WATEREQUITY

Fund I-III Environmental, Social, and Governance Policy

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1. Introduction

1.1. PURPOSE

WaterCredit LLC ("WC") is committed to improving our approach to integrating Environmental, Social, and Governance ("ESG") into our investment strategy. This ESG Policy ("Policy") reflects our current approach, and we expect that this Policy will evolve over time to reflect changes in industry practices, business structures, technology, and the law. WC reviews and approves this Policy annually, or more frequently if necessary.

At WC, our investment professionals are individually responsible for incorporating all factors believed to have an impact, including those of an ESG nature, into the investment process.

1.2. SCOPE

This policy applies to all employees, borrowers, partners, external contractors, stakeholders, and relevant third parties directly associated with WC's business. This Policy includes:

- identifying potential ESG risks during due diligence process;
- making ESG an integral part of WC funds loan agreements with borrowers;
- ESG risk categorization for WC borrowers based on completed ESG scorecard (template attached);
- outlining post-investment ESG monitoring & reporting by WC; and
- documenting WC's ESG framework (general ESG principles and potential risk factors) and due diligence toolkit (ESG scorecard) for employee induction and subsequent training.

1.3. STANDARDS

This Policy is based on industry standards. In particular, WC's approach to ESG management relies on:

- International Finance Corporation ("IFC") Performance Standards;
- IFC Industry Sector Guidelines, in particular for Water and Sanitation;

- environmental, social and quality standards issued by the International Organization for Standardization ("ISO"), in particular, those relevant to the water and sanitation sector;
- SASB's Materiality Map; and
- for Financial Institutions, the Smart Campaign's Client Protection Principles and the Universal Standards for Social Performance Management.

2. Policy Principles

2.1. EXCLUSION LIST

The exclusion list identifies the types of sectors, businesses, or processes that WC does not lend to. In addition, some projects not on the exclusion list may require additional ESG consideration before investment. For the full list of excluded activities and projects requiring disclosure see Schedule I.

2.2. MINIMUM REQUIREMENTS

Any prospective borrower must meet basic ESG requirements, including compliance with local environmental laws and regulations, compliance with local labor laws, and good governance and business integrity practices. In addition, Financial Institutions must adhere to minimum client protection practices. For the full list of minimum requirements see Schedule I.

2.3. ESG RISK ASSESSMENT

Borrowers that meet minimum requirements and do not participate in any excluded activities, must also demonstrate strong environmental and social management in areas of higher material risk.

Environmental Risk Assessment

- Identify the potential risks, impact, and issues on the environment and the appropriate mitigating and management measures, in particular with regards to: (i) the carbon emission; (ii) the potential change in biodiversity; (iii) the waste management system; (iv) the supply chain practice that involves the use of natural resources or disposal of harmful byproducts; and (v) the use of scarce resources.
- Apply the appropriate measures from the best practices of environmental standards[1] if the situation is considered relevant or if the business is considered to possess significant environmental risks, even when the measures are more stringent than local and national legislations.

[1] IFC Performance Standards of Environmental & Social Sustainability (Effective January 1, 2012)

- Report impact and issues on environmental aspects that result from the operation of the business, with a particular emphasis on material issues that raise significant concerns and require greater attention.

KEY ENVIRONMENTAL ISSUES	POTENTIAL ENVIRONMENTAL RISKS
Compliance with local environmental law	Regulatory/Compliance Risk
Environmental certificates, permits, and licenses	Operational Risk
Greenhouse gas (GHG) emissions	Reputational Risk
Chemical pollution	Legal Risk
Impact on landscape and wildlife	Technological Risk
Waste management	
Soil & Groundwater Contamination	

Social Risk Assessment

- Identify the potential risks, impact, and issues at the levels of society, stakeholders, and labor and the appropriate mitigating and management measures, before making investment and during the investment monitoring process, in particular
  - society's living conditions,
  - the labor policies and regulations,
  - the impact of the supply chain practice on the local community,
  - the health and safety working conditions,
  - human rights, and
  - stakeholder engagement process.
- Report impact and issues on social aspects resulting from the operation of the business, with a particular emphasis on material issues that raise significant concerns and require greater attention.

KEY SOCIAL ISSUES	POTENTIAL SOCIAL RISKS
Local Labor Law Compliance	Compliance/Regulatory Risk
Workplace Health & Safety	Reputational Risk
ILO Compliance (if applicable)[2]	Legal Risk
Formalized Human Resource Policy	Operational Risk
Fair Compensation Structure	Ethical Risk
Child Labor Law Compliance	
CSR Activities	

Governance Risk Assessment

- Identify potential risks, impacts, and issues on the governance and legal front and the appropriate mitigating and management measures before making an investment and during the investment monitoring process.

[2] ILO Guide to International Labor Standards (2008)

- Report impact and issues on governance aspects that result from the operation of the business, with a particular emphasis on those that raise significant concerns and require greater attention.

GOVERNANCE ISSUES	POTENTIAL GOVERNANCE RISKS
Internal Misconduct	Management Risk
Communication	Financial Risk
Responsibility/Liability	Information Risk
Public and Employee Perception	Compliance/Regulatory Risk

3. Implementation

3.1. INVESTMENT CYCLE

WC's ESG activities throughout the investment cycle are summarized in the following stages:

- **Screening Stage**: WC Investment Officers ("IOs") will ensure that the investment opportunity is not on WC's Exclusion List (Schedule 1).

- **Due Diligence Stage**: WC IOs will conduct comprehensive due diligence on ESG risks and opportunities using the WC general ESG scorecard (Appendix I), which is a standard assessment of core ESG-related policies and practices. In addition, the IO completes a sub-sector ESG scorecard (Appendix II), which identifies specific material ESG considerations for each sub-sector. Loan applicants will be assigned a score out of 100, based on these two scorecards. IOs may engage external ESG specialists or consultants as necessary depending on WC's capacity and the risk category determined during the screening stage.

- **Investment Decision Stage**: The assigned IO will present findings from the screening and diligence stages to the WC Investment Committee ("IC"). ESG risks and opportunities are identified, and specific short-term and long-term recommendations are made to close ESG performance gaps and enhance ESG practices. A section of each investment memo is dedicated to the ESG scorecard and assessment. An ESG specialist or consultant may be engaged to develop the appropriate materials and present findings to the IC for relevant deals.

- **Investment Agreement Stage**: ESG terms will be negotiated and incorporated into the legal investment agreement(s), as appropriate. Depending on the nature of the investment, time-bound ESG action plans to close ESG performance gaps, set ESG targets, and report on performance may be included in the definitive documentation (Appendix III). Alternatively or additionally, IOs and company management may incorporate such action plans, targets, and reporting requirements into management's ongoing key performance indicators. All borrowers will sign an ESG certificate certifying that the borrower, as well as its directors, officers, and affiliates, complies with specific ESG requirements. In cases where candidates do not have acceptable ESG risk levels and are unwilling to agree to action plans to close ESG performance gaps, WC will not invest. Finally, WC will conduct background checks to avoid transactions with any party confirmed by the U.S. Treasury Department's Office of Foreign Assets Control to be on the Specially Designated Nationals List or potential linkages to terrorist financing organizations.

- **Holding, Monitoring & Reporting Stage**: WC IOs will monitor the investment's ESG action plan and compliance with applicable laws and standards, as well as opportunities for improvement. WC will require borrowers to report annually on their environmental and social performance, and resubmit the signed ESG certificate on an annual basis. Capacity-building support and guidance may be provided or retained for the management team, as needed. WC is committed to ensuring that each of its investments has appropriate grievance procedures for their stakeholders (commensurate to the level of ESG risk of the investment) and will maintain a grievance mechanism at fund manager level, as well (see Grievances section below).

  On a regular and ongoing basis, WC is committed to providing ESG training to its investment and compliance staff to ensure effective implementation of the ESG management system. At times, WC may procure additional external expertise to assist in such training and build internal capacity.

3.2. GRIEVANCES

To effectively address any operational, social, environmental, labor, and other general concerns, WC has in place a structured grievance redressal framework supported by a review mechanism. This redressal mechanism can be used not just by its customers, but also by its employees, third-party contractors, and other relevant stakeholders. Stakeholders can directly reach out to WC (https://waterequity.org/contact/) to lodge a complaint against WC. Any such complaints are reviewed by the Chief Compliance Officer in coordination with the Director, Impact and ESG, and resolved in a timely manner.

3.3. POLICY MAINTENANCE

The Director, Impact and ESG is responsible for keeping this Policy current, including ensuring that it is reviewed on a regular basis. The WC Board of Managers will review and approve this Policy no less than annually, and changes to the Policy are subject to review and approval by the WC Board or Managers.

Schedule 1: Requirements and Exclusion List

S1.1. ENVIRONMENTAL

- Comply with all applicable local and national laws and regulations on environmental aspects.

S1.2. SOCIAL

- Comply with all applicable local and national laws and regulations on social and labor aspects and have a fair compensation structure in place. Regulations include the right of association, organization and collective bargaining, forced labor, child labor, wages, hours of work, and occupational health and safety.
- Treat all employees and contractors fairly and with respect, including by not employing forced labor and child labor in any form. This includes not employing persons under the age of fifteen (15) for any form of labor or under the age of eighteen (18) for work involving hazardous labor activity.
- Apply appropriate measures from the best practices of social and labor standards if the situation is considered relevant or if the business is considered to possess significant social and labor risks, even when the measures are more stringent than local and national legislations. This is especially important when the business takes place in a country that has not ratified one or some International Labor Organization ("ILO") Fundamental Conventions.
- For Financial Institutions, apply policies and practices to foster client protection, including:
  - Ensure transparency and actively disclose and promote client understanding of loan terms before loans are disbursed to clients.
  - Ensure that Effective Interest Rates (inclusive of fees and commissions) are clearly disclosed to clients prior to any loan agreement.
  - Have developed policies to avoid over-indebtedness in clients and clearly disseminate them to staff.

S1.3. GOVERNANCE

- Comply with all the applicable local and national laws and regulations on transparency and corporate governance and promote the use of the international best practice on corporate governance when relevant and possible.
- Apply high standards of business ethics, integrity, and honesty to the business and to WC, and ensure that no corruption, bribery, money laundering, or internal misconduct activities are taking place in the business. This is especially important when the business is considered to possess significant governance risks.
- Deal with the relevant stakeholders, such as the regulators, tax authorities, and auditors in an open and co-operative manner.

- Clearly define the roles and responsibilities of the business shareholding and management structures through a relevant corporate governance manual.

Exclusion List

WC will not deal with any borrowers or vendors who are engaged in the business or trade of any product or activity deemed to be illegal under the laws or regulations in force in countries that WC funds invest in, or those appearing the following list of prohibited activities:

- conversion or degradation of critical forest areas or forest-related critical natural habitats
- leasing or financing of logging equipment, unless an environmental and social impact assessment indicates that; (i) all timber harvesting operations involved will be conducted in an environmentally sound manner which minimizes forest destruction; and (ii) the timber harvesting operations will produce positive economic benefits and sustainable forest management systems
- construction of dams that significantly and irreversibly: (a) disrupt natural ecosystems upstream or downstream of the dam; (b) alter natural hydrology; (c) inundate large land areas; (d) impact biodiversity; (e) displace large numbers of inhabitants (5,000 persons or more); or (f) impact local inhabitants' ability to earn a livelihood
- production or trade in any product or activity deemed illegal under host country laws or regulations or international conventions and agreements or subject to international phase-outs or bans such as pharmaceuticals, pesticides/herbicides, ozone-depleting substances, polychlorinated biphenyls and other hazardous substances, wildlife or wildlife products regulated under the Convention on International Trade and Endangered Species of Wild Fauna and Flora and trans-boundary trade in waste or waste products
- resettlement of 5,000 or more persons
- any impact on natural World Heritage Sites (http://whc.unesco.org/en/list/) unless it can be demonstrated through an environmental assessment that the project (i) will not result in the degradation of the protected area and (ii) will produce positive environmental and social benefits
- any impact on areas on the United Nations List of National Parks and Protected Areas (http://www.unep-wcmc.org/) unless it can be demonstrated through an environmental assessment that the project (i) will not result in the degradation of the protected area and (ii) will produce positive environmental and social benefits.
- extraction or infrastructure in or impacting: protected area Categories I, II, III, and IV (Strict Nature Reserve/Wilderness Areas and National Parks, Natural Monuments and Habitat/ Species Management Areas), as defined by the International Union for the Conservation of Nature (IUCN). Projects in IUCN Categories V (Protected Landscape/Seascape) and VI (Managed Resource Protected Area) must be consistent with IUCN management objectives (http://www.iucn.org/about/work/programmes/gpap_home/) unless it can be

demonstrated through an environmental assessment (i) there is no degradation of the protected area and (ii) there are positive environmental and social benefits.
- production of or trade in radioactive materials, including nuclear reactors and components thereof
- production of, trade in or use of un-bonded asbestos fibers
- marine and coastal fishing practices, such as large-scale pelagic drift net fishing and fine mesh net fishing, harmful to vulnerable and protected species in large numbers and damaging to biodiversity and habitats
- use of forced labor or harmful child labor
- projects or companies known to be in violation of local applicable law related to environment, health, safety, labor, and public disclosure
- projects or companies where the primary business activities are in the following prohibited sectors: gambling; media communications of an adult or political nature; military production or sales; alcoholic beverages (if contrary to local religious or cultural norms); or tobacco and related products
- projects or companies that replace U.S. production or are likely to cause a significant reduction in the number of employees in the U.S., including "runaway plants" and outsourcing the provision of goods and services (e.g., Business Process Outsourcing) from the U.S.
- projects or companies subject to performance requirements that are likely to reduce substantially the positive trade benefits to the U.S.
- projects or companies in which host country governments have majority ownership or effective management control (except for investments in privatizing companies made in accordance with the Finance Agreement)
- companies found by a court or administrative body of competent jurisdiction engaging in unlawful monopolistic practices
- projects or companies that provide significant, direct support to a government that engages in a consistent pattern of gross violations of internationally recognized human rights, as determined by the U.S. Department of State
- Companies which are treated as inverted corporations under 6 U.S.C. 395(b).

Projects Requiring Disclosure

The following types of water and sanitation projects require disclosure to WC and must go through additional due diligence and reporting requirements to ensure compliance with the ESG policy.

- Construction or significant expansion of large dams and reservoirs not otherwise prohibited.
- Groundwater abstraction activities or artificial groundwater recharge schemes in cases where the annual volume of water to be abstracted or recharged amounts to 10 million cubic meters or more.

- Municipal wastewater treatment plants servicing more than 150,000 people.
- Greenfield housing developments that contain more than 2,500 residential units.
- All projects with potentially major impacts on people or which pose a serious socio-economic risk, including Physical and Economic Displacement, impacts on Indigenous Peoples and adverse impacts on Cultural Heritage.
- Projects, not categorically prohibited, but located in or sufficiently near sensitive locations of national or regional importance which may have apparent environmental impacts on:
  - Wetlands;
  - Areas of archeological significance;
  - Areas prone to erosion and/or desertification;
  - Areas of importance to ethnic groups/indigenous peoples;
  - Primary temperate/boreal Forests;
  - Coral reefs;
  - Mangrove swamps;
  - Nationally designated seashore areas; and
  - Managed resource protected areas, protected landscape/seascape (International Union for the Conservation of Nature (IUCN) categories V and VI) as defined by IUCN's Guidelines for Protected Area Management Categories. Additionally, these projects must meet IUCN's management objectives and follow the spirit of IUCN definitions.

Appendix I – General ESG Due Diligence Scorecard

EXTERNAL RATIONS OR CERTIFICATIONS – 5%

1. Has the company obtained any external social or environmental rating in the last 3 years?
2. How did the company perform?

ENVIRONMENTAL POLICIES AND MANAGEMENT – 10%

1. Does the company have a written policy regarding compliance with all local environmental laws and regulations, or in the case of FIs, a policy prohibiting financing businesses with negative environmental impact?
2. Does the company have a written policy regarding the impact of its internal practices on the environment?
3. Does the company have valid environment-related licenses and permits as required by local law?
4. Is there a monitoring, evaluation, and reporting plan in place for environmental-related business activities of the company?
5. Has the company paid any environmental fines over the last 2 years?

SOCIAL – 15%

1. Has the company developed specific social goals and assigned them measurable targets?
2. Is the company's staff trained on the institution's social mission and goals?
3. Does the company have a separate HR department?
4. Is there a clearly defined HR policy?
5. Does the company have a Health & Safety policy that is signed off by the CEO or equivalent?
6. Does the company have a non-discriminatory policy with respect to gender, race, color, disability, political opinion, sexual orientation, age, religion, social or ethnic origin, or HIV status?
7. Does each employee have a written employment contract that includes his/her salary, benefits, and employment conditions?
8. Does the company have a formal grievance mechanism in place that allows employees to raise workplace concerns in a confidential manner?
9. Does the company ensure local minimum wage standards are met and employees are fairly compensated?
10. What is the employee turnover rate? (Enter rate from the last fiscal year, or last 12-month period)
11. In the past 3 years, has the company violated any relevant local health and workplace safety laws, standards, and regulations?

GENDER – 5%

1. Has the company integrated gender into its strategy?
2. Are women represented at leadership, including the board and c-suite levels?
3. Do employment policies and performance reflect gender equity?
4. Does the company target to women clients?

GOVERNANCE – 15%

1. Is the Board of Directors made up of independent members? (versus the promoter, family members, close friends)
2. Does the Board of Directors hold regular, in-person meetings?
3. Is there a board-approved code of ethics that management and staff are expected to follow and a committee dedicated to oversight?
4. Does the company have an internal audit function?
5. Does the company employ external auditors to audit financial statements on an annual basis?
6. Are specific staff explicitly responsible for ensuring ESG compliance and reporting noncompliance?
7. Does the board monitor social and/or ESG performance regularly and suggests improvements?
8. Does the company have policies in place for fulfilling anti-corruption and/or internal whistleblowing policies?

Appendix II – General ESG Due Diligence Scorecard

Financial Institutions

WATER SUPPLY & SANITATION PORTFOLIOS – 10%

- Does the financial institution conduct loan use verification checks on a periodic basis to ensure that loans are properly used by clients, according to the purpose originally indicated in the loan application?
- Does the financial institution ensure that minimum environmental standards are met by clients for construction? Or does the financial institution ensure minimum environmental standards are met by third-party products?
- Is the financial institution a current WaterCredit partner of Water.org?
- What was the % of loans correctly utilized for WSS based on the latest Water.org PMV?
- Does the operational manual include mention of water and sanitation loans (or marketing of/requirements for water and sanitation facilities, if not a WSS loan)?

PRODUCT DESIGN & CLIENT SATISFACTION – 15%

- Does the financial institution provide emergency loans?
- Is there a policy that defines how the financial institution will design and offer suitable products and services through appropriate channels, in order to tailor products to client needs?
- Does the financial institution underwrite loans without underlying collateral?
- Does the financial institution conduct market research and then use the research to design new products/review products?
- What is the percentage of client drop-out or inactive clients over the last 12 months [number of drop-outs over the average number of clients over the last 12 months/financial year]?
- Over the last 24 months, did the financial institution conduct market surveys to improve the quality of services to clients?
- Does the financial institution conduct client satisfaction studies, including input from drop-outs, clients, and potential clients, and then use the information collected?
- Does the financial institution offer savings products to its clients?
- Does the financial institution provide emergency loans?
- Is there a policy that defines how the financial institution will design and offer suitable products and services through appropriate channels, in order to tailor products to client needs?

CLIENT PROTECTION – 20%

- What was the financial institution's ROA in the last fiscal year?
- Does the financial institution endorse the Smart Campaign?
- Has the financial institution endorsed the Client Protection Principles (CPPs)?
- Do the financial institution's Loan Officers conduct structured due-diligence to ensure that borrowers are not subject to over-indebtedness?

- Does the financial institution run its prospective borrowers through a Credit Bureau system or equivalent information sharing system (where no credit bureau exists)?
- Does the financial institution ensure transparent communication with clients about prices, terms, and conditions of financial products?
- Is the staff trained to communicate effectively with all customers, ensuring that they understand the product, the true costs, and risks, the terms of the contract, their rights and obligations?
- Does the financial institution include the APR and all fees and describe all terms and penalties in the loan agreement?
- Does each client receive a repayment schedule that breaks out principal and interest?
- Does the loan underwriting process require an assessment of repayment capacity?
- Is there a sound loan restructuring policy requiring the number and amounts of rescheduled loans to be clearly reported and designated a higher reserve rate?
- Does the financial institution have a written privacy policy that requires staff to explain how clients' data will be used and seek their permission for use?
- Does the financial institution have written collections policies that clearly lay out appropriate and inappropriate behavior?
- Is there a mechanism to handle customer complaints that is actively used and has a dedicated staff?

Engineering, Procurement, & Construction Firms

WORKER HEALTH & SAFETY – 15%

- How many major injuries or fatalities have occurred on project sites in the last 3 years?
- Is there a specific checklist or plan to implement the policy that ensures worker health and safety?
- Is staff regularly trained in health and safety?
- Does the company conduct regular training programs for all relevant staff on occupational health and safety?

SUBCONTRACTORS – 7%

- Does the company ensure sub-contractors are in compliance with relevant labor laws?
- Does the agreement with subcontractors include provisions for workers, such as toilets, drinking water, and medical facilities?
- Does the company ensure sub-contractors are in compliance with relevant environmental regulations?
- Does the company ensure sub-contractors dispose of waste appropriately?

ENVIRONMENT – 10%

- Does the company monitor the appropriate disposal of construction waste?
- Does the company conduct environmental impact assessments across all projects?

- Does the company explicitly include considerations of climate change and sustainable water resource management in the development of the water supply?

COMMUNITY – 3%

- Does the company monitor noise pollution?
- Is there a community grievance mechanism?

BUSINESS INTEGRITY – 15%

- Is there clear guidance for employees on avoiding bribes and facilitation payments?
- Is there training for employees in avoiding bribes and facilitation payments?
- Is the bidding process that the company engages in open and transparent?
- Are client negotiations (for example, for cost increases) or requests for permits open and transparent?

Appendix III – ESG Action Plan Template

Item #	Gap to be Addressed	Corrective Actions	Priority	Responsibility	Deadline	Completion Indicator
1		-				
2		-				
3		-				