OPERATING PRINCIPLES FOR IMPACT MANAGEMENT

Disclosure Statement

January 2023

Microfinance Enhancement Facility SA, SICAV-SIF (MEF or the Fund) hereby affirms its status as a Signatory to the Operating Principles for Impact Management (the Impact Principles).

This Disclosure Statement applies to the investments made by MEF (Covered Assets).

The total Covered Assets in alignment with the Impact Principles is USD 529M as of 30/09/2022.

Date: January 2023

Momina Aijazuddin

Ruurd Brouwer
Chair

Momina Aijazuddin
Director

Principle 1

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.

The Fund aims to support economic development and prosperity globally through the provision of additional development finance to micro-enterprises, via qualified financial institutions, in emerging markets. The Fund aims to ensure that financial services are delivered in a responsible and inclusive way through MFIs for the ultimate benefit of its clients, namely any borrower, investee or other person financed or served directly or indirectly by a microfinance institution, including to underserved women, women-owned or women-led businesses.

Since the Fund's launch in February 2009, it has successfully supported economic development and prosperity in emerging markets globally through the provision of additional development finance to micro-enterprises and low-income households, via qualified financial institutions. The microfinance industry has evolved and matured since 2009 with increasingly diverse forms of microfinance and actors involved. In this evolving market, building on its historical positive outcome, the Fund is now also focusing on a key priority within financial inclusion: gender-smart investing. "Gender-smart" or "gender-lens" investing is defined as the use of capital to simultaneously generate financial return and advance gender equality. It integrates gender analysis into financial analysis, for example to assess gender segmentation of the portfolio. The Fund wishes to enhance its mission and investment strategy to strengthen the provision of gender-smart and responsible financial services to underserved women as well as women-owned or women-led businesses in emerging markets. The aim is to improve livelihoods, support income generation and employment, and promote women's leadership. This transition of the mission and investment strategy of the Fund will be gradually implemented as from January 2023 and is expected to be further strengthened as from January 2024.

In addition, a technical assistance facility may be established alongside the Fund, supporting the MFIs in their development and growth toward the achievement of the Fund's mission statement.

The Fund promotes a widespread adoption and further deployment and outreach of responsible finance and social performance standards based on industry-wide international principles and practices.

The Fund's vision and mission have been translated into the following strategic impact targets consistent with the investment strategy and social and environment goals of the Fund:

- Supports economic development and prosperity globally by providing additional development finance to micro-enterprises and private households engaged in entrepreneurial activities via qualified financial institutions.
- Observes principles of sustainability and additionality, combining development and market orientations in pursuing its development goal.

To ensure alignment with its impact objectives, the Fund defined sustainability indicators aligned with the SDG framework. These are considered in investment decisions, and sustainability data is collected on an annual basis using a social performance assessment tool. Each investment shall contribute to the below SDGs targeted by the Fund.

As a global microfinance impact fund, MEF tracks its impact both as a Fund and, more importantly, through impact achieved at the MFIs level, which are key actors in the delivery of impact. This builds on MEF's vision of supporting microfinance markets in developing countries around the globe by offering a reliable and flexible source of debt to carefully selected MFIs which support microenterprises and low-income households.

The impact objectives are embedded in the investment strategy to ensure alignment between the Fund's portfolio and development goals such that 100% of the portfolio is allocated to sustainable investments – investments focusing on emerging markets institutions financing micro or small enterprises and low-income households. Such requirements, among others, are set out in the Fund's documentation.

Adherence to constantly evolving social performance standards are core components of MEF's approach to responsible finance. As a global fund, MEF has engaged four Investment Advisors (IAs) – each a reputable leader in the impact asset management field – to identify, appraise, structure, and negotiate MFI investments and perform ongoing monitoring of the portfolio and risk management.

As an impact fund and observing the principles of sustainability, in February 2021, MEF introduced disclosure as a Fund designated to sustainable investments as set out in the EU Sustainable Finance Disclosure Regulation (SFDR), Article 9. These standards on sustainable investments, effective since 10 March 2021, aim to stimulate sustainable investments in the EU to help achieve the climate goals of the Paris Agreement and the European Green Deal by increasing transparency on how sustainability risks and opportunities are integrated into investment decisions. MEF is committed to both these initiatives and the greater transparency and standards they foster to promote sustainable impact investing.

Principle 2

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.

MEF has a process for integrating impact considerations throughout the investment process. This is outlined at a high level in the Fund's documentation.

The portfolio has been constructed in such a way that the impact of each project contributes to achieving the impact objectives at the level of the portfolio. The Fund's investment process is aligned with its impact intent at each step – from screening and due diligence all the way through to ongoing monitoring and reporting as well as exit. Key indicators are defined and considered by the Fund's Investment Committee (IC) before approving deals and reported at the portfolio level once a year. The IC monitors the portfolio and MFI investee performance on an ongoing basis whereby any concerns emerging from the investment proposals prepared by the IAs are reviewed as they arise.

The Annual Report captures how the Fund, as a whole, performs based on traditional microfinance indicators and assesses the social performance of its MFI investments, as well as benchmarking its portfolio against the universe of MFIs. The MFIs and the Fund report against the Universal Standards for Social Performance Management (USSPM).

On impact and ESG management, the Fund is responsible for the implementation of all aspects of the investment process. The impact management at the Fund is fully integrated with the portfolio management function, with the IAs monitoring at investee and respective IA pool-levels.

As a responsible lender, MEF remunerates its Investment Advisors according to competitive market rates, whereby the IAs integrate assessing sustainability risks as part of their core duties and are each a signatory to the Impact Principles. In addition, the fund has linked the remuneration requirement with impact assessment which is also in line with best market practices on incentivizing impact investment advisors.

More specific information can be found in the annual reporting of the Fund available on the website:
www.mef-fund.com

Principle 3

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.

The impact appetite of the Fund for a specific investment is determined by its potential to meet the Fund’s Sustainable Investment Objective as defined in the Issue Document.

The IAs assess each potential MFI using their respective internal methodology and/or proprietary rating methodology. The IC considers this score and analysis in its investment decision. In parallel, prospective investments are reviewed against the due diligence questionnaire of the ALINUS-STPF social performance assessment when available, and the IC gauges the impact potential of an investment based on the IA’s impact assessment of the MFI.

To achieve the impact objectives, MEF has established that in the process of choosing an investment, the following aspects shall be considered:

- Alignment with the Fund’s sustainability objectives
- Investments’ viability and adequate risk profile
- Alignment with the Fund’s requirements
- Developmental and social impact

These requirements are reflected in the agreements entered into by the Fund with its IAs and the Fund’s partner MFIs through Impact and ESG covenants. The Fund also reviews these requirements on a regular basis.

The Fund’s impact is portrayed in its Annual Report, including an assessment based on the widely recognized social audit tool SPI4-ALINUS. Annual reporting of the Fund available on the website: www.mef-fund.com/publications.php as well as on www.cerise-spm.org/alinus/

Principle 4

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.

IAs, alongside an ESG assessment, perform an assessment of the potential impact each investment is expected to deliver during the life of the loan. Defining and quantifying the impact intent of an investment is a fundamental step for understanding the contribution and likelihood of achieving such impact throughout the investment period – from initial assessment to exit, with ongoing monitoring. This intent assessment is integrated in the IAs' tools and impact assessment methodologies in a systematic manner.

IAs are required to first complete their respective due diligence on a prospective MFI, including identification and evaluation of social and governance aspects as well as risks and opportunities. Final proposals of all potential MFI investments are then submitted to the Fund's IC for decision-making and, if required, to the Board of Directors of the Fund.

ESG and Impact matters are considered over the life cycle of the investment. MEF strives to maintain an appropriate level of oversight for as long as the Fund is a lender and to periodically reconfirm that the MFI continues to meet ESG requirements. Any material adverse impact or ESG matter identified shall be avoided, where possible, or will be mitigated through the implementation of an effective mitigation and monitoring plan and completion of all necessary corrective actions. The Fund also considers impact risks which are relevant and measurable alongside sustainability risks at due diligence and throughout the investment process with ongoing monitoring.

Principle 5

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.

The Fund aims to achieve a positive social impact through each of its investments. By screening potential investments and monitoring existing investments against the identified principal adverse impacts on sustainability factors (PAI), the Fund seeks to ensure that its investments do not do any significant harm, do not harm the impact objectives, and seek to reach the impact objectives of the Fund. Those PAIs shall be identified, assessed, and, as appropriate, mitigated.

As of due diligence, ESG risk identification and scoring are embedded in the respective tools used by the IAs and the Fund requests the IAs to classify their proposed MFIs following IFC's risk categorization for Financial Institutions.

The IAs shall:

- Ensure MFIs' ongoing compliance with all relevant laws and other standards and regulations
- Support and encourage the MFIs to work towards continuous improvements in their ESG process through trainings and continuous involvement of management and staff.
- Monitor, record, and report any serious incidents involving the MFIs.

MFIs are also required to comply with the Fund's exclusion list in line with international standards set forth by development finance institutions, the Fund's ESG & Impact covenants, and the Client Protection and Responsible Finance Principles as defined in the Fund's Investment Guidelines, which include the ESG framework.

The Fund aims to ensure that its investments do not cause any social or environmental harm. As such, MEF carefully filters potential MFIs and systematically assesses ESG risks. IAs are required to monitor and provide timely reporting and, as the case may require, escalation regarding external E&S factors with respect to any MFI, or their underlying clients, that could reasonably materially impact the MFIs' compliance with the Fund requirements and/or the MFI's profitability and risk profile.

Any breaches of ESG covenants or any serious ESG-related incidents shall be communicated by the IAs with the aim to:

- Clearly identify the cause/reason for such breach or incident
- Assess the potential impact on the investment
- Give details of the action plan that the MFI has proposed, if any
- Inform the IC of the actions taken or planned to be taken by the IA (e.g., granting a waiver)
- Recommend actions for the approval of the IC, if any (e.g., making provisions in the fund)

Monitoring at the level of the Fund furthermore includes the monitoring of the overall portfolio quality and ESG portfolio risks. The overall risk level of MEF's portfolio shall remain low. The Board must be informed in case of a deterioration of the overall level of risk below that standard and shall strive to re-establish the overall level of risk in line with the required standard.

Each MFI receiving funding from the Fund is expected to comply with the Fund's ESG and Impact requirements and to identify, assess and manage ESG risks as well as implement an ESMS commensurate with the ESG risks of its operations. MFIs are also expected to meet the conditions of Fund loan agreement, including ESG monitoring and reporting requirements. The Fund, with the information provided by the IAs, will (i) monitor thoroughly and consistently how ESG factors are addressed and (ii) check whether investment proposals, loan agreements and monitoring reports contain adequate and relevant information.

Principle 6

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.

In addition to market outlook and portfolio development aspects, the Annual Report is based in large parts on financial, developmental, outreach and social indicators reported by the MFIs. The aggregate responses on aspects such as outreach, products, and services or on the range of social performance indicators provide a yearly "snapshot" of the MFIs in MEF's portfolio.

Since 2018, the Board of Directors has engaged CERISE to coordinate and analyze social performance assessments of MEF's MFIs, in close collaboration with the IAs. CERISE, a global leader in impact measurement, manages the widely recognized social audit tool SPI4-ALINUS aligned with the USSPM.

The Annual Report captures how the Fund performs based on traditional microfinance indicators and assesses the social performance of its MFI investments, as well as benchmarking its portfolio against the universe of MFIs. However, for a global fund such as MEF, capturing the impact and benchmarking across various investees' profile such as low-income households, micro-entrepreneurs as well as small enterprises requires a more nuanced approach. For this purpose, selecting adequate indicators and adjusting the ESG and Impact initial assessment and monitoring requirements according to the profile is key.

As detailed in previous principles, the IAs monitor impact and ESG aspects on a regular basis and update their assessments accordingly. Any deterioration is brought to the attention of the IC, and as required, also the Board, to be addressed to ensure sound business continuation.

MEF recognizes that developmental effects at the outcome level typically cannot be captured by portfolio or MFI reporting alone. The Fund is therefore considering how best to address this, such as through impact studies or evaluations, to support the impact narrative as well as to assess any unintended effects. To strengthen its reporting, MEF is furthermore assessing the possibility of applying a model developed by the industry to the entire portfolio, which will serve to provide an estimation of impact effects at the portfolio level.

Principle 7

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.

MEF invests through private debt instruments, which are self-liquidating once the loans have been repaid. The timing, structure, and process of exiting these investments are set at the beginning of the financing relationship with the MFI. The terms of each agreement, including repayment schedules, are reached in consideration of the repayment capacity, risk level and liquidity needs of each MFI, as well as the sustainability of its impact on the MFIs' borrowers, the end-beneficiaries. While there is no exit strategy per se due to the pre-determined exit nature of the instrument, Impact and ESG performance are still factors to be considered for business continuity – any serious breach of ESG and Impact covenants can lead to acceleration should it be necessary – and for any renewal or new loans to partners MFIs.

The fact that a significant number of the MFIs in MEF's portfolio are repeated borrowers evidences the long-standing relationship with the partner MFIs. The Fund stays engaged and grows with its investees, aiming to support their growth and development as contributors of economic development and prosperity in emerging markets globally through the provision via qualified financial institutions of additional development finance to micro-enterprises and households engaged in entrepreneurial activities.

Principle 8

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.

The Fund commits to integrating lessons from the Fund's processes and investments within its documentation which are living documents that constantly evolve as the Fund and markets develop.

The Fund's IAs are signatories to the Impact Principles. Over the years, their annual reporting methodologies and tools have evolved, leveraging on past experience with investees, research and industry standards. In parallel, as mentioned in Principle 6, since 2018, the Board of Directors has engaged an external provider to coordinate social performance assessments and analysis of MEF's MFIs, in close collaboration with the IAs. MEF's impact measurement and management have evolved significantly in recent years and now benefits from the use of a social audit tool aligned with the USSPM and the independent services of CERISE for data collection as well as the analysis and findings.

As the Fund seeks to evolve to best respond to market needs, over the last year, the Board of Directors has engaged in discussions with the initiators and investors of the Fund to brainstorm about the Fund's strategy for impact as well as the role MEF could play in the future. The outcome of the consultation is expected by mid-2022.

Principle 9

Publicly disclose alignment with the 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 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 affirms the alignment of the impact management systems for the Covered Assets with the Operating Principles for Impact Management. The Fund also confirms its commitment to publicly disclose alignment with the Impact Principles and to update it annually.

Also, the MEF completed its first independent verification in September 2022, demonstrating that its impact management process is aligned with the Operating Principles for Impact Management.

The verification was conducted by EY, and the independent assurance report is available on the Fund's website.

The Fund will regularly arrange for an independent verification every three years. Therefore, the next one will be completed by September 2025.

Microfinance Enhancement Facility S.A., SICAV-SIF

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Advised by four leading private Investment Advisors coordinated by MEF's General Secretary

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DISCLAIMER

This fund is reserved for eligible investors, meaning, with respect to the Shares, only professional investors as defined under Annex II of the Directive 2014/65/EU of the European Parliament and of the Council on 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, and with respect to the Notes, well-informed investors as defined under article 2 of the Luxembourg law of 13 February 2007 (the "2007 Law") on specialized investment funds, as both the preceding terms may be amended or supplemented from time to time. The distribution of Shares and Notes in this investment fund may be restricted in certain jurisdictions. In particular, Shares and Notes in this investment fund may not be offered, sold or transferred, directly or indirectly, in the USA or its territories or possessions or areas subject to its jurisdiction, or to citizens or residents thereof ('US Persons') other than in accordance with the laws of the United States. The information given in this report constitutes neither an offer nor a product recommendation; it is provided for individual information purposes only.

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