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**OPERATING POLICIES AND PROCEDURES**

**Chapter 12**

**Due Diligence Policy and Procedures**

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**Effective from 28 November 2016**

## Contents

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1. Policy Statement .....	3
2. When to conduct due diligence .....	5
3. New Business Committee (NBC) (or equivalent) .....	6
4. Due Diligence .....	8
5. Environmental and Social .....	12
6. Reliance on Third Party Due Diligence including KYC .....	13
7. Credit Committee (or equivalent) submission.....	14
8. Completion and Ongoing Monitoring.....	16

## 1. Policy Statement

- 1.1. The PIDG Due Diligence Policy and Procedures is a minimum standard for due diligence for PIDG Participants. This, however, is not intended to change any legal or regulatory obligations which PIDG companies are required to comply with.
- 1.2. The Due Diligence Policy and Procedures set out a framework that is split into a number of different stages of the investment process. It is recognised that a one-sized fits all approach cannot be applied to due diligence, and therefore each Facility will decide on the level of due diligence which is required on each individual opportunity. The scope and depth of the due diligence assessment will be proportionate to the risk, location and value of the opportunity, recognising the balance to be achieved between seeking assurance and the need to minimise unnecessary burden on the Facility, but recognising the need to keep PIDG Members informed of any reputational risks.
- 1.3. PIDG Participants may be subject to stronger principles, standards or rules than those set out herein, e.g. as a result of more stringent requirements imposed by funding PIDG members or by law in which event the more stringent principles/rules should be adhered to.
- 1.4. Unless otherwise indicated, the Due Diligence Policy and Procedures are to be applied on a “comply or explain” basis. However, as the Due Diligence Policy and Procedures provide for a certain amount of flexibility and judgement by the PIDG Facility, PIDG Facilities are only required to explain non-compliance in the following circumstances:
  - ▶ If they are not carrying out their own due diligence and are relying on third party due diligence and do not propose to review this third party due diligence;
  - ▶ If KYC checks are not going to be carried out;
  - ▶ If any environmental, social or integrity issues are discovered during due diligence and the facility does not propose to commission an in-depth due diligence report.
- 1.5. In the circumstances set out above the PIDG Participant shall inform the CMO in advance and in reasonable time through its supervising entity (a list of supervising entities is set out in Annex 1 of the Code). The CMO shall seek the approval of the CEO to the non-compliant policy or practice within 10 days of receipt of the request from the PIDG Facility.
- 1.6. The investment process covered by the framework set out in the Due Diligence Policy and Procedures includes origination of the opportunity up until completion and post-investment. The framework recognises that the Facilities may each have their own “New Business Committee” or “Credit Committee” (or equivalent) process and have established their own approval process for new opportunities. Accordingly, the framework set out in the Due Diligence Policy and Procedures does not require the Facilities to adopt a particular investment approval process, but serves to act as a guide for the different stages involved in the due diligence process within PIDG with a focus on the specific due diligence policies and practices required.
- 1.7. A due diligence assessment should ensure that procedures uses, including on assessments of financial and operational performance, are as robust as possible.
- 1.8. The separate stages of a due diligence process are typically as follows:

- ▶ New Business Committee;
- ▶ Due Diligence;
- ▶ Credit/ Investment Committee Submission;
- ▶ Completion, Monitoring and Reporting.

## **2. When to conduct due diligence**

- 2.1. A due diligence process will be carried out before entering into any business relationship and/or before executing any transaction or investment. The exceptions to this general rule, unless there has been a significant change in any factor of the business and/or programme, are when:
- ▶ The proposed opportunity is a continuation of funding or development of an existing project; and/or
  - ▶ A recent due diligence assessment, within the last [one year], has been carried out on the proposed partner/project and where this assessment relates to activities in a similar or related sphere of activity.
- 2.2. The best time to conduct a due diligence process will vary, however most assessments are envisaged to be commenced in PIDG on a preliminary basis before NBC. However, the full detailed due diligence will be undertaken between the New Business Committee Approval and concluded prior to Credit Committee, as illustrated in the framework.
- 2.3. Stand-alone due diligence assessments should remain valid for a maximum of [one year]; however, the Facility may determine an earlier re-assessment is required where circumstances indicate that:
- ▶ Partner/project risks have not been properly identified;
  - ▶ Events infer that partner/project risk control strategies are ineffective;
  - ▶ There is a significant change in a partner's/project's circumstances such as restructuring; or
  - ▶ A shorter period is deemed more appropriate.

### **3. New Business Committee (NBC) (or equivalent)**

3.1. A summary 'New Business Paper' (NBP) is drafted by the respective investment team for each individual proposal and submitted to the New Business Committee for approval. The NBP should include a proposed approach to due diligence and conditions in respect of and tailored to the individual proposal as part of the wider investment opportunity.

3.2. NBPs are a high-level preliminary assessment of the investment opportunity, and unlike Credit Committee papers, should not seek to address all investment criteria requirements. As guidance on content, NBPs may typically include the following information:

#### **3.3. Background**

- ▶ Opportunity and management team's backgrounds;
- ▶ Country and industry analysis highlighting previous exposure and experience(s); Summary of investment rationale, including fit with approved strategies and investment policies, and development impact;
- ▶ Nature of the proposed opportunity and partners;
- ▶ Timeline and probability of completion;
- ▶ Key issues for subsequent due diligence stage including for example sponsor, project company, construction, technology, operation, exchange rate, interest rate and market risks;
- ▶ Recommendation on how to progress the opportunity;

#### **3.4. Risk Management/Financial**

- ▶ Initial Conflict of Interest review;
- ▶ Initial assessment of Bribery, Fraud or Corruption risk including Government Risk and potential involvement;
- ▶ Investment quantum and deal structure, including a summary of the key deal terms proposed for negotiation prior to an investment decision;
- ▶ Initial comments on the commercial attractiveness of the opportunity, including:
  - Key drivers of risk/return;
  - An overview of the business plan including summary financials.
- ▶ An initial estimated budget for the opportunity, which includes, but is not limited to travel, due diligence and the appointment of external advisors. If in due course the investment team believes it will exceed the approved budget before submission to the Credit Committee, it would typically secure NBC approval of a supplemental budget.

#### **3.5. Preliminary Risk Rating**

- ▶ New opportunities will be categorised as high risk, medium risk or neutral risk (or equivalent), which will guide the necessary and appropriate due diligence. For ongoing/repeat opportunities, the relevant risks still need to be reassessed to check if the risks remain unchanged.

#### **3.6. Environmental, Economic and Social Development**

- ▶ Satisfied additionality requirement;
- ▶ Any Environmental, Social and Health & Safety issues including Child Protection issues, as stated in the PIDG Environmental and Social Policies and Procedures, which can be identified as likely to require particular attention during due diligence.

- 3.7. Approval from the NBC may be required before entering into any initial communication which will result in the declaration of a non-binding expressions of interest, submission of non-binding offer letters or term sheets, or similar documents;
- 3.8. It is the responsibility of the investment team to address any, Environmental, Social and Health & Safety issues at an early stage. The sections addressing the aforementioned matters should be either prepared or approved by a member of the investment team with the relevant skills.
- 3.9. Any concerns in relation to bribery, fraud or corruption, or any other actual or potential reputational risk should be raised at this stage in accordance with PIDG's Anti-corruption and Integrity Policy and Procedures:
  - ▶ Initial business integrity checks on proposed investments and any known associated entities will bring up any issues that can be further flagged at the later due diligence stage. These should be noted in the NBP and include entities' background checks, initial review of shareholders/borrower/other relevant parties, review of transparency issues, identification of fraudulent practices.
- 3.10. Any potential conflicts of interests with a third party's involvement in the proposed transaction should be disclosed by the investment team in the NBP in accordance with PIDG Conflicts of Interest and Share Dealing Policy and Procedures:
  - ▶ All disclosed conflicts shall be presented and discussed with the NBC; the investment team will ensure that appropriate actions are taken to ensure they are adequately mitigated, depending on the nature and extent of the conflict; and
  - ▶ The members of the NBC will disclose any potential conflict of interests regarding the potential transaction and appropriate actions will be taken to mitigate such conflicts in accordance with PIDG Risk Management Policies and Procedures;
- 3.11. In some situations, the Facility is likely to have sufficient capability to carry out the due diligence without recourse to external advisors. However, in other situations, particularly for high risk opportunities, it will likely be necessary to appoint external advisors to carry out due diligence procedures. However, the Facility should always conduct their own due diligence, including opportunities where external advisors are engaged. The level and scope of in-house due diligence and also the need for external due diligence advisors should be discussed and decided during the NBC meeting for the opportunity. This will need to be determined and allocated on a case-by-case basis due to the varying levels of risk for each individual opportunity. The use of external advisors is at the discretion of the Facility.
- 3.12. A legal team may be involved in a transaction before approval is sought from the NBC if there are, on an initial high-level analysis, any particular regulatory, structuring or other legal points of importance to the proposed transaction.
- 3.13. Typically, it is the role of the NBC to review the NBPs and then a decision will be made to either go forward with or reject the opportunity.
- 3.14. If the opportunity is approved, the project will move into the due diligence phase.

## **4. Due Diligence**

- 4.1. Depending on the business activities of a PIDG facility, it may be likely that in order for due diligence to proceed (particularly in respect of seeking access to investment target records, book, site visits etc.), documentation (at least a term sheet or joint investment agreement) may need to be signed. Therefore, it may be impractical to require a detailed due diligence compliance step immediately after the NBC and prior to further negotiations, discussion and documentation occurring between the parties.
- 4.2. The PIDG due diligence policy and procedures are divided into five separate streams as follows:
  - ▶ Preliminary Due Diligence;
  - ▶ Know Your Client;
  - ▶ Integrity Due Diligence;
  - ▶ Financial and Commercial; and
  - ▶ Environmental and Social including Child Protection issues.
- 4.3. Investment team resources will be allocated to the opportunity as required and will appraise all elements of the opportunity included, but not limited to the areas covered in the NBP and all issues raised at the NBC.
- 4.4. Following the NBC stage, financial, commercial or business integrity risks will be considered by undertaking comprehensive due diligence. The investment team should manage the due diligence process including scope and cost.
- 4.5. This due diligence process may require assistance from an external advisor and procured in accordance with the PIDG Procurement Policy and Guidelines.
  - ▶ If external due diligence providers are utilised, reports, where appropriate, should be shared with relevant investment personnel and also the management team of the opportunity.
- 4.6. **Preliminary Due Diligence**
- 4.7. During preliminary due diligence, the investment team will:
  - ▶ Review documentation of the investment opportunity including (to the extent available): feasibility study reports, policy manuals, reporting, proposed action plans, legal documents and public information;
  - ▶ Identify relevant individuals within the target opportunity to contact and understand processes, knowledge and commitment of the business and its management to high-risk areas. Site visits may also be required in addition to external advisors where appropriate and this should be considered in good time to allow for planning and to propose it to the Credit Committee. It is the responsibility of the investment team to facilitate interaction with the business opportunity;
  - ▶ Identify the development impact and additionality of the Facility's involvement.
- 4.8. At this stage, further and more detailed legal, structuring and regulatory issues will be discussed and a plan drafted to address these.
  - ▶ Legal advice may be needed from the NBC stage onwards and should be decided by the investment team. Where applicable, an in-house lawyer or other dedicated team member should be allocated to each opportunity in order to manage the process and ensure risk management and consistency to the PIDG Code of Conduct, OPPs and other relevant policies.

- ▶ The investment team should consider potential structures including tax structuring and corporate entity establishment.

#### 4.9. **Know Your Client (KYC)**

4.10. The KYC conducted should follow the applicable national regulatory and licencing standard or the PIDG Due Diligence Policy and Procedures, whichever is higher. The KYC risk assessment conducted should include:

- ▶ Identifying the business and verifying identity using reliable, independent source documents, data or information;
- ▶ Identifying board members, directors and verifying the identities of at least [two] board members;
- ▶ Identifying the ultimate beneficial owners (UBOs) and when to verify their identity;
- ▶ Understanding the ownership and control structure of the business;
- ▶ Determining if a Politically Exposed Person (PEP) is involved in the business;
- ▶ Identifying if a conflict of interest exists;
- ▶ Determining the purpose and intended nature of the business relationship;
- ▶ Monitoring the business relationship and its risk profile;
- ▶ Identifying any adverse media or negative information regarding the country, business/business' activities or related individuals;
- ▶ Determining whether there are any doubts concerning the business (e.g., source of funds); and
- ▶ Identifying if the country is prohibited by way of sanctions in place by the EU, UN, World Bank and List of funding PIDG Members;
- ▶ Identifying if the parties (the business or any individual or other party) is prohibited by way of sanctions in place by the World Bank and PIDG Members.

4.11. The above assessment will identify any red flags, e.g. for the country, business or related individuals, particularly in high risk classified opportunities. This can then prompt the need for enhanced due diligence measures, to be decided by the investment manager, for example :

- ▶ Visiting business for further assessment;
- ▶ Setting compliance governance milestones and following this, periodic monitoring to check adherence;
- ▶ Monitoring if/when a PEP is discontinuing/has discontinued the conflict of interest;
- ▶ Initiating an external independent investigation to conduct an in-depth investigation; and
- ▶ Performing frequent monitoring on the company to discuss the risk status.

#### 4.12. **Integrity Due Diligence**

4.13. All PIDG participants and entities receiving funding either directly or indirectly from the PIDG Members should take all appropriate measures to prevent and combat fraud and corruption, money-laundering and the financing of terrorism, as stipulated in the PIDG Anti-corruption and Integrity Policy and Procedures and all applicable national and international laws and regulations. Each participant has a duty to make arrangements to ensure that the funding from the PIDG Members is used for the purposes for which it was deployed.

4.14. Integrity due diligence should follow up and investigate any business integrity risks identified earlier in the investment process by undertaking the following:

- ▶ External background check report from relevant companies;
  - ▶ Financial due diligence;
  - ▶ Discussions with senior members of companies familiar with the proposed Investment and Investee Company or other means agreed with the NBC.
- 4.15. The Investment Team and relevant business integrity personnel are responsible for any corruption related risks that should be evaluated in the due diligence, including assessing whether the following require further particular enhanced due diligence based on the initial due diligence and KYC reports on the investment opportunity:
- ▶ The proposed investment base of the business and extent to which investments are made into government or state-owned assets;
  - ▶ Current anti-corruption procedures within the business and if they have sought to introduce compliance measures;
  - ▶ Results of internal reviews or audits of the business in relation to bribery;
  - ▶ Details held of third parties (identity, role, terms of engagement, compensation) if business relies on any third parties;
  - ▶ Details of process for obtaining government licenses required by business to engage in business activities;
  - ▶ Details of any political or charitable contributions by the business;
  - ▶ Details of any payments to government officials for any aspect of the business; and
  - ▶ Local legal requirements and the effectiveness of their enforcement.
- 4.16. The investment team will continue its AML/KYC checks in order to identify and resolve any potential issues prior to the submission to the Credit Committee.
- 4.17. Due to the nature of PIDG's work, many of the opportunities are situated in some of the more challenging countries meaning working in areas where known terrorist organisations operate, therein increasing risk of resources being diverted for use by terrorist organisations.
- 4.18. Enhanced due diligence should be undertaken to minimise the potential of funds being associated with terrorist organisations, based on the risk classification of the opportunity documented in NBP. In addition to this, entities should ensure that their colleagues have sufficient awareness of the risk of terrorist financing and the requirements to report any suspicion of terrorist financing immediately. In accordance with PIDG Anti-corruption and Integrity Policy and Procedures, appropriate systems and procedures must be in place to enable staff to identify potential links to terrorist organisations and also reporting systems in order that, should there be any suspicion of terrorist financing, it can be reported immediately.
- 4.19. **Financial and Commercial**
- 4.20. Obtain and review financial information of the organisation for the last [three] financial years;
- 4.21. Consider robustness of organisations current and forecast cash situation, reviewing gearing ratios, cash flow including sensitivity analysis if available;
- 4.22. Review any contingent liabilities and any pension liabilities in the accounts. Review any limits on these liabilities;
- 4.23. Consider any insurance cover available against requirements; and
- 4.24. Check that external audits are free from 'qualifications' on financial accounts.

- 4.25. Investment Teams must always assess the Investment Business's commitment, capacity and track record (CTTR) as they are leading indicators of the company's ability to achieve and maintain compliance with applicable standards and expected performance.

## **5. Environmental and Social**

- 5.1. Environmental and Social due diligence should be conducted in accordance with PIDG Environmental and Social Policy and Procedures (which are IFC Performance Standards on Environmental and Social Sustainability).

## **6. Reliance on Third Party Due Diligence including KYC**

- 6.1. It may sometimes be appropriate for a PIDG facility to consider using a third party's due diligence rather than conducting its own, for example if the PIDG facility is one lender in a syndicate, it may be appropriate for the syndicated lenders to rely on the due diligence carried out by the lead arranger. However, the PIDG facility should, as a minimum, request copies of the due diligence to ascertain by a desk review whether there are any gaps which the PIDG facility would need to fill by carrying out its own additional due diligence or requesting the third party to supplement their due diligence if appropriate.

## **7. Credit Committee (or equivalent) Submission**

- 7.1. Following the NBC and due diligence activities, the investment team shall consider when the investment appraisal and due diligence is sufficient to make a recommendation to its Credit Committee (or equivalent). Any further due diligence after Credit Committee submission will typically be confirmatory only.
- 7.2. Typically, a credit committee submission should contain the following sections:
- ▶ Introduction;
  - ▶ Confirmation of no breach of Investment Policy limits;
  - ▶ Development Impact and Additionality;
  - ▶ Company/Project History and Background;
  - ▶ The Market and Jurisdiction;
  - ▶ Financial and Operational Performance;
  - ▶ Business Plan;
  - ▶ Proposed Investment Structure and Terms;
  - ▶ E&S including Health and Safety Systems (both at country and project level) and Business Integrity Considerations;
  - ▶ Valuation, Returns and Exit;
  - ▶ Summary of all due diligence workstreams and Post-Investment Plan;
  - ▶ Summary of Risks and mitigating action plan; and
  - ▶ Conclusion.
- 7.3. In summary, the credit committee submission will include all information relevant to the investment appraisal including all necessary E&S, BI and DI assessments, and any outstanding issues to be addressed following credit committee approval. The credit committee submission should also propose (as a part of the due diligence plan section) a budget for all additional due diligence costs and completion legal costs.
- 7.4. The credit committee submission will document how the investment will be managed and the way in which performance will be tracked and what the key performance indicators will be. This should include proposed team members and structure and an assessment of their relevant skills and experience within country and industry.
- 7.5. Content should focus on value-add, any key E&S and BI risks and opportunities identified in the NBP and also document an action plan to address any relevant issues including any outstanding due diligence issues.
- ▶ Summary of specific “value add” opportunities identified, resource costs and issues in addition to assumptions, implementation risks and potential impact.
  - ▶ Summary on the adequacy of a targets business integrity process and controls, if any, its AML/KYC procedures and any AML and/or business integrity risks. If procedures are considered inadequate, then an agreed remedial action plan must be set out in the credit committee submission.
- 7.6. Risk ratings should also be confirmed or updated from the NBP stage, this should include a summary of risk rating based on findings of due diligence, the compliance gap and any other requirements;

- 7.7. If there are any significant business integrity issues surrounding the investment, the investment team and relevant business integrity personnel should consider whether a third party report should be commissioned on the basis of risk management.
  - ▶ Further detail on areas of potential reputational risk and mitigation for highest risk issues.
- 7.8. The credit committee submission should address significant issues raised at the NBC and also outline the investment structure and terms including the tax effects. Any intermediary entities should be identified and explained. If necessary, a legal team should review this section.
- 7.9. Each due diligence work stream outcome should be summarised and a conclusion reached on any issues that need to be raised at Credit Committee.
- 7.10. The submission should include an action plan for ensuring compliance with PIDG Code of Conduct and OPPs as well as Monitoring plan including frequency and scope as well as resourcing.
- 7.11. The credit committee submission should be submitted to the Credit Committee in accordance with the Facilities' internal policies and procedures.
- 7.12. Representatives of the investment team who prepared the credit committee submission should attend the Credit Committee Meeting in addition to any other relevant personnel required to discuss E&S, BI, DI and legal issues. The credit committee submission can either be approved or rejected by the Credit Committee and, where required, submitted to the Board for approval. .
- 7.13. Following Credit Committee (and/or Board) approval, relevant term sheets, agreements and negotiations will be negotiated with third parties by the Investment Team using standard templates where possible. These should be aligned with the deal terms approved by the Credit Committee (and/or Board) and reviewed by the legal team and approved by the [investment team].
- 7.14. Whilst some credit committees may require an initial meeting to assess a high-level investment opportunity first before carrying out continued due diligence, others may complete this process at the same time.

## **8. Completion and Ongoing Monitoring**

### **8.1. PIDG's Anti-Money Laundering and Know Your Client checks**

8.2. The investment team will start the necessary AML/KYC checks shortly after NBC approval so that any money laundering issues are identified at an early stage.

8.3. It is essential that PIDG's AML/KYC procedures and all applicable national and international laws and regulations are strictly followed as set out in the Due Diligence section above and contained in the Anti-corruption and Integrity Policy and Procedures. Prior to the completion of a transaction, the investment team members will review the KYC documents. In addition, AML/KYC checks will be carried out regularly throughout the life of a project/transaction. Customer relationships and ongoing investment projects should be reviewed and monitored regularly. The due diligence/KYC file should be periodically reviewed to determine if material changes have taken place that may impact the risk of the customer/investment. This information should be updated where relevant

### **8.4. Legal Negotiations, Monitoring and Documentation**

8.5. The investment team is responsible for ensuring that the underlying investment complies with PIDG's Code of Conduct and OPPs.

8.6. Legal terms will typically include covenants which require compliance with relevant sections of PIDG's Code of Conduct and OPPs.

8.7. The treatment and monitoring and reporting of any risks identified, recorded and analysed during the due diligence phase needs to be agreed and recorded.

8.8. Post-investment, the Facility must ensure that they have oversight of ongoing monitoring and compliance with agreed standards including ensuring that each project has an adequate health and safety management system and that there is compliance with this system throughout the PIDG participant's involvement with the project.

8.9. The Facility must ensure that they maintain post-investment complete and up-to-date files in relation to each opportunity which has been taken forward for completion. These files would, for example, include records of opportunity origination, New Business Paper details, all documentation of due diligence streams including any external due diligence reports, Credit Committee submission details, and completion documents in addition to any ongoing procedures undertaken during or post-transaction.

8.10. A key outcome of due diligence is improved knowledge and understanding of project stakeholders and opportunities as well as the nature and process of gaining assurance of the business or project identified in order to be able to make an informed investment decision and in addition, go to the extent necessary to protect the PIDG Trust, Members and Facilities from the risks associated with the specific opportunity. The PIDG Facilities should maintain a Due Diligence Assessment Register (or equivalent) of completed assessments in order to provide continuity for future reference.