KFW CAPITAL

Sustainability Policy

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[2] Image: © CUBE Kommunikationsagentur GmbH/ KfW Group

Summary

I. Significance of sustainability for KfW Capital

Transitioning to a sustainable society is the key challenge of our time. In the coming years and decades, this transformation will require ongoing and extensive investment, innovation and continual further developments. For the global financial system, entrepreneurial action and social responsibility are inseparable in order to accompany this transformation[3]. As a responsible investor and part of KfW Group, KfW Capital is committed to this global task and supports the sustainability objectives of KfW Group and the German Federal Government as well as the 2030 Agenda with its Sustainable Development Goals (SDGs).

II. KfW Capital as a sustainable investor

As a venture capital fund investor, KfW Capital follows the sustainability definition of the UN Global Compact: *„Corporate sustainability is a company's delivery of longterm value in financial, environmental, social and ethical terms"*.

KfW Capital is convinced that the identification of major ESG risks and opportunities as well as their management constitute key elements for the enduring success of enterprises. Possible negative effects that result from enterprises and their activities, in particular, must be taken into consideration in the interest of appropriate risk management as they can have a substantial impact on the value of an enterprise and, thus, the investor's risk-return profile and reputation.

Furthermore, KfW Capital has the ambition to capture the impacts caused associated with portfolio enterprises on the basis of suitable indicators and to report them both internally and externally in order to create more transparency in the market and, in this way, contribute to sustainable development in the meaning of the 2030 Agenda and the Sustainable Development Goals (SDGs).

III. KfW Capital as a sustainable enterprise

KfW Capital has also implemented sustainability in its own corporate strategy and governance. This includes the respectful treatment of its employees, compliance with the Corporate Governance Codex, close integration of the Compliance Department, in-house environmental protection and further measures aimed at ensuring its employees' well-being and further development.

Sustainable investment | How does KfW Capital integrate sustainability as a VC fund investor into the investment process?

KfW Capital regards sustainability as the interplay of multiple factors that contribute to making portfolio enterprises successful on a sustained and long-term basis. The expected profitability of the investments is assessed in a due diligence process described in other documentation. This policy focuses on the integration of ESG criteria and impact indicators.

I. Managing ESG risks and opportunities: 'No harm'

The assessment of ESG aspects generally distinguishes between two perspectives: The outside-in perspective looks at events in the environmental, social and governance areas, the occurrence of which can have significant actual or potential negative effects on the value of an enterprise. The inside-out perspective, for its part, examines possible (negative) effects of an enterprise on the areas mentioned. This aspect is not necessarily limited to the preservation of financial value.

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[3] See also: https://www.kfw.de/PDF/Download-Center/Konzernthemen/Nachhaltigkeit/englisch/Nachhaltigkeitsleits%C3%A4tze-der-KfW-Bankengruppe_E.pd

That is why KfW Capital examines ESG aspects both when making a decision to invest in a VC fund and when monitoring it. The process of the sustainability assessment is described below.

Operationalisation of the ESG strategy in the investment process

Initiating a transaction: The Investment Management and Investment Committee conduct a first assessment of the VC fund

If KfW Capital has received an investment request from a VC fund, it checks the general compatibility with the portfolio guidelines and criteria for inclusion in the deal pipeline and sends a fact sheet to the Investment Committee members. Among other things, this fact sheet contains an initial assessment relating to essential ESG themes.

Sustainability due diligence

Sustainability due diligence is conducted using an ESG questionnaire that covers the following areas:

Minimum criteria

The first step is to ensure that the VC fund does not contravene any criteria of KfW Capital's exclusion list, which takes into account the exclusion list applicable throughout KfW Group. In addition, it must have a formal sustainability/ESG policy that is accessible to all employees. If the VC fund does not yet have a sustainability/ESG policy at the time of the due diligence, the Investment Committee will issue a recommendation for the investment with the proviso that such policy must be prepared before the contract is signed.

ESG Capabilities

As part of the due diligence, KfW Capital assesses the target funds using a standardised and quantified ESG questionnaire on the basis of an 'ESG Capabilities House'. In most cases the VC fund has a blind pool or at best a partial portfolio at the time of commitment. A fund investor like KfW Capital must therefore analyse the capabilities and processes of the VC fund in order to gain an impression as to whether and how the fund has appropriately implemented an ESG management strategy and associated processes taking into account its size and strategy.

ESG heatmap

The VC funds are also assessed early for their relevance with regard to environmental, social and governance risks. This involves identifying and estimating the nature and scope of negative impacts and risks that may possibly arise from an investment in a particular sector (environmental/social impacts) and potentials for mitigating these effects. To this end, KfW Capital has developed an ESG heatmap with external support to enable the materiality of a risk to be assessed on the basis of the specific VC strategy. It is applicable at both fund and portfolio company level.

ESG assessment in the documentation

As soon as the ESG questionnaire and further detailed information have been submitted in full, the entries are verified for plausibility. An important element of this is the personal discussion with the fund managers in which individual open points are clarified and specific investment processes are discussed. The sustainability manager issues a written initial assessment by email. The risk manager includes an assessment of ESG risks in the investment proposal while the investment manager describes the fundamental compliance with the minimum criteria as well as the capabilities, ESG risks and opportunities and the impact orientation of the investment in the detailed due diligence report.

Sustainability manager in the Investment Committee

The fund is presented to the (Pre-)Investment Committee. One of the permanent members of this body is the sustainability manager, who is in charge of assessing the strategy and ensuring compliance with ESG minimum standards. Covenants that should be met even before signing the contract (such as the existence of an ESG policy) are proposed as and where necessary. Furthermore, the sustainability manager may also make recommendations on potentials for improvement that have been identified as being essential and define these as part of an action plan with the fund.

Signing process and action plan

Any need for improvements is communicated particularly when the due diligence identifies a major risk or development potential. A corresponding action plan is based on the completed and coordinated ESG due diligence questionnaire. The action plan is either included as a side letter to the contract or communicated informally by email depending on the progress of the fund and the materiality of the issue. As impact funds measure the achievement of their objectives on the basis of the impacts of their investments, KfW Capital also requires a higher minimum standard for the ESG criteria.

Reporting

In addition to periodic needs-based exchange, the agreed action plans and goal achievement in particular are discussed one year after conclusion of the contract. An additional detailed ESG and impact report is submitted once a year. KfW Capital adheres to the submission deadline of the European ESG Disclosure Regulation ((EU) 2019/2088; Sustainable Finance Disclosure Regulation – SFDR).

Guidance and engagement

Through its engagement KfW Capital wants to systematically raise the profile of sustainability as a topic for the target funds and establish market standards. KfW Capital's sustainability managers and the Investment and Risk Management Committee stand ready to engage in regular talks and knowledge exchange. As part of the further development of the VC ecosystem, KfW Capital also publishes a study with BCG that explores the extent to which VC funds and start-ups have already integrated sustainability into their strategy and operational activities.

Exit: Evaluating the sustainability of the investment

There are plans to conduct a final evaluation of the fund and possibly also at the level of the portfolio enterprises throughout the entire investment period of the fund. The methodology for this is still being developed.

II. Sustainability governance and responsibilities

Role of the sustainability manager

The sustainability manager is responsible for the content of the process and is involved in the operational assessment of the fund. The sustainability manager verifies the ESG policy of a fund and the completed ESG questionnaires in the due diligence process. On this basis an assessment is provided to both the investment manager and the risk manager. The assessment and plausibility verification of the ESG tool is used as a basis for preparing an action plan where necessary (see signing process and action plan), which is also closely coordinated with the sustainability manager.

Role of the risk manager

The risk manager is closely involved in the ESG process and prepares the risk assessment in the investment proposal on the basis of the ESG questionnaire and the assessment of the sustainability manager.

Role of the investment manager

The investment manager is the primary contact in the investment process; it prepares an assessment of the fund in the due diligence report on the basis of the ESG questionnaire and the assessment of the sustainability manager. Where necessary, the investment manager involves the sustainability and risk manager in a discussion with the fund.

Role of the Management Board

The Management Board regards sustainability is an important theme at KfW Capital and is responsible for the general sustainability strategy, processes and incentive systems for operational sustainability (see chapter Sustainable Enterprise) and in the investment process (see chapter Sustainable Investor). It is an important internal and external communication channel and makes the necessary strategic decisions.

III. Beyond ESG: Impact on the environment and society: 'Do Good'

KfW Capital not only applies ESG criteria but goes one step further: It aims to measure the impact on the environment, society and the business community in order to lay the groundwork for effective impact management.

As KfW Capital was founded with the mandate to invest in German and European venture capital and venture debt funds and thereby improve the supply of capital for innovative, technology-oriented start-ups and fast-growth enterprises, the key areas of impact derived from its strategy are SDG 8 'A decent work and economic growth' and SDG 9 'Industry, innovation and infrastructure'. KfW Capital also intends to capture impacts under SDG 12 'Responsible consumption and production'. It has defined specific indicators for these areas of impact that are to be captured annually.

Beyond their economic success, the funds and enterprises financed by KfW Capital also contribute to further SDGs. That is why additional objectives that have a major share in KfW Capital's portfolio are also captured.

Mapping investments to SDGs

In order to illustrate in what ways KfW Group's new financing commitments specifically contribute to achieving the UN Sustainable Development Goals, KfW has developed a standardised procedure to identify the SDGs to which its new commitments can be mapped each year. That makes the contributions transparent for the group and the individual business unit.

Sustainable enterprise | How does KfW Capital implement sustainability within its business?

I. Sustainable employer

Diversity and equal career development opportunities for all employees are a matter of course for KfW Capital. No employee may be discriminated against on grounds of gender, origin, ethnicity, religious beliefs, world view, disability, age or sexuality. The respectful treatment of all employees is very important to KfW Capital.

It offers them an attractive and healthy working environment and a fair remuneration system with a company pension plan and private accident insurance. KfW Capital supports its employees by providing ongoing professional development opportunities and is committed to balancing work and family life, for example through part-time and home working arrangements.

II. Corporate governance and compliance

KfW Capital performs all its functions in accordance with its bylaws and procedural rules, applicable law and prudential regulations. This explicitly includes compliance with statutory regulations and provisions that apply to ecological, social and economic matters as well as to the prevention of money laundering, terrorism financing, corruption, fraud, violations of privacy laws, insider regulations and embargo provisions.

KfW Capital complies with the 'Public Corporate Governance Code' (PCGC). The code was adopted by the German Federal Government on 1 July 2009. KfW Capital publishes a Corporate Governance Report for each preceding business year.

The group-wide Code of Conduct and the KfW Capital Compliance Policy form the basis for ethically correct conduct within the company. Furthermore, the code of conduct for the Management Board of KfW Capital regulates the acceptance of gifts, honorary positions and extracontractual activities, among other things.

III. In-house environmental protection

The business operations of KfW Capital have been largely climate-neutral since the 2020 financial year. Under the 'Prevent, Reduce, Offset' approach, the aim is, first and foremost, to prevent emissions, to systematically and consistently reduce the quantity of unavoidable CO_2 emissions, and to offset the unavoidable emissions with compensation projects through the group. To achieve this, all emissions from energy consumption and business trips are offset by corresponding quantities of emissions certificates.

KfW Capital's in-house environmental protection measures therefore comprise improvements to energy efficiency (e.g. more efficient use of electricity, heating and air conditioning) and resource consumption (e.g. reduction in paper consumption, avoidance of plastic waste and waste separation). In addition, KfW Capital buys certified green electricity. KfW Capital also takes into account environmental and climate aspects in business trips, for example by avoiding business trips where possible through the use of video or telephone conferencing and by giving preference to resource-efficient transport.