from investees, not estimates made by Norfund.
- Each direct investment requires a baseline and target for key KPIs at time of investment. Progress can then be tracked annually against target impact.
- Targeted, in-depth case studies and impact studies are undertaken in certain instances to capture wider development outcomes of selected strategic investments.

Principle 7 - Exits

“Conduct exits considering the effect on sustained impact: When conducting an exit, the Manager shall, in good faith and consistent with its fiduciary concerns, consider the effect which the timing, structure, and process of its exit will have on the sustainability of the impact.”

- Norfund operates without a defined or hard exit timeframe for direct equity investments, as this allows for flexibility in the timing of exit. The life of an investment is determined primarily by how long Norfund’s investment is considered additional.
- An exit is considered when Norfund no longer sees itself as additional, meaning that the investee is self-sufficient and can continue to operate and grow with commercial financing and investors, or if an investment is seen to require a partner other than Norfund with specific competency to ensure future growth and sustainability. An exit is then pursued if an appropriate buyer can be identified.
- Each equity exit (with exceptions for certain pre-defined exit arrangements) requires a presentation to the investment committee for approval. This is documented with an exit approval note presenting the overall situation of the investment, as well as options and recommendations for exit strategies. This document includes a section specifically on development impact.
- Investment sustainability is an important element of the exit decision. This is considered key for maintained development impact and can affect the timing, structure, and choice of buyer.
- Norfund is currently assessing its exit processes, including exit planning, potential investment manual updates and investment document templates.

Principle 8 – Lessons learned

“Review, document, and improve decisions and processes based on the achievement of impact and lessons learned: The Manager shall review and document the impact performance of each investment, compare the expected and actual impact, and other positive and negative impacts, and use these findings to improve operational and strategic investment decisions, as well as management processes.”

- Every equity investment exit requires a post-exit note, wherein process, management and results are discussed. A specific section on lessons learned is written and included and development impact is considered along with financial and ESG performance.
- An investment baseline and target are mandatory inclusions in investment decision papers and project impact performance is assessed at exit in the exit approval note.

- Norfund regularly analyses the development of exited projects at the portfolio level. Data is collected for investees after Norfund exit and an analysis is conducted for investee survival and post-exit performance.
- To improve on its post-exit tracking, Norfund established a routine in 2019 whereby investee outcomes and development impact data are collected (to the extent possible) for 3 years after Norfund exit. This standardisation allows for continuous updates of a post-exit database and investigation of the sustainability of exited investments. This is instituted as an internal learning tool, but with select publication of results.
- As part of the implementation of the 2019-2022 strategy, Norfund is updating investment exit document templates and as part of this, the section pertaining to development impact performance in the post-exit note will be assessed.

Principle 9

“Publicly disclose alignment with the Impact Principles and provide regular independent verification of the alignment: The Manager shall publicly disclose, on an annual basis, the alignment of its impact management systems with the Impact Principles and, at regular intervals, arrange for independent verification of this alignment. The conclusions of this verification report shall also be publicly disclosed. These disclosures are subject to fiduciary and regulatory concerns.”

- This Disclosure statement is published on Norfund’s website.
- The verification report is attached as an annex to the disclosure statement.
- The verification is performed by an Independent Internal Impact Assessment Committee, consisting of designated staff members belonging to the legal department and finance department.
- The appointed committee members are staff who are not directly involved in investment identification, due diligence, decisions on investment terms, impact or additionality assessments, impact monitoring, or the writing of the initial disclosure statement. This to cater for appropriate independence for the committee in the verification process. The names of committee members are included in the verification report.
- The internal verification process is chosen as this is considered a fit-for-purpose process for efficient verification and institutional learning, taking into account that Norfund has a small organisation, operates under a government-given development mandate, reports regularly on operations to the Ministry of Foreign Affairs and is transparent in its operations and disclosure of portfolio data.
- The committee has received the disclosure statement, along with all supporting documentation. The committee has reviewed documents, undertaken other activities as deemed necessary to perform its function and has subsequently submitted the verification report with its conclusion regarding the content of the disclosure statement.
- A new disclosure statement will be published in 2022 by an annual schedule and a new verification statement in 2023 by a biannual schedule in line with the Impact principles.