



INDEPENDENT VERIFICATION REPORT OF
ALIGNMENT WITH THE OPERATING
PRINCIPLES FOR IMPACT MANAGEMENT

MCE Social Capital

October 19, 2023

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Introduction

MCE Social Capital (“MCE”) engaged Tidal Impact Holdings Inc (“Tidal Impact”) to conduct an independent review and provide assurance on the alignment of MCE’s impact management systems, processes, and policies with the Operating Principles for Impact Management (“the Principles”).

Tidal Impact is a sustainability, impact measurement, and management firm with a presence in North America, Europe, and the Middle East. The firm offers tailored advisory services for a wide client base, including social enterprises, corporations, and private equity firms. The objective of Tidal Impact is to assist clients in integrating sustainability and impact as core competencies, thereby driving business growth.

Tidal Impact’s assessment for this engagement included:

- Reviewing MCE’s Impact Principles statement.
- Reviewing MCE’s impact management policies, practices, and systems against the requirements of each principle.
- Conducting interviews with key stakeholders at MCE who are responsible for structuring, managing, and implementing impact policies and systems.
- Providing future recommendations during a stakeholders’ workshop.

This verification letter assesses each principle on a scale from 1 to 3, as outlined below:

- A rating of 1 indicates that the principle has been addressed comprehensively.
- A rating of 2 indicates that the principle has been mostly addressed, with some room for improvement.
- A rating of 3 indicates that the principle has not been addressed well and needs further improvement.

Areas of Strength:

- **Principle 3:** MCE is transparent about its contribution to impact through the provision of senior and subordinated debt, and these objectives are well-documented during the initial due diligence process.
- **Principle 5:** MCE has robust environmental and social responsibility policies and a proactive approach to avoiding ESG risks.
- **Principle 6:** MCE has a thorough annual impact survey and collaborates with third-party assessment partners to monitor impact.
- **Principle 8:** MCE’s frequent data collection and internal review meetings demonstrate a committed approach to impact evaluation.

Areas of Improvement:

- **Principle 1:** Although there is alignment with the Sustainable Development Goals (SDGs), this is not mentioned early in the documentation. MCE could also improve this by including simple visual aids to illustrate its theory of change and setting specific, tangible targets related to these objectives.
- **Principle 2:** MCE could further clarify how it identifies and mitigates governance risks. While annual reports from investees include environmental and social topics, it’s unclear whether

negative impacts are also reported. Further, MCE could provide a clearer explanation of how staff incentives are aligned with impact achievements.

- **Principle 4:** MCE could provide more specific details about its results measurement framework and potential impact. Additional context and high-level case studies or scenarios would also offer more depth.
- **Principle 7:** MCE could offer more information on how it balances fiduciary responsibilities with impact goals, especially during potential loan defaults. A distinct ESG due diligence process for renewals could be beneficial and more efficient.

Conclusion of the Assessment

In conclusion, and based on the assessment conducted, nothing comes to our attention that causes us to believe that MCE has not aligned with the Impact Principles. A detailed assessment of each principle is available on the following pages.

Dima Alashram
Co-founder & Chief Impact Officer
Tidal Impact Holdings



October 19, 2023

Detailed Assessment

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.

Areas of Strengths:

- MCE clearly articulates its theory of change and highlights its impact objectives which are: (i) Investing in a Thriving Environment (increasing farmer productivity, enhancing resilience to environmental stressors and climate change, managing climate risks, and reducing emissions) and (ii) Investing in Women (focus on women and the enhancement of gender impact by examining gender balance both at the end beneficiary and investee levels).
- MCE explains the link between its impact objectives and investment strategy by making loans to Financial Service Providers (FSPs) and Small and Growing Businesses (SGBs) and the intended impact for each. Both FSPs and SGBs focus on underserved communities.

Areas for Improvement:

- While an alignment with the SDGs exists, it is not mentioned in Principle and only mentioned in later principles. It is recommended that MCE mentions this alignment early on.
- MCE could include additional visual elements to further explain its theory of change.
- While the impact objectives are highlighted, MCE does not provide targets. For example, MCE states that it focuses on ‘enterprises committed to generating sustainable livelihoods, with a focus on women and environmental and climate action’. Even though metrics to measure this objective exist in MCE’s impact rating models, it would be beneficial to set tangible targets related to these objectives.

Area	Explanation	Rating
Overall Alignment		2
1.1. Strategic Alignment	The impact investor should articulate how the impact objectives align with the overall strategy of the organization or fund, and how they support the mission and values of the organization.	1
1.2. Targeted Impact	The impact investor should identify and prioritize the social or environmental outcomes they seek to achieve, and clearly define the intended beneficiaries.	2

1.3. Aligned with the SDGs	The impact investor should highlight how its investment is aligned with the SDGs	2
1.4. Contribution Analysis	The impact investor should analyze and report on the extent to which their activities contributed to achieving the intended impact, considering the activities of other stakeholders and the broader context.	2
1.5. Continual Improvement	The impact investor should continually review and refine their impact objectives, targets, and measurement methodologies to improve impact performance over time.	1

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.

Areas of Strengths:

- MCE has a comprehensive environmental and social due diligence process in place to identify and assess impact on the portfolio level based on its initial appraisal and due diligence investment memo.
- Investees report on social and environmental impact metrics on an annual basis via MCE’s impact survey. MCE has developed these metrics in alignment with the SDGs, IRIS+, CSAF, and the 2X Challenge.
- MCE informs stakeholders about its impact performance through an annual impact report available on MCE’s website.

Areas for Improvement:

- MCE could explain how governance risks are identified and mitigated.
- While investees monitor and report on social and environmental topics, MCE could highlight whether they also report on negative social and environmental impact.
- MCE could introduce a mechanism to align staff incentive systems with the achievement of impact.

Area	Explanation	Rating
Overall Alignment		2
2.1. Identification	The impact investor should identify and assess potential negative impacts that their investments may have on the environment, society, or	1

	stakeholders, including those that may be unintended or indirect.	
2.2. Mitigation	The impact investor should have strategies and processes in place to mitigate and manage negative impacts and take action to address any negative impacts that occur.	2
2.3. Monitoring and Reporting	The impact investor should monitor and report on negative impacts and disclose how they are managed and mitigated.	2
2.4. Accountability	The impact investor should be accountable to stakeholders for the negative impacts of their investments and the effectiveness of their mitigation strategies.	1
2.5. Employee incentives	The impact investor should put in place a staff incentives plan designed to create impact.	3

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.

Areas of Strengths:

- MCE communicates its contribution to the achievement of impact through the provision of senior and subordinated debt in a clear and cohesive way.
- MCE’s impact objectives are assessed during the initial due diligence process and are documented in-depth in the investment memos. In addition, the impact achievements are monitored through quarterly financial and operational metrics, and on a qualitative basis through monitoring calls, site visits, and annual impact surveys.

Areas for Improvement:

- MCE could further elaborate on its own additionality and specify how the additionality on FSPs and SGBs is quantified.
- MCE could provide further case studies on its contribution to the achievement of impact for its investments as part of its annual impact report.

Area	Explanation	Rating
Overall Alignment		1
3.1. Impact Strategy	The impact investor should have a clearly defined impact strategy that sets out how impact is	1

	integrated throughout the investment lifecycle, from deal sourcing and selection to exit.	
3.2. Investment Selection	The impact investor should use impact criteria to screen potential investments and prioritize investments that are likely to generate positive social or environmental outcomes.	1
3.3. Structuring	The impact investor should structure investments to maximize positive impact, while minimizing negative impact, and negotiate impact-related terms with investees.	1
3.4. Managing	The impact investor should actively manage their investments to maximize impact performance, including setting impact targets, monitoring impact performance, and providing strategic and operational support to investees.	2

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 (RMF) 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 to 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 practices.

Areas of Strengths:

- MCE provides a clear articulation of its intended impact throughout the Impact Principles, supported by a robust due diligence, impact rating, and monitoring process.
- MCE clearly states how it conducts a thorough structured risk analysis as part of the due diligence process of each investment opportunity, further supporting its commitment to impact.

Areas for Improvement:

- MCE could provide more clarity on its results measurement framework, as well as the potential impact in more quantified terms during the initial appraisal and due diligence stage.

- While MCE provides a comprehensive overview of the social and environmental metrics used, the organization could elaborate more on how it evaluates the potential impact of its investments, as well as measures taken to reduce the risk of falling short of the anticipated impact.
- MCE could provide information on how it considers opportunities to increase the impact of its investments. Given the close relationship MCE is building with the FSPs and SGBs, it would be beneficial to include more context, possibly also in the form of case studies.

Area	Explanation	Rating
Overall Alignment		2
4.1. Clear articulation of the intended impact (What)	The impact investor should have a results measurement framework (RMF) that aims to explain what the intended impact is.	2
4.2. Clear articulation of the beneficiaries (Who)	The impact investor should have a results measurement framework (RMF) that aims to explain who the beneficiaries of the intended impact are.	2
4.3. Significance of this impact (for a target beneficiary group in question) (How much)	The impact investor should have a results measurement framework (RMF) that aims to explain how much beneficiaries are part of the intended impact.	2
4.4. Risk of not achieving the intended impact	The impact investor should use processes to understand the likelihood of the intended impact and potential negative risks.	2
4.5. Assessed opportunities to grow impact further	The impact investor should assess opportunities to grow impact further.	2

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.

Areas of Strengths:

- In addition to a careful investment pipeline development process to avoid and mitigate ESG risks, MCE has a wide range of prohibited activities in its exclusions list.

- MCE has a robust environmental and social responsibility policy.

Areas for Improvement:

- MCE supports investees in developing more sophisticated impact strategies or setting specific targets when there is room for improvement. Providing examples would help illustrate MCE's role in mitigating ESG risks and will enhance understanding of their impact.

Area	Explanation	Rating
Overall Alignment		1
5.1. Assessment	How does the investor assess and document the ESG risks of each investment.	1
5.2. Collaboration	The impact investor should collaborate with the investee to take actions to address potential gaps	2
5.2. Monitoring	The impact investor should seek to achieve regular monitoring and reporting to assess any potential negative ESG risk.	1

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.

Areas of Strengths:

- If an investment is no longer on track to achieve its intended impact, MCE collaborates with the client to address the issue before considering denying a loan renewal.
- MCE uses a comprehensive annual impact survey to monitor and report on the impact of its investments.
- MCE collaborates with a trusted third-party impact assessment partner to monitor the investees' impact in addition to utilizing its impact survey.

Areas for Improvement:

- Although Principle 6 mentions that the "MCE's impact assessment framework" is found under Principle 4, there is no link provided to access the framework. It is recommended to add the link.

- It would be beneficial to further elaborate on the process and actions taken when impact objectives are not met.

Area	Explanation	Rating
Overall Alignment		1
6.1. Monitoring	The impact investor should monitor the impact progress of each company in comparison to the expected impact that was set.	1
6.2. Monitoring Process & Reporting	The impact investor should monitor the progress by using a predefined process and sharing the performance data with the investee.	1
6.3. Actions Taken when Intended Impact not Met	The impact investor should seek to pursue appropriate action when the expected impact is not met.	1

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.

Areas of Strengths:

- MCE prefers to restructure loans instead of declaring default when there's potential for long-term success. This aligns with the objective of maintaining long-term impact.
- All loan decisions require approval by an investment committee that explicitly factors in the expected impact.

Areas for Improvement:

- MCE could provide additional information on how fiduciary responsibilities are balanced with the goal of sustaining long-term impact in the event of a loan default, when loan restructuring is not possible.

Area	Explanation	Rating
Overall Alignment		2
7.1. Exit Strategy	The impact investor should have an exit strategy in place highlighting how to assess which negative impact could lead to an exit.	2
7.2. Effect of timing, structure, and process of an exit on sustaining impact created	The impact investor should explain in which timeline, structure, and process an exit occurs.	2

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.

Areas of Strengths:

- MCE collects financial and operational data frequently— monthly for financial service providers and quarterly for small businesses, adding to the robustness of its impact evaluation.
- MCE holds weekly meetings with the portfolio and impact team and biweekly meetings with the loan committee. This shows a consistent review and application of findings to operational and strategic decisions.
- MCE uses Social Ratings from established agencies, providing an external perspective on the investees’ impact performance.

Areas for Improvement:

- While MCE notes that findings inform decisions, it's unclear how this directly improves investment or operational strategies. A case study, or providing scenarios, demonstrating the practical application of impact findings could add clarity.

Area	Explanation	Rating
Overall Alignment		1
8.1. Revision	The impact investor should review the impact performance of each investment.	1
8.2. Comparison	The impact investor should compare the expected impact and the actual impact.	1
8.3. Strategic Investment Decisions	The impact investor should use the findings of actual impact and positive and negative risks to improve strategic investment decisions.	2

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.

Areas of Strengths:

- MCE publishes an annual Impact Principles Disclosure Statement, showcasing its commitment to transparency and accountability in adhering to the Principles. MCE proactively seeks independent verification of its alignment with the Principles by engaging an independent third party to conduct a verification.

Areas for Improvement:

- No areas of improvement are identified for this Principle.

Area	Explanation	Rating
Overall Alignment		1
9.1. Statement detailing the process and intervals for independent verification	The impact investor should disclose its intention to undergo an independent verification in its Impact Principles Disclosure Statement	1