Principles for Responsible Investment

THE LIMITED PARTNERS' RESPONSIBLE INVESTMENT DUE DILIGENCE QUESTIONNAIRE

AND HOW TO USE IT

FINANCE INITIATIVE

United Nations Global Compact

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

1 **We will incorporate ESG issues into investment analysis and decision-making processes.**

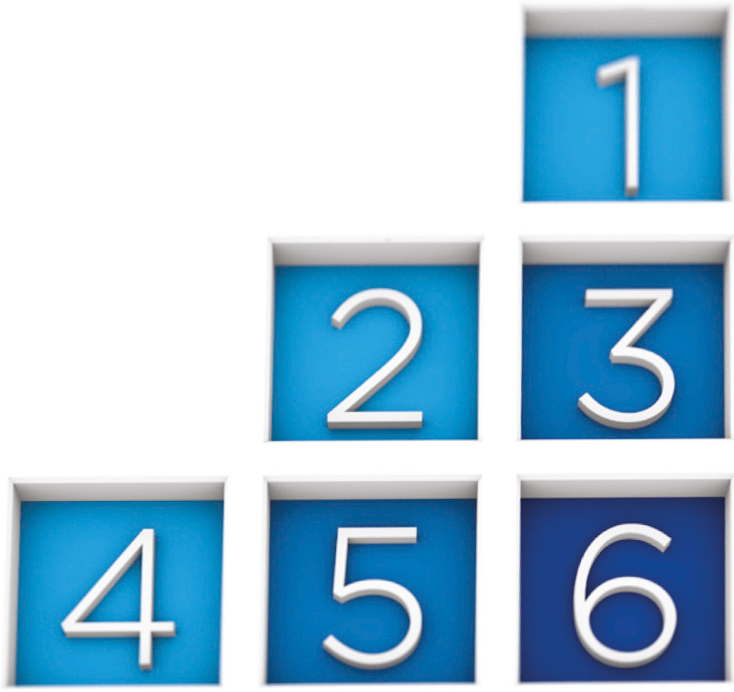
2 **We will be active owners and incorporate ESG issues into our ownership policies and practices.**

3 **We will seek appropriate disclosure on ESG issues by the entities in which we invest.**

4 **We will promote acceptance and implementation of the Principles within the investment industry.**

5 **We will work together to enhance our effectiveness in implementing the Principles.**

6 **We will each report on our activities and progress towards implementing the Principles.**



ABOUT THIS GUIDANCE DOCUMENT

This guidance document accompanies the Limited Partners' Responsible Investment Due Diligence Questionnaire (LP Responsible Investment DDQ). The *LP Responsible Investment DDQ* is not intended to be used as a check-list, but as a tool to establish dialogue, which this guidance document is designed to support and enhance.

- "Developed questioning" guides Limited Partners (LPs) on how to develop their dialogue with General Partners (GPs) further and guides GPs on the level of detail that an LP might expect in response to the questions in the *LP Responsible Investment DDQ*. It is not the intention of this guidance document to add substantially to the *LP Responsible Investment DDQ* itself. Furthermore, LPs should recognise that some of the "developed questioning" would be considered to be advanced, and may not be universally appropriate or applicable.
- Short case studies demonstrate the market relevance of the due diligence questions.
- GPs are pointed towards publicly available resources that will help develop both understanding and application of the responsible investment practices referred to in the *LP Responsible Investment DDQ*.
- Footnotes highlight where questions are in alignment with the *PRI Reporting Framework* and the *ILPA Due Diligence Questionnaire*.

INITIAL STEPS

GUIDANCE FOR LIMITED PARTNERS

LPs need to establish their own expectations and processes around responsible investment before they can engage with their GPs. The PRI offers the following guidance for asset owners:

ALIGNING EXPECTATIONS – on how to include expectations on responsible investment in interactions with external managers.

PRI GUIDE FOR LIMITED PARTNERS – how an LP might integrate environmental, social and governance (ESG) considerations into investment policy, decisions and ownership activities; includes an overview of some key characteristics of private equity that demonstrate strong alignment with responsible investment to consider when developing and implementing a policy.

WRITING A RESPONSIBLE INVESTMENT POLICY – offers a suggested policy structure based on an analysis of PRI signatories' existing responsible investment policies.

LPs can also refer to GP case studies for examples of good responsible investment practices:

BVCA GUIDE TO RESPONSIBLE INVESTMENT: SUPPLEMENT (2015)

INSEAD GPEI: ESG IN PRIVATE EQUITY - A FAST-EVOLVING STANDARD (2014)

LAVCA LATIN AMERICAN PRIVATE EQUITY DEAL BOOK & ESG CASES (2014)

PRI GUIDE FOR GENERAL PARTNERS: CASE STUDY SUPPLEMENT (2014)

FUND MANDATES

A GP's Private Placement Memorandum, Offering Memorandum, or any introductory marketing materials may allow an LP to establish whether a GP's fund mandate addresses ESG considerations.

Before conducting more detailed due diligence through the *LP Responsible Investment DDQ*, an LP may wish to establish responses to the following questions:

- Does the fund have a formal policy to exclude investments in any sectors or geographies, or based on any ESG criteria?
- [If the LP has an exclusions policy] Does the scope of the fund mandate potentially include areas of investment that would conflict with this policy? [If so] Would the GP be willing to ensure that the LP's capital is not used for such investments?
- Does the fund target sectors or geographies that have specific ESG risks and/or opportunities that the GP plans to pay particular attention to during the investment analysis and/or due diligence process?

LPs are also encouraged to check for any publicly available information on the GP's approach to responsible investment at this initial stage. If the GP is a PRI signatory, LPs can review their latest public PRI Transparency Report on the PRI website.

INVESTMENT STRATEGIES

Taking into account the diverse nature of the private equity asset class, an LP should discuss with the GP how their approach to ESG integration is influenced by their investment strategy, by establishing responses to the following types of questions:

- How does your approach to integrating ESG factors vary whether you make a minority or majority investment?
- How does your approach to integrating ESG factors vary depending upon the stage of company growth cycle that you might target?
- What is your approach to considering ESG factors in the context of secondary investments, and why?

Different funds will have different exposures to ESG-related risks and opportunities, and different GPs will have different capacities, leverage and management approaches for addressing ESG issues. An LP should take these considerations into account when assessing the GP's responses to the DDQ and in the ensuing dialogue.

FUNDS OF FUNDS

When investing in a fund of funds, an LP should have assurance that there is a thorough process in place to assess and monitor the underlying funds on their approach to responsible investment. An LP could ensure that the fund of funds manager uses the *LP Responsible Investment DDQ* as a basis for the ESG due diligence of the underlying funds and reports the collected information back to the LP. An LP could also ask a fund of funds manager to complete the *LP Responsible Investment DDQ* during fundraising (noting that Section 3 would not be applicable).

SECONDARY FUNDS

When investing in secondary funds, an LP should have assurance that there are appropriate processes in place to integrate ESG factors into investing at the indirect and direct level(s). An LP could ask a secondary fund to complete the *LP Responsible Investment DDQ* during fundraising (noting that Section 3 may not be applicable).

LP RESPONSIBLE INVESTMENT DDQ: GUIDANCE FOR DIALOGUE

1. WHAT ARE YOUR ESG-RELATED POLICIES, AND HOW DO ESG FACTORS INFLUENCE YOUR INVESTMENT BELIEFS?

Prior to investing in a fund, an LP could establish whether the GP has the relevant policies and systems in place to align their investment practices with the LP's responsible investment beliefs and expectations. After investing in a fund, an LP could continue to review this information to assess whether the GP's policies and systems are applied effectively and are continually improved.

POLICY

1.1 Do you have a policy that describes your approach to identifying and managing ESG factors within the investment and portfolio management processes? If so, please provide a copy. If not, please indicate whether you would consider adopting a responsible investment policy.[1]

Developed questioning
- Who has ultimate responsibility for the implementation of your responsible investment policy?
- Do you communicate your responsible investment policy publicly?

ASSESSING A RESPONSIBLE INVESTMENT POLICY

LPs should have an idea of what they require from a GP's responsible investment policy in order to assess if and how it aligns with their own policy and investment beliefs. A GP's responsible investment policy may cover the following points:

- Investment beliefs/motives
- Adherence to standards or principles
- Approach and objectives
- Policy coverage/scope
- Responsibility and resourcing for policy implementation
- Policy compliance
- Thematic focus (if any)

LPs may wish to see evidence of a GP's internal commitment to upholding ESG standards in their own operations.

1.2 What is the current implementation status of your responsible investment policy? Do you have any firm plans to develop your approach toward the management of ESG factors?

Developed questioning
- When was your responsible investment policy written? What is the process for reviewing your responsible investment policy?
- How have you historically implemented your responsible investment policy?

1.2 IN PRACTICE: AP7

AP7, one of six national pension funds in Sweden, hopes to be able to contribute to the development of ESG methodology within the private equity sector and to add value to all participants in the investment process by an increased focus on material ESG-risks and opportunities.

AP7 strongly believes in incorporating elements of both assessment and development in their dialogue with GPs on their approach toward the management of ESG factors. In 2014 they launched a three-year ESG Program for Private Equity in order to increase transparency and ESG integration practices within their private equity investments with the aim of continuous improvement throughout the whole investment chain.

As part of the three year program, AP7 has introduced an annual ESG private equity evaluation process with four steps:

1. Information gathering – the GP receives the questionnaire at the beginning of the year with questions on manager commitment, investment process, ownership engagement and monitoring/ reporting.
2. Assessment – AP7 evaluates the information collected and gives the GP a rating from 1 to 4 (1: Leader, 2: Developed, 3: Initial, 4: Laggard).
3. Development – AP7 holds a feed-back meeting with the GP to follow up on the previous year's targets and to set new ones. Discussion will focus on areas for improvement and what would be required of the manager to improve their rating.
4. Reporting – AP7 reviews the evaluation process and reports on portfolio progress and lessons learned in their annual sustainability report.

1 This question overlaps with the PRI Reporting Framework – Overarching Approach OA 01 and the ILPA Due Diligence Questionnaire 9.1.

IMPROVING APPROACH TO ESG INTEGRATION

CDC ESG TOOLKIT FOR FUND MANAGERS – helps GPs to design an ESG management system, including initial steps and advice on how to develop and communicate an ESG policy.

EDF ESG MANAGEMENT TOOL – defines the building blocks of a successful ESG management programme and provides GPs with a framework to assess, analyse and improve their ESG performance.

PRI GUIDE FOR GENERAL PARTNERS – offers practical guidance for GPs on developing a framework for integrating ESG factors within their investment activities, linking this with organisational governance, structure and culture.

1.3 Do you commit to any international standards, industry (association) guidelines, reporting frameworks, or initiatives that promote responsible investment practices?[2]

Developed questioning

- Are you a signatory to the PRI? Do you belong to any membership organisations or collaborative initiatives that promote responsible investment? If so, what is your level of participation?[3]
- Have you incorporated any international or industry standards or guidelines into your responsible investment policy/processes? If so, how?
- Do you promote responsible investment independently of collaborative initiatives? If so, how?[4]

STANDARDS FOR RESPONSIBLE INVESTING IN PRIVATE EQUITY

EBRD PERFORMANCE REQUIREMENTS

IFC PERFORMANCE STANDARDS

PEGCC GUIDELINES FOR RESPONSIBLE INVESTMENT

UN-SUPPORTED PRINCIPLES FOR RESPONSIBLE INVESTMENT

1.4 Do you make formal commitments relating to ESG integration in fund formation contracts, Limited Partnership Agreements, or in side letters when requested by investors?[5]

1.4 IN PRACTICE: MN

MN is a Dutch fiduciary manager with around EUR 110 billion AUM and a private equity allocation of approximately 5%. MN and their clients have adopted ten Leading Principles of Sustainable Shareholder Return [the Leading Principles]. The Leading Principles seek to ensure that the companies that MN's clients are invested in are managed according to accepted international treaties and codes, such as the UN Global Compact, the OECD Guidelines for Multinational Enterprises and relevant codes for good corporate governance.

Every GP of the funds that MN invests in is asked to acknowledge and to confirm in a side letter that they will manage the portfolio companies according to these Leading Principles. The side letter is also used for other purposes:

1. The GP acknowledges the exclusion policy of MN's clients, which precludes investment in companies active in the production, maintenance, or distribution of products or services that are non-compliant with international treaties, including cluster munitions, anti-personnel mines and chemical or biological weapons.
2. MN has the right to opt out or be excluded if the Fund intends to make an investment that is not compliant with the exclusion policy.
3. The GP reports periodically (at least once a year) on its responsible investment activities.
4. The GP reports any incidents or issues that are of concern to MN on an ongoing basis.
5. The GP will have established a responsible investment policy before a certain deadline if MN judges the GP does not have a sufficiently strong responsible investment policy, or no investment policy at all.

2 This question overlaps with the ILPA Due Diligence Questionnaire 9.0.
3 This question overlaps with the PRI Reporting Framework – Overarching Approach OA 10.
4 This question overlaps with the PRI Reporting Framework – Overarching Approach OA 11.
5 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 06.

2. HOW DO YOU IDENTIFY AND MANAGE MATERIAL ESG-RELATED RISKS AND USE ESG FACTORS TO CREATE VALUE?

Having established an understanding of the GP's responsible investment policies, an LP could then ask the GP to demonstrate how their investment decision-making processes will protect and/or create value by identifying and managing ESG-related risks and/or opportunities. An LP could also establish whether the GP has the capacity, commitment and capability to execute these processes.

RESOURCES FOR INTEGRATING ESG FACTORS INTO INVESTMENT PROCESSES

BVCA GUIDE TO REPONSIBLE INVESTMENT – a reference tool for fund managers with detailed and practical advice on how ESG factors can be managed throughout the life cycle of investments.

CDC ESG TOOLKIT FOR FUND MANAGERS – a framework that offers guidance and tools for identifying, evaluating and managing ESG factors at all stages of the investment cycle, from initial screening through to exit.

FMO ESG RISK MANAGEMENT TOOL FOR PRIVATE EQUITY – based on the IFC Performance Standards, this toolkit provides three outputs at the investment level and at the portfolio level in aggregate: the most relevant ESG risks, a score for the effectiveness of ESG risk management and the main ESG opportunities.

INVEST EUROPE HANDBOOK OF PROFESSIONAL STANDARDS – practical and clear guidance on principles of governance, transparency and accountability between private equity managers and their investors, and between managers and the companies they back. Includes guidance on responsible investment matters for different stages of the investment cycle.

PROCESS

2.1 How do you define the materiality of ESG factors? Please give 2-3 examples of ESG factors that you have identified as material to portfolio companies in your most recent fund.

ESG AND MATERIALITY

When asking about "materiality," LPs are asking GPs how they determine which ESG factors are likely to have the most impact on their investments. Materiality encompasses quantifiable impacts on financial performance and investment returns, reputational risks and broader potential consequences on business operations (such as license to operate). When responding to the *LP RI DDQ*, the GP is expected to focus on material ESG factors. The GP's determination of materiality should be based on both their own assessment of materiality and an assessment oftheir LPs' views. Where necessary, LPs should discuss and agree with the GP to ensure an aligned approach.

2.1 IN PRACTICE – AP6

AP6 is one of six national pension funds in Sweden, investing exclusively in private equity both directly and through funds. AP6's mandate is to create high, long-term return with balanced risk, and responsible investment is an integral part of this. The fund investment team currently manages SEK23.6 billion and invests mainly in European buyout, with a Nordic focus.

Based on existing frameworks such as the *ESG Disclosure Framework for Private Equity* and the *PRI Reporting Framework*, AP6 has developed a proprietary method for GP evaluation. The evaluation factors are biased toward policies and processes as these are comparable between GPs, but AP6 believes that it is only when specific issues or cases are discussed that they really understand the granularity of the GP's approach to ESG integration. If a GP can provide examples from recent funds of material ESG issues that extended beyond legal liabilities into broader ESG risks and even into business opportunities, that is telling of the GP's capacity to identify material ESG issues.

Asking for examples of material ESG issues can result in responses such as, "We invest in mature Nordic companies so there are very few ESG risks involved." The answer indicates that, although policies and processes may be in place, there is a fundamental lack of understanding around the potential ESG risks and opportunities in any investment. Take a cloud-based digital business case, for example. The mature GP would perhaps answer that, in addition to employee relations, data integrity and server capacity/energy consumption would be relevant areas to manage, whilst the less mature GP might answer that a cloud-based digital business case does not have an environmental or social impact. Tangible examples such as these help AP6 to understand the maturity of a GP's approach toward responsible investment.

2.2 Describe your process for identifying and understanding (i) potentially material ESG risks and (ii) ESG-related opportunities during due diligence.[6]

Developed questioning

- What is the scope of your ESG due diligence?

SCOPE OF ESG DUE DILIGENCE

It useful for LPs to understand how a GP reasonably decides the level of ESG due diligence that is needed for each target investment. By asking about "scope", LPs are asking GPs to specify the purpose, process and depth of their ESG due diligence with the aim of determining whether it goes beyond minimum compliance. The GP can illustrate the typical scope of their ESG due diligence and demonstrate good practice by establishing, through examples, the:

- Purpose – what the motivation is for conducting ESG due diligence, e.g screening for high-level risks, identifying outstanding liabilities or compliance obligations that may have a financial or reputational impact and/or affect investment returns, identifying risks to mitigate post-closing, thereby identifying opportunities for value creation or cost efficiencies during ownership;
- Process – what the process is for determining the depth of ESG due diligence that is needed; is a materiality assessment conducted and what is the typical materiality threshold;
- Depth – what resources are allocated for ESG due diligence (either internally or externally resourced) and what this level of resource typically delivers during due diligence.

The scope of ESG due diligence may be determined by an inherent risk rating according to industry/sector/geography. It may be useful for the GP to share a typical scope of work for different levels of perceived ESG risk.

The scope of the GP's ESG due diligence may be restricted by circumstance, depending on the nature of the transaction and the varying complexity and size of different investments. It may be that the GP only has a short time window in which to conduct ESG due diligence before submitting its offer for the business and/or finalising the transaction. It would therefore be useful for the GP to clarify whether there is:

- A minimum standard of ESG due diligence required for closing deals;
- A systematic process in place for conducting a more detailed ESG assessment post-closing that can be used to inform the improvement programme.

A minimum standard of ESG due diligence could be a combination of desk based research on publicly available information and working knowledge of ESG impacts on the target industry and sector. Whether internally or externally sourced, the GP should ensure that there is the requisite expertise in place to deliver this minimum standard and subsequently determine the scope of the ESG assessment that is needed.

- Do you have a process to grade the ESG risks and/or opportunities of each investment during due diligence?

2.2 IN PRACTICE: BRIDGES VENTURES

Bridges Ventures, a UK-based specialist fund manager dedicated to sustainable and impact investment, applies its Impact Radar* to grade investment opportunities during due diligence. ESG is one of four key dimensions of impact analysed, with a simple 1-3 scoring approach for ESG risk (3, or a high risk, indicates high potential for significant unmanageable negative externalities) and ESG return (3, or a high return, indicates significant potential for positive externalities for material stakeholders).

Behind this simple grading approach, used to inform and guide discussion at Investment Committee, are several steps of analysis. First, depending on the sector in which the business operates, the investment team (supported by Bridges Impact+ team) identifies appropriate ESG issues to be reviewed. In order to make this as practical as possible, Bridges makes it a conversation about operational excellence—using this analysis as a basis for an ESG opportunities workshop with management, which explores existing and potential ESG issues in relation to material stakeholders (e.g., customers, employees, regulators, the local community). The high likelihood / severity (risk) and high potential (return) issues identified through this process are captured in an ESG materiality analysis, which details priority issues and action points which arise. Post investment, these form part of the 100-day plan and inform engagement throughout ownership.

These steps serve to identify ESG KPIs (both risk and return) that are tracked against pre-agreed benchmarks or targets in an Impact Scorecard reviewed during Board meetings and a portfolio-wide annual review. The Impact Radar is also revisited on an annual basis, forming part of LP reporting.

*see Bridges Ventures (2013) A Spotlight on our Methodology

6 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 07 and the ILPA Due Diligence Questionnaire 10.5.

- Explain whether this is a systematic approach that is consistently applied to all new investment opportunities.
- Specify the point(s) at which ESG due diligence is typically carried out.
- Which sources do you use to get information on potential ESG-related risks and opportunities? (e.g., internal expertise, company data, company interviews, benchmarking, sector codes and guidelines, external expertise, third party audits)[7]
- If you engage external expertise, describe what type(s) of service is provided and at what stage of the due diligence process.[8]
- Specify whether you would conduct ESG due diligence on the supply chain(s) of a target company during due diligence and under what circumstances.

CDC GOOD PRACTICE: ENVIRONMENTAL AND SOCIAL DUE DILIGENCE - this good practice note covers nine themes that should be considered when determining an appropriate ESDD process; for example, how to define the scope of ESDD and when/how to involve third party technical consultants.

2.3 Once identified, how might (i) potentially material ESG risks, and (ii) ESG-related opportunities impact the investment decision?[9]

Developed questioning
- Provide recent examples of situations, if any, where a potentially material ESG factor was identified during the due diligence process. How did you identify the issue(s) and how did it impact the investment decision-making process?

2.4 How are ESG risks and/or ESG-related opportunities reported to, considered and documented by the ultimate decision-making body, such as the Investment Committee?

Developed questioning
- Provide recent examples, if any, of situations where potentially material ESG considerations have impacted the Investment Committee's decision and/or pricing negotiations.

2.5 During deal structuring, what is the process for integrating ESG-related considerations into the deal documentation and/or the post-investment action plan?[10]

Developed questioning
- Provide recent examples, if any, of situations where potentially material ESG considerations have been integrated into the deal documentation and/or the post-investment action plan.

2.5 IN PRACTICE: NEW FORESTS

New Forests is a sustainable real assets investment manager in forestry, land management and conservation in Australia, New Zealand, Southeast Asia and the United States. Their certification policy sets requirements for the use of specified third-party standards and guidelines, such as the Forest Stewardship Council and the IFC Performance Standards. Therefore their deal structuring must ensure that these certification requirements and standards can be met throughout the lifetime of the investment, through a combination of transaction documentation and shareholder controls.

As an example, during a recent transaction to acquire a minority interest in a growing Indonesian plantation company, New Forests developed an Environmental & Social Agreement (ESA) that forms part of the Shareholders Agreement and covers implementation of ESG measures. This includes defining an Executive role with Board-level representation and charged with oversight of compliance with the ESA and implementation of an Environmental & Social Action Plan (ESAP). The ESA also requires appropriate resourcing for ESG management and compliance, as well as describing remedies in the case of breaches. The ESAP is a living document initially developed from due diligence exercises focusing on gap analysis against the IFC Performance Standards, community appraisals and a land use assessment. This executive role is also responsible for all operational planning and preparation of annual work plans and budgets related to the ESAP. These work plans and budgets require approval by a board member representing each material shareholder, and so provide a regular mechanism to ensure mutual agreement on management of ESG considerations within the core operations of the business.

By developing and negotiating operational controls and third-party certification and standards requirements during deal structuring, New Forests is able to collaborate with portfolio companies and investment partners on ESG management from the start of investment and ensure operational controls are in place for the lifetime of the investment.

7 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 10.

8 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 08.

9 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 12 and the ILPA Due Diligence Questionnaire 10.5

10 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 11

CAPACITY

2.6 Please describe how (i) oversight responsibilities, and (ii) implementation responsibilities for ESG integration are structured within your organisation. Please list the persons involved and describe their role, position within the organisation and how they are qualified for this role. Please also describe any external resources you may use.[11]

Developed questioning

- How are staff, in particular investment staff, incentivised to implement responsible investment practices through your performance management and/or reward processes?[12]

2.7 Do you provide training, assistance and/or external resources to your staff to help them understand and identify the relevance and importance of ESG factors in investment activities? If so, please describe what level of training is provided.[13]

11 This question overlaps with the PRI Reporting Framework – Overarching Approach OA 07 and OA 08.

12 This question overlaps with the PRI Reporting Framework – Overarching Approach OA 09.

13 This question overlaps with the PRI Reporting Framework – Overarching Approach OA 09.

3. HOW DO YOU CONTRIBUTE TO PORTFOLIO COMPANIES' MANAGEMENT OF ESG-RELATED RISKS AND OPPORTUNITIES?

The average ownership period for a private equity portfolio company is four to six years, during which time ESG-related risks and/or opportunities may arise that were not material at the time of investment. An LP could therefore assess the degree to which the GP ensures that the policies, systems and resources are in place to enable portfolio company management to effectively manage ESG factors through the life of the investment. An LP could furthermore have an understanding of how the GP monitors and, where relevant, contributes to portfolio companies' approaches to managing ESG factors at different stages of the portfolio management process, including at exit.

This section is only relevant to funds investing directly into companies.

PROCESS

3.1 Upon investing in a company, would you review existing compliance with sustainability or ethical business guidelines, or introduce new guidelines if necessary?

COMPANY GUIDELINES

The CDC ESG TOOLKIT FOR FUND MANAGERS and the IFC FIRST PORTAL give an overview of the international conventions and standards that a company may need to comply with. The IFC FIRST portal also gives an overview of various international sustainability standards and industry certifications, which have been established to promote more sustainable business practices.

The UN GLOBAL COMPACT is the world's largest corporate sustainability initiative, which supports companies to align their strategies and operations with Ten Principles on human rights, labour, environment and anti-corruption.

3.2 What monitoring processes would you have in place to assess portfolio companies' management of ESG factors?[14]

Developed questioning

- What is your process for grading ESG risks and/or opportunities that may arise during ownership?
- How do you ensure that the appropriate measures are in place to conduct ESG due diligence on any bolt-on acquisitions that a portfolio company might make?
- What mechanism are you using to collect and track ESG-related information?

3.2 IN PRACTICE: APAX PARTNERS

Apax Partners LLP (Apax), a global buy-out firm based in the UK, runs an annual data collection cycle designed to highlight each portfolio company's ESG performance in its key areas of risk and opportunity. To facilitate and streamline the data capture, Apax uses a specific sustainability software solution, CR360, which also functions as a central repository for portfolio company ESG information and its related supporting documentation.

Apax established a set of 80 ESG key performance indicators (KPIs) in 2012 based on the Global Reporting Initiative (GRI), specific LP questionnaires and other resources focused on the reporting of non-financial metrics. The KPIs consist of qualitative and quantitative data and binary yes/no inputs. Each portfolio company provides their KPI data to Apax on an annual basis, thereby creating an in-depth data base of ESG information across the Funds' portfolio companies. As a result each portfolio company is able to maintain, track and record its own ESG data and to additionally tailor specific KPIs, if needed.

Apax believes that its approach to obtaining ESG KPI data from the Funds' portfolio companies follows the growing public equity practice to integrate financial and non-financial metrics to provide a thorough understanding of all the material components of long-term value creation within a business.

The ESG KPI information received from the portfolio companies provides valuable insight into the profile of each company, which enables the deal teams and the Apax Operational Excellence team to focus its efforts in driving value creation, for example through resource efficiency programmes. Moreover the information provides further insight into the materiality of certain ESG factors to the portfolio.

For Apax, the key benefit of the KPI collection is that it affords significant visibility and relevant data capture, which in turn drives improvement of the ESG footprint across the overall Apax portfolio. And, crucially, through this mechanism the firm is able to provide ESG performance data to its LPs on a continuous basis.

14 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 13.

- Indicate the type and frequency of reports you request and/or receive from portfolio companies covering ESG issues.[15]
- Do you require portfolio companies to report on specific ESG-related performance indicators? If so, are any of these indicators general to all portfolio companies?[16]
- Do you track the proportion of your portfolio companies that have an ESG/sustainability-related policy (or similar guidelines)?[17]

3.2 IN PRACTICE: ROBECOSAM PRIVATE EQUITY

RobecoSAM Private Equity (RobecoSAM PE), the private equity division of Robeco and RobecoSAM, an investment specialist in sustainability investing based in Switzerland and the Netherlands, has a comprehensive system in place to monitor GPs on their management of ESG risks and opportunities in the portfolio. Through its ESG Due Diligence and annual ESG questionnaires, RobecoSAM PE asks private equity managers whether they track any ESG-related performance indicators for their portfolio companies or funds as a whole. It is very important to RobecoSAM PE that GPs are able to demonstrate effective ESG integration beyond due diligence, and to get assurance that their GPs are monitoring the most relevant risks and opportunities facing their portfolio companies.

RobecoSAM PE decided that, given the diversity of funds that they invest in, it made little sense to define a standard set of ESG-related performance indicators for all GPs to report on. Post-investment, through their annual ESG questionnaire, they do however list a number of example ESG performance indicators that GPs could report on, such as total direct or indirect greenhouse gas emissions, turnover rate and the number of incidents of customer privacy breaches per year. RobecoSAM PE will analyse the ESG information collected by their GPs and evaluate its materiality for the sectors and companies it relates to. This will allow RobecoSAM PE to better understand how their GPs are integrating ESG factors in their monitoring processes. RobecoSAM PE also uses this information to assess the ESG performance of the funds that they invest in – every PE fund receives a score that is based on a combination of the fund's ESG strategy and an assessment of how that strategy has been implemented within the underlying portfolio companies.

The majority of their GPs do collect ESG information but it tends to be company-specific - and RobecoSAM PE finds that the number of GPs that are able to provide aggregated ESG information for their funds is still very limited. However things are changing fast in this respect.

As certain ESG-related performance indicators, such as carbon emissions, electricity/water used and number of jobs created, become more widely and consistently used, RobecoSAM PE does not exclude the possibility that they may ask GPs to provide information on specific ESG-related performance indicators in the future. This will ultimately allow them to analyse the ESG-related performance of their underlying investments.

INDUSTRY RESOURCES FOR MONITORING

Sustainability reporting standards and guidelines that may help identify the relevant ESG factors to monitor at each portfolio company, and how.

CDP QUESTIONNAIRES – to address exposure to climate change, deforestation, water scarcity and supply chains.

G4 (Global Reporting Initiative) - sustainability reporting standards that also offer sector-specific guidance.

SASB (Sustainability Accounting Standards Board) – industry-specific sustainability standards to help determine which ESG issues are likely to be material and the associated metrics for reporting.

INTERNATIONAL INTEGRATED REPORTING FRAMEWORK – guidance for companies on how to develop an integrated reporting system that incorporates both financial non-financial information, the primary purpose of which is to explain to providers of financial capital how an organisation creates value over time.

3.3 Give 2-3 examples of how you have contributed to portfolio companies' management of ESG factors. Specify which initiative(s) you worked with management to identify and instigate, which you supported your portfolio company to achieve (and how) and/or what the portfolio company was already doing that you identified as existing good practice.[18]

Developed questioning

- Are you able to connect us with the relevant staff at 2-3 portfolio companies from a previous fund who would be able to discuss your commitments to ESG integration with us?

PORTFOLIO COMPANY REFERENCES

LPs should note that it would be good practice to integrate ESG-related questions into commercial conversations that they may already be conducting with a GP's portfolio company references, where possible.

15 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 16.
16 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 13.3.
17 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 14.1.
18 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 15.2.

CAPACITY

3.4 How do you assess that adequate ESG-related competence exists at the portfolio company level? How do you ensure that portfolio company management devotes sufficient resources to manage ESG factors that have been identified?[19]

Developed questioning

- Specify which function/position/role at the portfolio company is typically made responsible for ESG performance. Describe what assessment of their ESG-related expertise is conducted recognising that the management of ESG factors encompasses a broad range of specialisms.
- Describe what training, assistance or additional resources you typically provide to your portfolio companies to help them understand the relevance of managing ESG factors and to enable them to do so.
- How do you facilitate best practice sharing between portfolio companies?

3.4 IN PRACTICE: PAI PARTNERS

French buyout firm PAI Partners has, over recent years, worked to deeply integrate ESG factors into how they invest in the belief that attention to ESG issues can contribute to financial outperformance. In working to deliver that outperformance, ESG due diligence and post-acquisition audits are standard practice. PAI portfolio companies regularly meet to share their experiences of managing sustainability issues.

One of the strengths of the private equity investment model is that it creates a portfolio of companies with common ownership. This provides opportunities to share experiences between portfolio companies – and ensure that lessons are learned and acted upon. Since 2011, PAI has organised a biannual meeting, the "PAI Sustainability Club", to encourage dialogue between portfolio company managers responsible for ESG. These in-person meetings are a key feature of the PAI ESG programme. Firstly, they provide ESG managers with invaluable expertise either from external consultants or their peers. Secondly, they allow portfolio companies to discuss common issues and share best practices.

The Sustainability Club also acts as a privileged channel of communication between PAI and portfolio companies. The PAI ESG strategy is presented during these meetings, and portfolio company ESG policies are also introduced and discussed within the group and with PAI in order to ensure continuous improvement. The meeting topics are proposed and chosen by the ESG managers and PAI will source the requisite expertise from external consultants and from PAI professionals to address these topics. Presentations, workshops and lessons allow for creative interaction and brainstorming.

- If you engage external expertise to assist the portfolio company in their management of ESG factors, describe what type(s) of service is provided. Specify whether the external specialist is typically employed by the GP or the portfolio company.
- How is senior management incentivised to manage potentially material ESG factors?
- Describe the range of actions that you may take in the event that the portfolio company management does not adequately address ESG factors.

IMPLEMENTING AN ESG ACTION PLAN

CDC ESG TOOLKIT FOR FUND MANAGERS – offers guidance on when an ESG Action Plan is required, and how to work with company management and consultant to deliver it.

IFC ESMS IMPLEMENTATION HANDBOOK – provides instructions on how to develop and implement an Environmental and Social Management System in line with the requirements of IFC Performance Standard 1.

3.5 How do you use your interaction with the board to influence the portfolio company's management of ESG factors?[20]

19 This question overlaps with the PRI Reporting Framework – Direct Private Equity 15.1.

20 This question overlaps with the PRI Reporting Framework – Direct Private Equity 15.1.

IMPACT

3.6 Do you systematically incorporate ESG considerations into preparations for exit? If yes, please describe your approach. If not, please explain why.[21]

Developed questioning

- Have you, with past investments, managed to quantify, value and/or highlight the benefits of good ESG management in order to achieve a higher valuation at exit?
- Have you produced an ESG Vendor Due Diligence (VDD) report, or included an ESG section in a VDD? If so, for which companies?

3.6 IN PRACTICE: ARDIAN

At Ardian, an independent private investment company with US$50 billion managed and/or advised in Europe, North America and Asia, responsible investment is at the heart of their approach. Ardian considers that integrating factors into investment activities has a positive impact on the growth of their portfolio companies and favours a mainstream approach that integrates ESG factors at every step of the investment process: from due diligence right up to exit.

Ardian believes that ESG integration in portfolio companies should be results-driven – and results are only truly recognised at exit. By conducting an ESG Vendor Due Diligence (VDD), Ardian is able to communicate the value of ESG integration in practice, beyond goals and action plans. For example, during the ownership period of portfolio company Diana, Ardian performed four ESG reviews over seven years. One of the most important ESG goals was to achieve a 0% accident rate, a goal that the company's staff rallied behind. When approaching exit, Ardian decided to perform an ESG VDD in order to assess the financial and extra-financial benefits of ESG policies such as the 0% accident rate policy, and to measure the transformation of the company in terms of ESG beyond daily or annual monitoring. The results of the ESG VDD provided concrete evidence of its added value, prompting two potential buyers to request interviews with the ESG consultant who conducted the VDD.

By asking a GP about their ESG-related exit practices, LPs will get a better understanding of how the GP thinks about ESG integration in terms of value and of the penetration of their ESG integration practices throughout the investment cycle.

3.7 Do you measure whether your approach to ESG factors has affected the financial and/or ESG performance of your investments? If yes, please describe how you are able to determine these outcomes.[22]

Developed questioning

- Provide examples of how ESG factors have impacted the financial performance of previous investments.

3.7 IN PRACTICE - PARTNERS GROUP

Partners Group is a global private markets investment management firm with over USD 47 billion in investment programs under management (as of Q3 2015) in private equity, private real estate, private infrastructure and private debt.

When integrating ESG factors in due diligence and during the ownership period Partners Group:

1. Assesses how ESG factors affect returns in specific investments;
2. Measures the impact of ESG factors on returns.

The investment that Partners Group and Quadriga Capital made in AHT Cooling Systems GmbH (AHT) illustrates this. AHT is the global leader in producing horizontal refrigeration and freezer cases. It pioneered a cooling technology that is significantly more energy efficient than competing technologies. Lower energy consumption contributes to a cost of ownership for AHT customers approximately half that of competing products. The increased demand that this generated helped drive a 50% increase in revenues during the investment period. Partners Group estimates that about a fifth of the value created by the investment can be attributed to the faster sales growth AHT achieved, that is in part due to its more energy efficient products. In addition, AHT mitigated over 400,000 metric tons of carbon dioxide during the investment period by providing more energy efficient products than competitors.

21 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 17.
22 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 18.

4. HOW CAN LPS MONITOR AND, WHERE NECESSARY, ENSURE THAT THE FUND IS OPERATING CONSISTENTLY WITH AGREED-UPON ESG-RELATED POLICIES AND PRACTICES, INCLUDING DISCLOSURE OF ESG-RELATED INCIDENTS?

Responsible investing requires proactive and transparent disclosure that supports aligning LPs' and GPs' interests. A GP should be able to assure an LP of the nature and frequency of ESG-related reporting and disclosures during the life of the fund. An LP could discuss with the GP the types of material ESG incidents for which the GP should provide disclosure, and in what format this disclosure could take.

PROCESS

4.1 Which channels do you use to communicate ESG-related information to LPs? Can you provide samples of ESG-related disclosures from an earlier fund? If not, please indicate whether you would consider introducing ESG-related disclosures.

Developed questioning

- When communicating ESG-related information to LPs, do you use any industry standard for disclosure?

4.2 Is the management of ESG factors included on the agenda of the Limited Partners Advisory Committee and/ or Annual General Meeting?[23]

4.3 Describe your approach to disclosing and following up on material ESG incidents to your LPs.

4.3 IN PRACTICE: APG

On behalf of its clients APG manages the pension assets of around 4.5 million Dutch citizens with approximately €400 billion in assets under management, as of August 2015. One of APG's investment beliefs is that the risk–return profile can be improved by factoring non-financial elements into the investment process. APG takes account of environmental, social and governance (ESG) factors as an integral part of the investment process in order to:

1. Contribute to risk-adjusted financial returns
2. Demonstrate social responsibility and
3. Contribute to the integrity of financial markets.

For effective monitoring of the ESG impact on their private equity investments, it is essential for APG to understand the GP's approach to transparency on ESG issues during the life of an investment. A significant piece of this information exchange is the GP's willingness and ability to adequately disclose and deal with ESG incidents.

During due diligence, APG will enquire about the GP's awareness of what a material ESG incident is and how the GP would typically respond to it. APG will also take time to explain to the GP why it is important to APG and its clients to have transparency on any material ESG incidents in the portfolio. APG also requires the GP to (i) demonstrate that there is an adequate process in place to respond to an ESG incident in a timely and transparent manner, should there ever be a need to do so, and (ii) describe how an incident could be mitigate and managed.

Developed questioning

- What is your definition of a material ESG incident that should be communicated immediately to LPs? Give examples.
- Describe the procedures for:
    1. Portfolio companies to report ESG incidents to you;
    2. How you assess the incident and the actions required to address it;
    3. How you communicate that incident and actions to the LP.
    4. Explain the types of disclosure that an LP could expect to get at the time of an incident, during its management and after it has been resolved (taking into account related confidentiality considerations).
- Provide redacted examples of previous incident disclosures for review, describing the steps taken to remedy or mitigate the effect of the relevant non-compliance and to ensure that there is no further non-compliance in respect of the same matter in the future.

For an example of a serious incident reporting template, refer to the CDC ESG TOOLKIT FOR FUND MANAGERS.

23 This question overlaps with the PRI Reporting Framework – Direct Private Equity PE 20.

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- ILPA (Institutional Limited Partners Association)
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The Principles for Responsible Investment (PRI) Initiative

The PRI Initiative is a UN-supported international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation's investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

UN Global Compact

Launched in 2000, the United Nations Global Compact is both a policy platform and practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org

United Nations Global Compact