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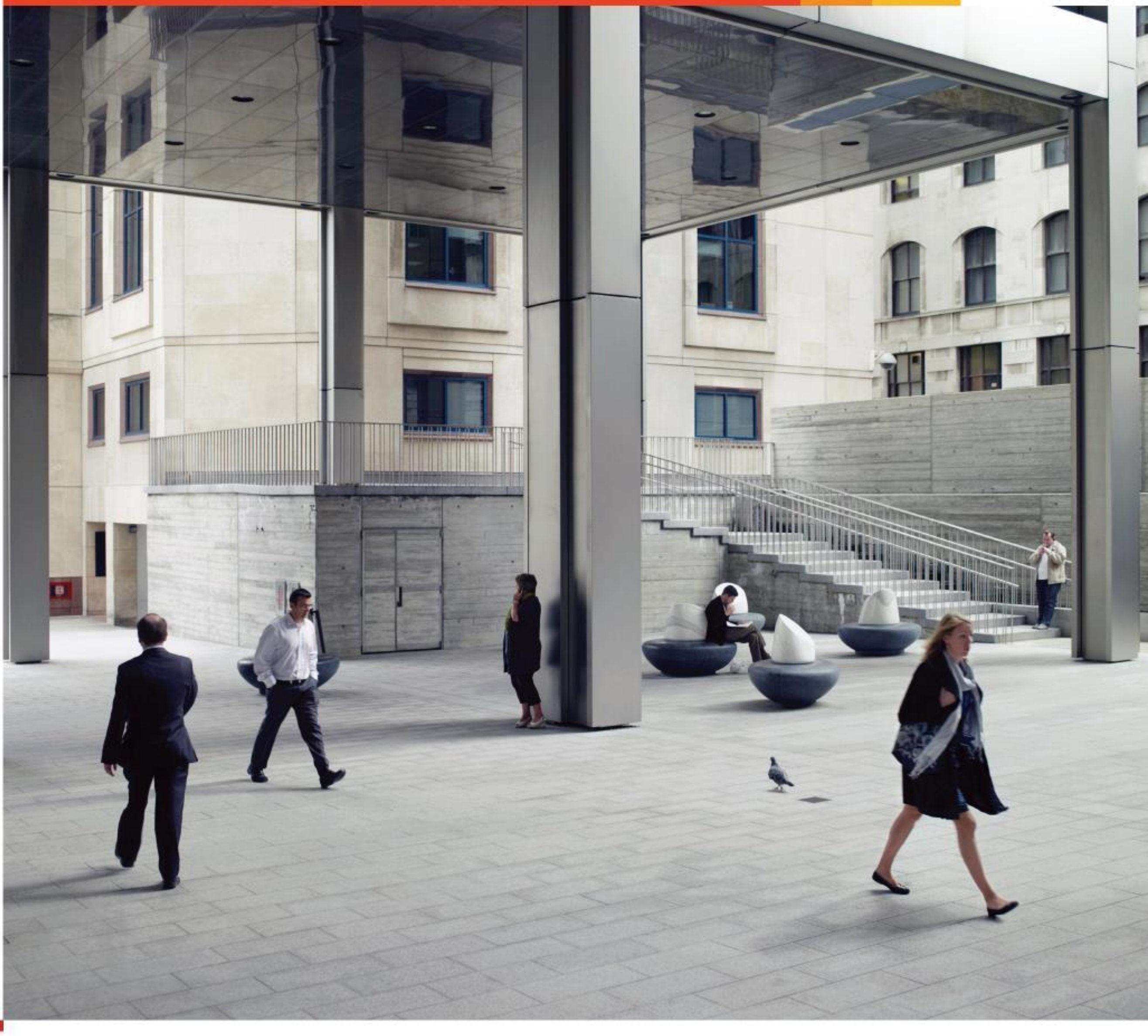
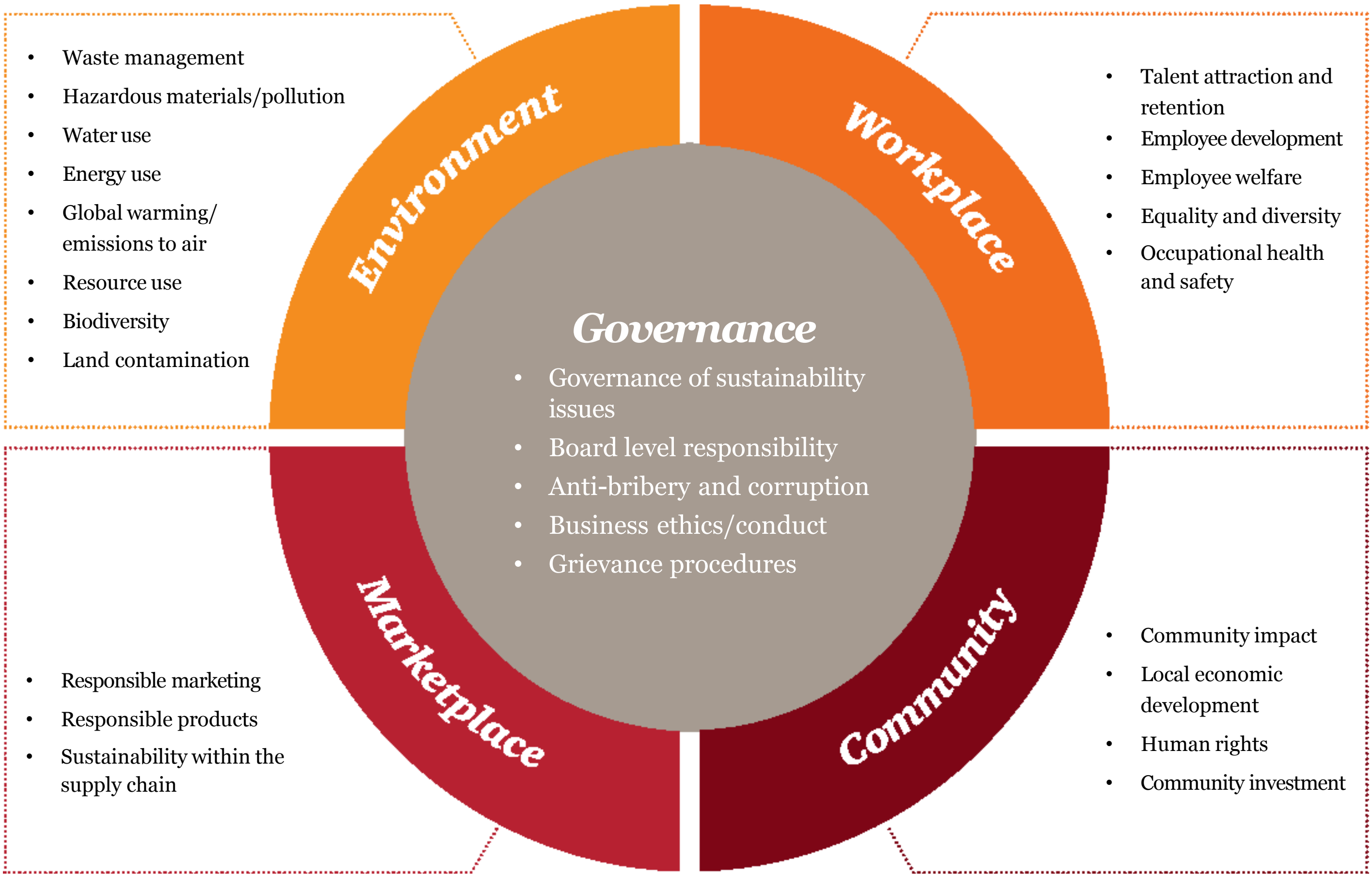
ESG considerations for private equity firms



ESG considerations for private equity firms

What do we mean by ESG issues?

Environmental, social and governance (ESG) issues cover a broad agenda. Therefore, we break the issues down into five categories: Environment, Workplace, Community, Marketplace and Governance. The 'ESG wheel' below shows examples of issues within each category. The relevance of the issues will depend on the specific situation, for example, related to a portfolio company's sector or geography.



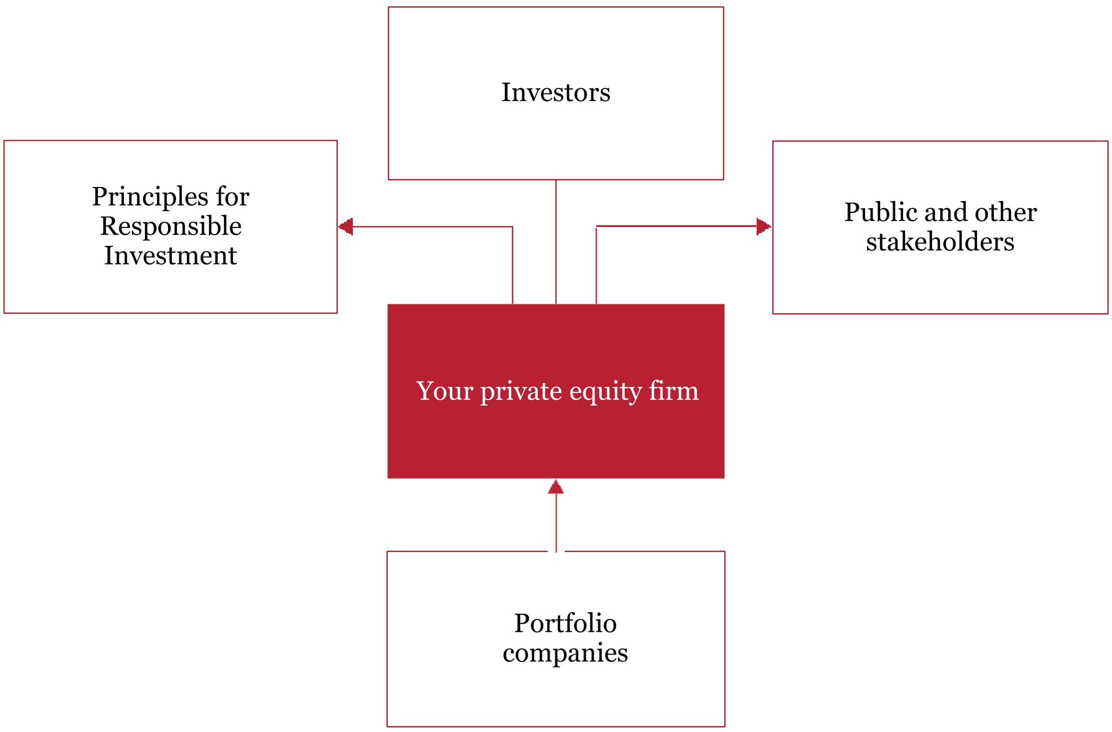
We recommend that a wide range of activities – from strategy and policy development to tools creation and use, and training are needed to appropriately manage ESG risks and opportunities.

What are the different elements of ESG reporting?

As the name suggests, private equity has traditionally remained 'private' and has not reported non-financial issues. However, that stance is changing:

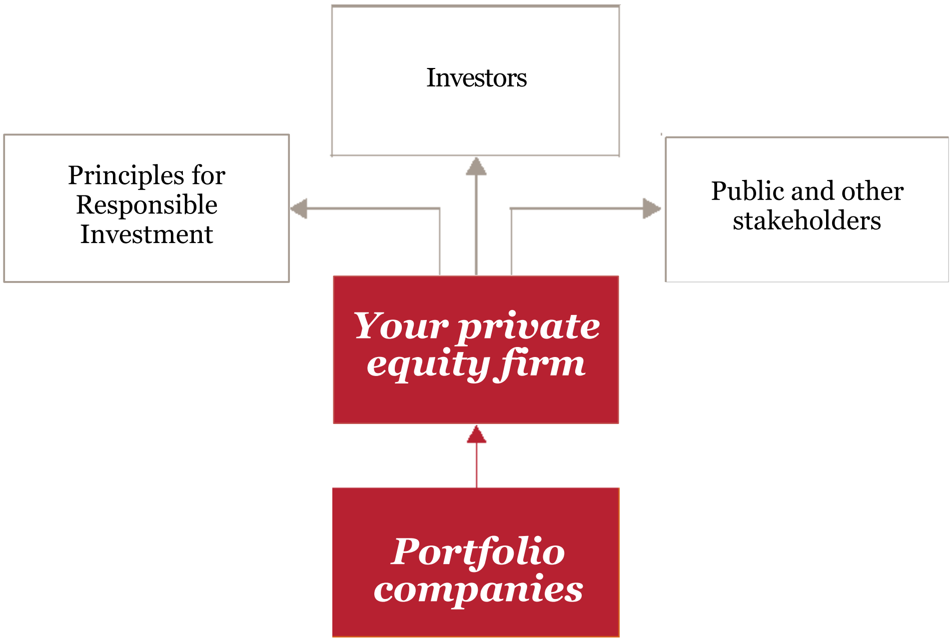
- Public perception of the industry remains poor following the financial crisis and other high profile incidents in portfolio companies.
- 'Soft' regulation is growing, for example, the Walker Guidelines for Disclosure and Transparency in Private Equity.
- Demand for non-financial reporting is rising from a range of stakeholders e.g. from investors, industry initiatives and the public.
- Only 8% of private equity firms indicated, in our 2013 survey, that they did not expect to report on responsible investment activity in the next two years*.

ESG reporting means reporting up from the portfolio companies to your private equity firm, and then from your firm to a range of stakeholders. This document addresses the four elements described below:



* Source: 'Putting a price on value' – PwC's global responsible investment survey, 2013

Reporting from portfolio companies



What do we mean?

- Information related to the ESG activities of the portfolio companies, and how they are responding to your encouragement to improve ESG performance.
- Quantitative (e.g. metrics) and qualitative information (e.g. case studies).

Why is this important?

- ESG performance is directly related to revenue and costs – it is important to monitor how your portfolio companies are managing these issues and encourage performance improvement.
- Reporting to external stakeholders requires robust, relevant information from the portfolio companies.
- Maximising value on exit is dependent on monitoring ESG performance during ownership so that you have a 'great ESG story to tell' in a prospectus.
- Placing a monetary value on ESG activities relies on data from the portfolio companies.

How are firms responding?

- 88% of portfolio companies formally report ESG monitoring results to their firm*.
- Some firms have developed tools (or used proprietary ESG software) to collect information and agreed KPIs, integrating these into existing reporting processes.
- Firms have conducted ESG assessments of portfolio companies to check that significant ESG risks and opportunities are being managed.

* Source: 'Putting a price on value' – PwC's global responsible investment survey, 2013

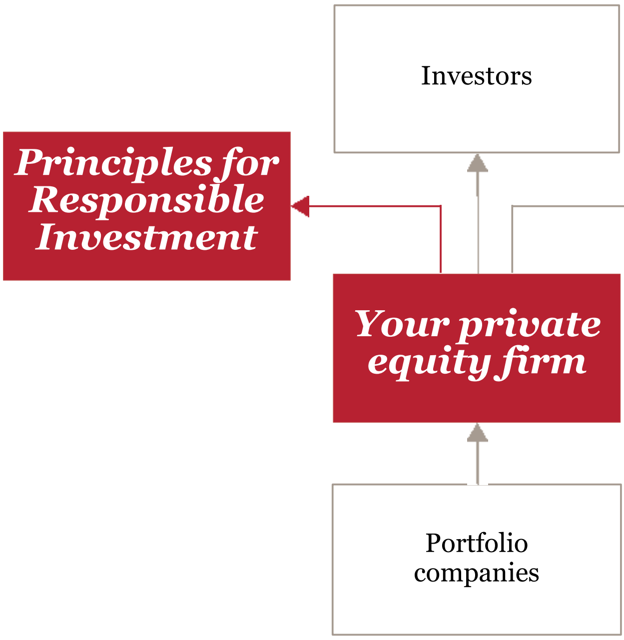
Getting the right support

How can PwC help?

We can:

- **Advise on developing ESG KPIs** to monitor the portfolio companies which directly link to value protection/creation. These will support your external reporting and balance the practicalities of data-collection.
- **Develop tools, templates and the internal control environment** for collecting data at the portfolio companies for efficient reporting to you.
- **Interpret the data you receive** from the portfolio companies, giving you an expert perspective on the quality and scope of information, as well as the underlying performance.
- **Assess the significant ESG risks and opportunities** through a portfolio review and evaluate the existing management activities at the portfolio companies, making recommendations for improvement.

Reporting to the Principles for Responsible Investment (PRI)



Who is this relevant for?

- The Principles for Responsible Investment (PRI) is an initiative to promote responsible investment across various asset classes, including private equity.
- It is becoming mainstream with over 150 private equity firms now being signatories.
- Furthermore, 250 investors are signatories and must report on their responsible investment performance, driving increased demands on private equity firms for action and information.

When do you need to report?

- It is now mandatory for almost all signatories to report annually on their responsible investment performance (except those in a 'grace' period), in line with the reporting framework released in 2013.
- The reporting window for mandatory reporting closes on 31st March each year.

What is going to happen?

- Signatories must complete the three mandatory reporting 'modules' plus further modules, depending on the composition of their portfolios by asset class e.g. private equity, infrastructure, property.
- The PRI will publicly disclose a defined set of each signatories' responses and there will be the option for signatories to disclose additional responses voluntarily.
- Assessment of signatories' reporting is round the corner – the assessment framework will be rolled out to all signatories in the coming years.

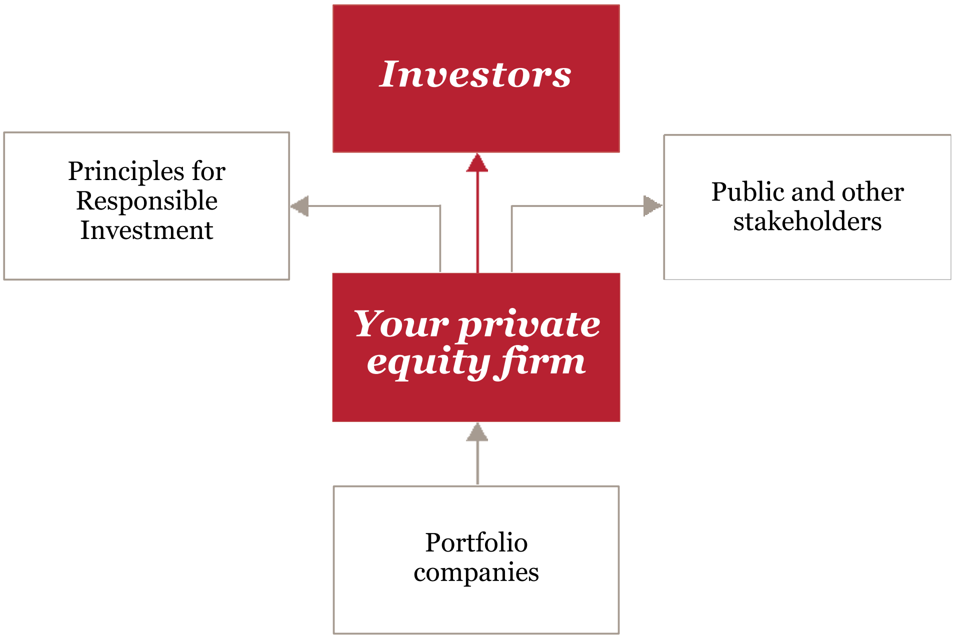
Getting the right support

How can PwC help?

We can:

- **Demystify the requirements** of the PRI reporting framework, determining which modules are applicable to your firm. Explain which responses will be publicly reported and how the responses will be scored.
- Perform a **'shadow' review** so you can understand the process and see how you will rate absolutely and relative to your peers (if data is available), before completing the official submission.
- Provide you with **tools to easily collate the information**, saving you time and taking the burden off your hands.
- Use your report to **identify gaps in your approach**, advising on how to address them before next year's report.
- **Provide assurance** on your report so you can give additional comfort to your stakeholders. External assurance will also boost your score in the report assessment.

Reporting to investors



What is happening in the market?

- More investors are interested in the ESG activities of private equity firms – currently 85% of UK firms report an interest and no firms expect this to decrease in the next two years*.
- The ESG Disclosure Framework now gives firms a guide to reporting to investors – 42% of firms plan to use this Framework*.
- The latest ILPA guidance suggests specific ESG disclosures from a firm to its investors.

How are firms responding?

- The majority of firms (56%) are already reporting some ESG activity to investors*.
- Some investors are now looking for firms to report on ESG issues throughout the life of a fund, not just at fund-raising.

Why is this important?

- There is evidence that some investors are beginning to restrict access to capital due to poor ESG performance.
- Reporting can build trust and confidence amongst investors on how non-financial, as well as financial, issues are being managed.
- A proliferation of different information requests from investors may be time-consuming to respond to – proactively articulating your 'ESG story' once, would be more efficient.
- Investors expect to find out about material ESG incidents before reading about them online. Determining materiality and incident report timing is critical.

* Source: 'Putting a price on value' – PwC's global responsible investment survey, 2013

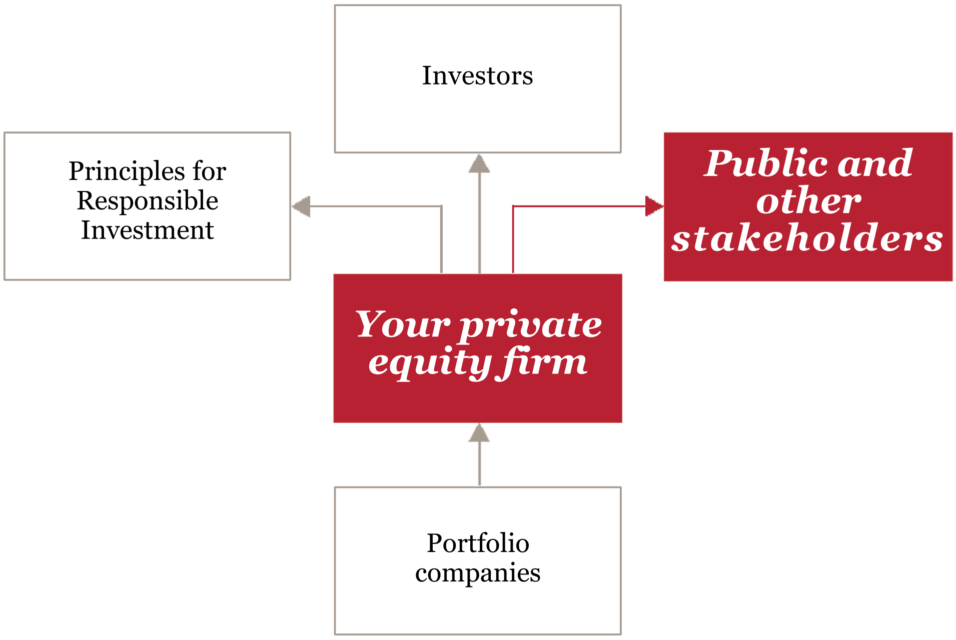
Getting the right support

How can PwC help?

We can:

- Support you to **decide on what to report**, for example, aligning a report to the ESG Disclosure Framework. This could include discussing expectations with investors.
- **Draft or review content** of reports/questionnaire responses to investors, using our expertise to interpret information from the portfolio companies and our knowledge of the market, and saving you time.
- Assess your report to **identify gaps in your approach**, advising on how to address them.
- **Provide an assurance opinion** on your report so you can give additional comfort to investors.
- **Build fundraisers' knowledge and confidence** through tailored ESG training sessions.
- **Present at investor meetings** using our understanding of your business to showcase your work.

Reporting to the public and other stakeholders



What is happening in the market?

- Numerous stakeholder groups are increasingly interested in a private equity firm's ESG activities e.g. public, regulators/governments, employees, the media and interest groups.
- There are growing expectations for transparency and accountability across the corporate world.

How are firms responding?

- The trend is increasingly for private equity firms to use their websites to publicise their ESG positions e.g. publishing their ESG policy or profiling ESG activities in specific portfolio companies.
- Firms are reporting more to the public and other stakeholders in line with 'soft' regulation, such as the Walker Guidelines and the Stewardship Code.
- Some firms are using extensive public ESG reporting to differentiate themselves e.g. voluntary Walker assessments or specific ESG reports.

Why is this important?

- Public reporting of ESG activities has become mainstream and expectations are set to increase further.
- Regulatory requirements are unlikely to get any easier.
- If a portfolio company exit is expected through an IPO on the London market, mandatory carbon reporting will need to be addressed.

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