Private Equity International

Co-hosted by

PRI Principles for Responsible Investment

# Responsible Investment Forum: Europe
London 2020

11-12 November | Jumeirah Carlton Tower

privateequityinternational.com/rif

# Responsible Investment Report

Private Equity International,
Responsible Investment 2020

PEI

# Seven takeaways from this year's Responsible Investment report

**LP scrutiny of approaches to ESG is intensifying, with climate change a key concern. Here are seven takeaways from this year's Responsible Investment report.**

### 1 Climate change is a growing focus

"The biggest challenge is how to address the risk and the opportunity," says Sean Collins, service manager (pensions) at Oxfordshire County Council, which runs the £2.5 billion ($3.3 billion; €2.9 billion) Oxfordshire Pension Fund. The fund, with a 7.2 percent allocation to private equity, is currently developing its first climate change policy.

Environmental activism has played its part. The Oxfordshire Pension Fund came under pressure from activists Fossil Free Oxfordshire (FFO) to divest from all its fossil fuel holdings. But other factors are at play, too. There's a clear sense that with climate change becoming more visible – most strikingly with the Australian bushfires – investors need to open their eyes to this global crisis. "We're not only doing this because we've been shouted at, but the protesters have helped our thinking. There's been a recognition that we need to do more and be more transparent and work with others including FFO to develop a policy," says Collins.

### 2 LPs want to be seen to lead by example

With C$327 billion ($245 billion; €221 billion) of net assets, of which C$43 billion is invested in private equity (through funds and direct investments), Canadian pension fund Caisse de Dépôt et Placement du Québec believes it can influence GPs and their response to climate-related issues. "We try to sensitise them to the importance of it, and educate those that don't realise the importance," says chief stewardship investing officer Bertrand Millot. "We lead by example and increasingly we are going to take a more demanding approach.

At the UN in December, we announced we're going to be net-zero carbon by 2050. In that context it's inevitable that at some point all the money we manage will have to be strictly climate-compliant. And that will apply to external managers. For GPs that don't do anything on climate, I'm not sure we'll be investing with them in the future."

### 3 Risk management is key

Directors have a duty to take ESG into account, says Simon Witney, special counsel at Debevoise & Plimpton. "Any issue that affects a firm's risk profile can fall within the ESG category," he says. "In my view, a lot of this is about governance – it doesn't really matter if you classify an issue as being part of ESG; what matters is ensuring good corporate governance and proper risk management."

Data protection is paramount. "Cybersecurity and data privacy are becoming more of an issue for private equity, because of the GDPR but also because society at large is focusing more on these issues. And of course, anti-corruption is a perennial concern," says Witney.



Source: Private Equity International, Responsible Investment 2020

4

### A sense of understanding is required

The £2.5 billion Church of England Pensions Board describes itself as being on a "fairly early stage of our private equity journey" and has just started working with Cambridge Associates to increase its holdings to a target allocation of 7 percent.

On climate change, it describes its approach as "nuanced" as it tries to contribute to a move towards a more carbon-free economy. "We require all our managers to have the capacity to analyse, understand and act on ESG criteria," Stephen Barrie, deputy director of ethics and engagement at the CEPB, tells *Private Equity International*. "We want to be at the forefront of driving the transition."

Private equity is in a powerful position to drive change, says Barrie: "We think that GPs have got the opportunity for greater influence on the portfolio companies. There are opportunities for excellent responsible investment practices in private equity – the model is corporate governance-based."

5

### GP behaviour is changing

Swedish pension funds, which have been among the most vocal in demanding action on ESG issues, say the private equity industry is responding to their demands, especially on climate change.

"In our 2019 ESG assessment we aggregated our portfolio climate change data for the first time," says Anna Follér, sustainability manager at the Sixth Swedish National Pension Fund (AP6). "It revealed that a number of GPs carry out climate-related risk assessments based on forward looking scenarios. We haven't seen this before."

There's also been a shift in emphasis from the fund manager itself to the companies it invests in.

"We also realised carbon emissions and the impact on the climate was not the only issue," says Follér. "The other side is how climate change impacts portfolio companies. Over time, that's been a big change in how we look at climate impact and diligence it."

> "For GPs that don't do anything on climate, I'm not sure we'll be investing with them in the future"
>
> Bertrand Millot
> CDPQ

6

### Diversity is rarely a deal breaker

LPs are becoming more diversity-conscious, but a lack of gender balance in investment teams is rarely a reason to pull an investment.

Data compiled by Private Equity Recruitment, an executive search firm, suggests only 13 percent of partners in private equity firms are women. This figure falls to just 9 percent among senior partners and only 3 percent among operating partners.

Yet our latest *LP Perspectives Survey* reveals that although a significant proportion of LPs – 35 percent – say they are actively encouraging fund managers to promote gender diversity, just 14 percent of respondents report they have refused an opportunity due to a lack of diversity at the fund manager level.

7

### Blended finance offers impact

The rise of the impact investment movement has seen the growth of blended finance, where typically development finance institutions or other donor bodies provide the initial first-loss capital on below-market terms, allowing private sector investors in the fund to benefit from higher rates of return. The fund is normally managed by a GP that specialises in impact investments.

Katrina Ngo, a senior manager at the Global Impact Investing Network, says these structures can work well in the private equity sphere. "We're hoping that private equity investors can see blended finance as a tool that allows them to invest in sectors or regions or themes that they might not have explored due to the risk profile of the investment." ■