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INFRASTRUCTURE
LONG TERM INVESTORS

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Response to the European Commission Public Consultation on Long-Term and Sustainable Investment

About Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately-held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.

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Opening Remarks

Invest Europe welcomes and supports the European Commission's priority to foster growth and investment, and appreciates the opportunity to respond to the public consultation on Long-Term and Sustainable Investment.

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors. Our members provide an essential source of funding for innovative businesses at key stages of their growth journey, taking a long-term approach to investing in privately-held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Ethical behaviour is fundamental to the success of the private equity, venture capital and infrastructure industry (hereafter referred to as "industry"). Industry participants must operate in an environment of trust. Invest Europe members are entitled to expect their peers to act in accordance with the highest ethical and professional standards and are expected to behave in a similar manner towards the companies into which investments are made, service providers and other stakeholders. Membership of Invest Europe brings with it a responsibility to act in a manner that is both ethical and beneficial to the interests of the industry and its stakeholders.

Invest Europe is at the forefront of promoting the highest ethical and professional standards within the industry. All of these standards and guidelines come together in the Invest Europe Professional Standards Handbook (available here), which provides solid guidance and best practice standards on all aspects of the business throughout the life cycle of the fund and brings together the key elements of governance, transparency and accountability that are expected of industry participants.

More concretely, and designed to help practitioners exercise business judgment and act with integrity, the Handbook provides guidance on the principles that should govern professional conduct and the relationships between all those engaged in the industry, with a particular focus on the relationship between those operating the funds (fund managers, usually known as General Partners or GPs) and their investors (usually known as Limited Partners or LPs), and between GPs and portfolio companies (i.e. the companies, a majority of which are SMEs, into which investments are made), whilst also taking into account the importance of the role the industry plays in society at large.

The Handbook is the only set of industry professional standards written and endorsed by both investors and fund managers, with the strong input of the service providers who support them. It was most recently updated in 2015.

One of the key areas of focus during the most recent review was Responsible Investment. ESG[1] factors are a core consideration throughout the Handbook and are deeply integrated into the overall investment and fund management process. Transparency and reporting on ESG items also become more prominent in the 2015 update to the Handbook recommendations, including requirements for enhanced disclosure in Invest Europe's updated Investor Reporting Guidelines (which are an integral part of the Handbook).

The topic of responsible investment[2] is of great significance to Invest Europe's members and the industry as a whole; it is not just a specialist topic for certain investors. As society is addressing the sustainability agenda, the consideration and management of ESG opportunities and risks in the investment process are becoming more important to fund managers and LPs alike both to safeguard the long-term performance of their investments and to enable them to fulfil the broader social role that stakeholders expect. Individual fund managers and LPs will, nonetheless, be at different stages in their integration of ESG considerations, with some more developed than others. But the industry as a whole is developing rapidly in this area.

In this consultation response, we have answered the questions from the perspective of the European private equity, venture capital and infrastructure industry as a whole, based on the industry's professional standards and guidelines. Our responses do not therefore reflect specific strategies of individual member firms. The professional standards set out in the Handbook provide a general framework, leaving sufficient flexibility for GPs and LPs to implement them in a tailored way, adapted to their business's own model and processes.

In this submission, we have also chosen to concentrate on those questions where we have a specific contribution to make as the private equity industry. Many institutional investors will have broader contributions to make to the discussion around ESG than is captured by their role as LPs in private equity, but in this response we are restricting ourselves to the particular private equity dimension.

As always, we stand ready to provide whatever further contribution to this work the European Commission might find helpful, including attending meetings and contributing additional materials in writing.

[1] As defined in the Invest Europe Professional Standards Handbook, ESG stands for the environmental, social and governance factors that can impact (the performance of) a portfolio company and thus also an investment, including the GP itself. It is a phrase commonly used alongside responsible investment.

[2] According to the Invest Europe Professional Standards Handbook, 'responsible investment' involves an investment approach that integrates ESG factors into corporate conduct, investment decisions and ownership activities. A responsible investor will commonly be interested in the ESG conduct, impact or performance of a portfolio company it invests in, and in case of an LP, this may also include ESG aspects related to the GP.

Introduction

Private equity[3] is foremost an ownership model for investments in privately held companies of all sizes and at all stages of development. The nature of the long-term partnerships formed through negotiations and ongoing interactions between GPs and LPs as well as GPs and their portfolio companies is fundamental to how the industry operates and sets it apart from other asset classes. Given this hands-on active stewardship of businesses and long-term ownership timeframe, as an asset class private equity is particularly well suited to integrating and managing ESG matters.

The private equity industry is based on this active investment and ownership model involving the two key relationships:

1. The long-term partnership between investment managers (GPs) and investors (LPs)

Private equity funds typically have a lifespan of at least 10 years. During the life of a fund the GPs and LPs actively engage to ensure high professional and ethical standards are followed in all aspects of the investment and management of the fund. LPs expect accountability, transparency and alignment of interest from the GPs and the GPs expect accountability, transparency and timely engagement from the LPs.

2. The active and responsible ownership of portfolio companies by GPs

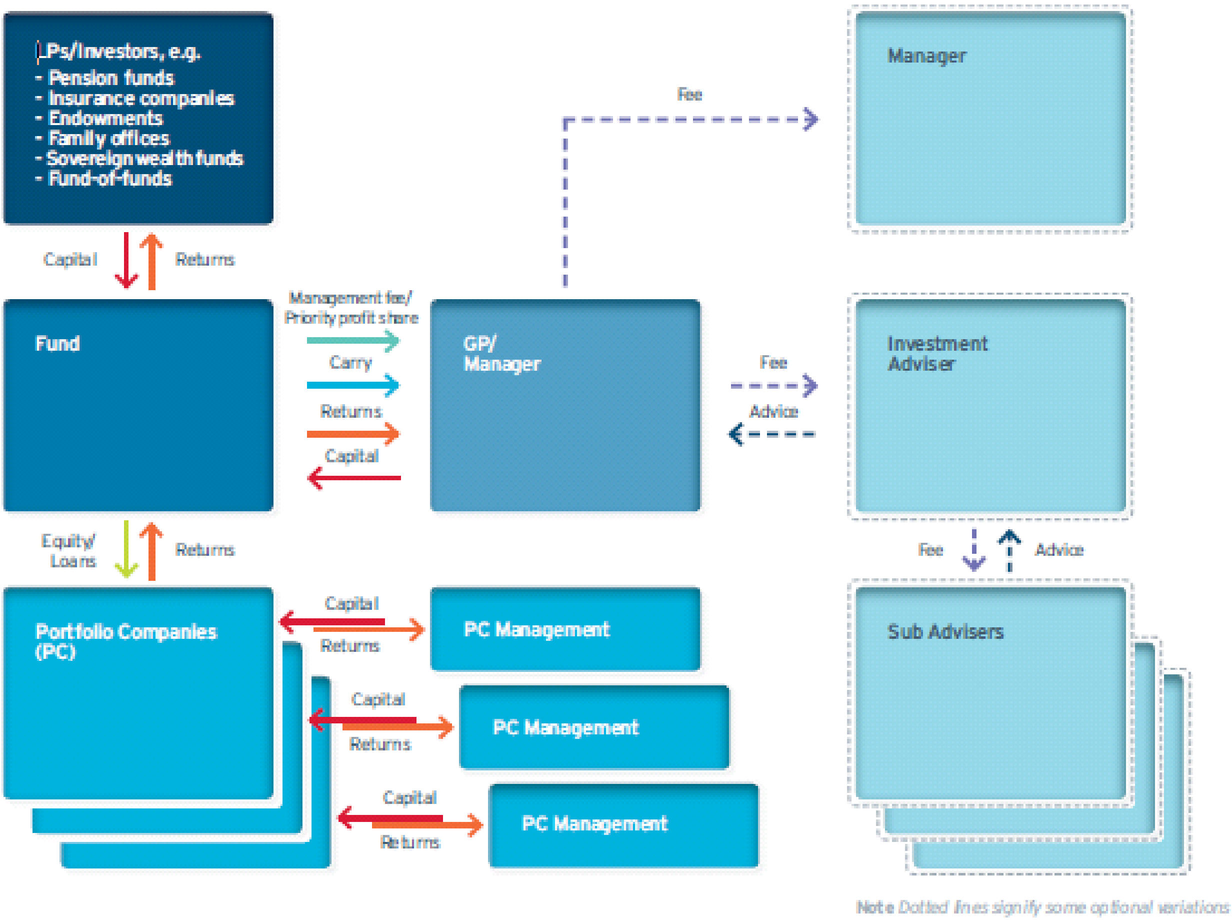
Private equity is generally characterised by a high level of engagement between the GPs and the portfolio companies into which investments have been made. GPs are able to bring not only investment capital, but also experience and knowledge as well as their valuable industry networks (e.g. board members; access to new markets; suppliers and/or new customer groups) to the portfolio companies. In order to create lasting value for stakeholders, GPs play an active role in the strategy and direction of the portfolio company, through their board representation and/or their dealings with portfolio companies outside the boardroom. GPs demand rigorous accountability, transparency (through monitoring and reporting), and adoption of best practices by their portfolio companies.

To exercise this active and responsible investment and create lasting value, putting in place good corporate governance is key for private equity, which in turn is instrumental in developing good corporate governance standards across the unlisted component of the corporate world.

Successful investment requires well-informed decision-making at all levels and by all parties. At its core, good governance creates alignment of interests and the environment for the attitudes, mechanisms and behaviours that allow this well-informed decision-making to take place. Poor governance can lead to misalignment of interests, bad decisions and business failures.

[3] For the purposes of this consultation, "private equity" is used as a generic term to refer to and to encompass venture capital, infrastructure and private equity.

The diagram below sets out a typical private equity fund structure showing the relationship between LPs and GP and fund and portfolio companies. *This is illustrative only. There are many variations to this model.*



Consultation response

1. Rationale for ESG inclusion into investment decisions

Question 1.a. Do ESG factors play a role in the investment decisions of investors? If not, why? If yes, please specify which considerations are reflecting in your investment policy and mandates? In what form is this commitment expressed?

- Yes. The responsible investment agenda is a key component of private equity industry practice. Responsible investment has increasingly become a top-of-mind issue for fund managers and investors in the private equity industry. ESG factors continue to play an important role in their investment decisions and the on-going development of the company after investment.

- Set out below is an overview of the responsible investment and ESG aspects/issues that are being considered and reflected in the different stages of a private equity fund's life, from early-stage planning to making investments and portfolio management.

  Please note that all of the issues covered below are also addressed in more depth in the Invest Europe Professional Standards Handbook. More information can be found here.

Fund formation: Early-stage planning at the GP group

- Appropriate early-stage design and planning of a fund is vital to its success. The structural elements of the fund must match the intended investment strategy.

  <u>Responsible investment considerations</u> including their incorporation into the GP's organisation and its investment and portfolio monitoring processes and policies, <u>are already taken into account by fund managers when doing their early-stage planning</u>. The same applies to the marketing strategy including what type of LPs will be targeted for the fund and the resulting regulatory requirements for marketing, the structural impact on the fund, and other specific requirements of the targeted group (such as <u>environmental, social and governance ("ESG") or other reporting needs</u>).

Fundraising: Due Diligence at LPs

- The due diligence that a prospective investor will undertake before deciding to commit to a fund (the period known as 'fundraising') will normally look at a number of factors relating to the GP's operations:

  - corporate governance processes, culture and values;
  - <u>policies and procedures (including in the field of responsible investment)</u>;
  - investment, divestment and portfolio company decision-making processes;

- reporting processes;
- compliance and risk management processes;
- business continuity plans; and
- conflicts of interest management and resolution procedures.

Making investments - the GP

- As detailed in the Handbook, when making investments on behalf of the fund, the GP should implement the fund's investment policy with due skill, care and diligence and in accordance with the agreements the GP has made with the LPs in the fund. Given that the success of an investment may be impacted not only by its financial performance but also by other performance criteria, a GP should be mindful of:

  - the risks posed and opportunities presented to its portfolio companies by ESG factors. It is also important that ESG risks and opportunities are considered across portfolio companies' value chains;
  - its own LPs' approaches to responsible investment and should seek to comply with their requirements, which may include expectations in relation to reporting on responsible investment factors in the investment and ownership processes and in some cases exclusion from investing in certain sectors;
  - the responsible investment impact of the conduct of its business and should give due consideration to material risks and opportunities associated with ESG and potential other responsible investment factors throughout the period of its investment in each respective portfolio company and more generally throughout the life of the fund.

- Against this background, GPs should integrate consideration of responsible investment risks and opportunities into their due diligence and investment approval processes and keep their investment documents and processes under periodic review.

  Any staff training needs on responsible investment and ESG matters should be identified, addressed and kept under regular review.

- Evaluation of responsible investment matters should not be limited to legal compliance, but could also include any additional standards and practices that could materially impact an investment from an ESG perspective; potential future regulation and marketplace factors such as existing or emerging voluntary standards; consumer expectations and client requirements; long-term ESG value creation projects; materiality and consistency with the investment project; and broader operational issues that could have a reputational as well as value creation or preservation impact.

Portfolio investment

- A GP should aim to ensure that its own and its portfolio companies' awareness and due consideration of responsible investment and ESG guidance and codes of conduct as applicable to the sectors and geographic regions in which each portfolio company operates are maintained throughout the life of the investment.

More concretely, the GP should ensure that at portfolio company board and management level there is appropriate awareness and adequate knowledge of responsible investment and ESG matters relevant to the country and sector the portfolio company operates in, including familiarity with appropriate external guidance issued by national, supranational and private bodies.

- Where the GP has identified ESG risks and opportunities that are deemed (potentially) material to the success of the investment or are particular focus areas of LPs, the GP should ensure that practices are developed to mitigate associated risks and pursue opportunities. These practices should also be included in post-investment action plans.

  The implementation and effectiveness of these practices should be monitored (and reported on) as appropriate, and therefore the GP should consider how it will obtain relevant ESG data from the portfolio companies. Noting that the ESG context could evolve, the GP should undertake to regularly review and update its responsible investment risk/opportunity analysis and revise, remove or add governance and monitoring frameworks (including policies, procedures and tools for implementation) as appropriate.

- A GP may be in a position of considerable influence as regards the development, implementation and monitoring of ESG strategies, policies and practices in place at portfolio companies.

  The GP, ideally through the information produced and provided by the portfolio company, should be in a position to identify, monitor and support the mitigation of relevant risks and the recognition and pursuit of opportunities in responsible investment matters within the portfolio company. Where appropriate, the GP, through its board representation or through the exercise of shareholder voting or contractual rights, where so permitted, should be available to assist and advise the portfolio company on how to investigate and address the ESG factors that are relevant for the business. The GP should ensure that it remains informed of the progress being made towards achievement of ESG objectives.

- Examples of some of the practical arrangements for achieving integration of responsible investment include:

  - using ESG information requests/questionnaires for the portfolio company;
  - using a standardised or industry-specific ESG investment checklist and formally addressing ESG factors in the investment process;
  - putting in place an ESG value creation and/or ESG risk mitigation action plan based on these due diligence findings;
  - including ESG site visits during the due diligence and ownership phase;

- defining an ESG business plan with expected savings and value creation; and
- tracking and evidencing ESG value creation.

Guidance by other organisations

- In addition to Invest Europe, other industry associations and international organisations and financial institutions have produced standards and/or other materials on responsible investment in the private equity industry. For a comprehensive overview, please see the Invest Europe Responsible Investment Bibliography (available here).

- One example is the PRI's "Responsible investment in private equity – A guide for Limited Partners," which includes substantive guidance for how an LP might integrate ESG considerations into:
  - investment policy and investment decisions;
  - ownership activities, i.e. monitoring and engagement; and
  - the disclosures sought from a GP and underlying portfolio companies.

  Invest Europe (at that time, the EVCA) was directly involved in the development of the first edition of this guide.

- Another example is the PRI's "Integrating ESG in private equity – A guide for General Partners," which provides practical guidance on how GPs can develop a framework for the integration of ESG factors within their organisation and investment cycle and points to industry resources and case studies. The guide is divided into two sections covering both the integration of ESG factors within a GP organisation and its investment process.

  GPs are encouraged to use the practices and examples presented in the guide as a starting point and adapt them to their organisations and investment styles. LPs can use the guide to understand the different ESG integration practices being implemented in the market, which will in turn facilitate a more informed discussion with their GPs during both fund selection and monitoring.

Question 1.b. What is the main rationale for institutional investors and asset managers to take ESG risks and opportunities into account in their investment decisions? Please indicate all the relevant issues (multiple choice)

- All of the options provided. The specific rationales in any given case will depend on the particular investor. The opportunities for value creation is another relevant rationale not included in the proposed list.

  - a) ii – identifying value creation opportunities
  - b)
  - c)

- d)
- e)
- f) - The legal requirements may be simple compliance with relevant environmental, works, health and safety legislation. Examples include the Grenelle law and Energy Transition law in France.
- g) - For example, additional long-term value creation.

- Although the wider impact of their activities is something that investors and the portfolio companies into which they invest have been taking into account for some time, GPs are more and more aware of the benefit that the management of ESG can bring for value protection and creation. Putting systems in place to systematically reduce costs and minimise risks and to exploit opportunities, such as promoting supply chain sustainability and improving employee engagement, all generate benefits.

  LPs have similarly encouraged private equity firms and managers to consider this dimension to their activity, not least because of increasing demands on these investors from their stakeholders and from regulation.

2. Information on ESG risks and opportunities

Question2.a. Which ESG risks do you perceive as material to investors?

- The Invest Europe Professional Standards Handbook (available here) includes more information on the environmental, social and governance factors (risks and opportunities) that the GP should consider in relation to the management of the fund's portfolio companies, as well as guidance on how to deal with this and take this forward. An overview is set out below.

Environmental factors

- Environmental risks could concern a range of factors including resource use/depletion, water scarcity, waste production and disposal; emissions to air, land and water; energy use, cost of carbon and climate change; biodiversity and habitat conservation.

- Conversely, environmental opportunities may include energy (or other resource) efficiencies, waste reduction or the development of new products with positive environmental attributes (e.g. using timber labelled as being from sustainably managed forests).

Social factors

- Generally, factors which affect the workforce, customers, suppliers and communities of a portfolio company should be evaluated at board level. Social factors can include stakeholder dialogue and human rights issues, such as the right of association and freedom to bargain collectively, observance of core labour standards in areas including health and safety, child labour, illegal or forced labour, employment of migrant labour, trade union rights and discrimination in the labour market.

  Managed badly, social factors can give rise to risks to brand and reputation (e.g. a key supplier attracting negative publicity for poor labour practices), to the attraction and retention of high quality staff, and to productivity (e.g. strikes at production facilities). There may also be legal consequences for the company and its directors.

  Conversely, when managed well, social factors can add real value. Examples include establishing a reputation as an "employer of choice" through progressive employment policies and practices (thereby reducing recruitment costs and improving productivity), maintaining a "social licence to operate" (through strong community relations), and ensuring continuity of supply (through effective supplier selection, engagement and auditing).

Governance factors

- Another key area of due diligence that should be completed by a GP prior to investment is corporate governance at the prospective portfolio company. Risk factors include fraud, bribery, corruption and other breaches of legal rules applying to the company. Poorly structured incentivisation packages can also adversely affect governance.

- The corporate governance systems, processes and controls applied by the senior management team at the portfolio company will reveal much about the effective running of the business to be invested in. A business with effective corporate governance in place will provide a strong platform for the rapid implementation of value building initiatives. A business with weak, ineffective corporate governance will make a higher risk investment but is likely to reap considerable benefit from the implementation of robust new governance systems and processes.

How to deal with all of this?

- Generally, GPs are expected to support a prudent and sustainable approach, and to influence the management of environmental and social risk and opportunity factors in portfolio companies so as to reduce risk and/or create value, with a view to long-term sustainable change.

Environmental	Social
Management of investments should include:	
• an ongoing evaluation of the likely impact of portfolio companies, their products and their supply chains on the environment. • such evaluation should take into account the efficacy of environmental risk management policies and procedures (e.g. leading companies institute full environmental management systems, certified to ISO14001). • consideration should also be given as to the likely impact of environmental factors on the portfolio companies and their supply chains (e.g. climate change, extreme weather events, etc.).	• an ongoing evaluation of the likely impact of social factors on the businesses (e.g. availability/quality of workers, conduct of staff or business partners, trends in customer attitudes, etc.) as well as the social impact of products (e.g. responsible marketing, or health and safety concerns) or operations. • consideration should be given to the completeness and effectiveness of any existing socially related policies and procedures, to manage risks and leverage opportunities and to the need for, and implications of change.
GPs should recommend to the boards of portfolio companies,	
• pursuant to shareholder documents, to identify and take material environmental factors into account in the formulation of the portfolio company's business plan.	• to identify and take material social factors into account in the formulation of the portfolio company's business plan. • human rights (covering workplace and supply chain issues) are likely to be an integral part of the social factors and board level discussions may include development of strategies to prevent direct and indirect involvement in human rights violations. • depending on the size and nature of the business, a portfolio company should also consider integrating its management of social factors into a full corporate sustainability programme and publishing progress reports

	on a regular basis, as part of a defined external stakeholder engagement strategy. A GP should ensure that such items are put on the agenda for board discussion where appropriate.

- A portfolio company is likely to be provided with guidance on governance requirements by the GP at initial investment. In some cases, the implementation of specific requirements will be a condition of closing the transaction.

- If not already in place, the GP should typically ensure that each portfolio company has appropriate governance structures to safeguard against fraud, bribery, corruption and other breaches of legal rules applying to the company and to ensure internal financial control, quality assurance, risk and conflict management and transparent reporting and communication.

  The GP should also consider the incentivisation packages in light of their impact on alignment with the objectives of long-term growth and good corporate governance.

- To ensure that portfolio companies are applying appropriate good governance practices and standards, the GP should ensure it remains up to date and familiar with legal rules, good practice and guidance in the respective countries and industries in which its portfolio companies are based. Typically, the GP should periodically review the adequacy of its practices and standards.

- Effective corporate governance, once installed, should support the decision-making process and follow-through within the organisation and the alignment of interests across the stakeholders in the business including management, employees, the GP and investors in the fund. Such alignment of interest is also part of a responsible investment framework.

  Ensuring the GP's governance objectives are achieved, whilst preserving the autonomy of the portfolio company board to drive business growth and not hamper it with bureaucratic processes and controls, is an important balance to achieve.

Question 2.b. What are the main sources of reliable and relevant information for investors on material medium to long-term risks and opportunities, particularly on ESG issues?

- As a relationship-based investment model, the main source of information for private equity LPs and GPs on their investments is the direct questioning and diligence by the managers of their investments. The increased awareness of ESG risks and opportunities has resulted in increased expertise within professional investment organisations, including in some cases dedicated ESG professionals, who utilise developed diligence tools and approaches to identifying these risks.

The private equity model of direct engagement provides continuous opportunities throughout the investment cycle to obtain and act on ESG-related information.

- The Invest Europe Professional Standards Handbook, including the revised Investor Reporting Guidelines, provide detailed guidance on ESG transparency and reporting in the private equity industry. As outlined below, throughout the entire life of a fund and the investment process, there is a high level of transparency and disclosure between fund managers and their investors on these issues.

- A website is a good starting point for the GP to generally provide basic information regarding themselves and their investments in a timely fashion. The GP's website could include information on:

    - description of the firm and key elements of its organisation;
    - senior management or senior investment professionals;
    - size and investment strategy of the different funds;
    - investments made with the following information about each portfolio company:
        - date of investment
        - date of divestment
        - type of industry
        - link to the portfolio company's website
    - policies regarding responsible investment;
    - press releases issued by the GP;
    - public relations contact details.

    Many GPs also provide their investors with access to a secure specific investor relations website where more detailed information is regularly made available.

Fundraising documents – Due diligence materials

- The core information on the ESG policies and practices is obtained during the fundraising process. The use of due diligence data rooms can also be an effective and efficient way to provide information to prospective LPs. The GP's fundraising team will normally assemble a comprehensive data pack of documents about the fund, its investment strategy and the GP's prior track record, collectively comprising the due diligence materials. This material will often contain confidential and proprietary information from the GP as well as, potentially, on current portfolio companies and their ESG situation.

- In addition, the fundraising team may respond to specific investor questionnaires covering a variety of topics, including for example ESG disclosure.

    Within this context, it is worth noting that in November 2015, the PRI published a Limited Partners' Responsible Investment Due Diligence Questionnaire (available here), which aims to understand and evaluate a GP's processes for integrating material ESG factors into their investment practices and to understand where responsibility for doing so lies.

The Questionnaire, which was prepared with input from several industry associations including Invest Europe, builds upon the ESG Disclosure Framework for Private Equity (see below). Where the Disclosure Framework provides high-level guidance and explains the rationale behind asking ESG-related questions, the LP Responsible Investment DDQ provides a detailed list of such questions that LPs can ask GPs pre-commitment.

The Questionnaire focuses on 4 areas:

1. Section 1 aims to establish the GP's approach towards ESG integration;
2. Sections 2 and 3 aim to establish the GP's processes for ESG integration; and
3. Section 4 aims to establish the GP's communication practices on managing ESG factors.

For more information, please see: http://www.investeurope.eu/about-us/professional-standards/responsible-investment-bibliography/

Fund documents

- The fund documents should set out the key terms and provide the legal/contractual framework within which the GP will operate the fund. As per the Handbook, one of the matters that the fund documents should address is <u>the responsible investment approach of the GP and/or the fund</u> and <u>the procedures for ensuring compliance</u> with any associated policies.

  In addition, the fund documents should contain provisions regarding the GP's obligations to provide reports to LPs. These provisions should address *inter alia* <u>the form and frequency of responsible investment reporting</u>.

Annual LP meetings

- The Professional Standards Handbook recommends that an annual meeting of LPs be held. An annual meeting provides an excellent opportunity for the GP and LPs to meet together in person. GPs increasingly include <u>ESG updates and reports as a core part of their presentations</u> to investors as well as updating LPs on the progress of the fund(s) and providing an overview of developments in the market, along with any relevant updates on the GP's team or processes.

- Regular conference calls or webcasts are an efficient method of keeping all LPs up-to-date between annual meetings. Having a secure area on the GP's website, or using one of the secure electronic data site providers is an increasingly common way for GPs to make documents and notices available to LPs.

Making investments

- A GP that has created governance structures and due diligence processes for responsible investment factors should, as per the Handbook, report to LPs on its findings on a suitably regular basis. The GP may also choose to send unsolicited reports on responsible investment factors and performance to all LPs, or report following a significant incident with ESG implications.

Question 2.c. Is it difficult for investors to access such information? If so, please specify.

- No. Private equity funds increasingly have contractual provisions for disclosure of ESG matters. See also question 2.b.

- Overall, as outlined in the Handbook, GPs should have an appropriate communication strategy, reflective of their operations and scale, and should clearly define and document their responsible investment policy and the procedures for compliance with such policy.

- GPs will typically be asked by LPs to provide information both during due diligence and throughout the life of the fund. Suitable arrangements should be made to respond to queries from LPs promptly as they arise, as well as complying with the obligations in the fund documents on reporting and, if relevant, meetings.

- During fundraising, as set out in the ESG Disclosure Framework for Private Equity[4], a GP should seek to disclose information sufficient to enable an LP that has expressed an interest in ESG management to:

    1. assess if the GP is aligned with the LP's ESG-related policy and investment beliefs;
    2. assess the GP's policies, processes, and systems for identifying ESG-related value drivers and managing material ESG-related risks; and to identify possible areas for future development;
    3. understand if and how the GP influences and supports its portfolio companies' management of ESG-related risks and pursuit of ESG-related opportunities;
    4. assess how the GP will help the LP to monitor and, where necessary, ensure that the GP is acting consistently with the agreed-upon ESG-related policies and practices as set forth at fund formation;

[4] The Environmental, Social and Corporate Governance (ESG) Disclosure Framework for Private Equity helps managers report ESG-related information to their investors. It sets forth due diligence questions (which may be effective for many LPs when considering whether or not to invest in a fund), and disclosure questions (which may be applicable during the life of a fund). Invest Europe supported the development of the Framework, alongside more than 20 Private Equity Associations, 10 private equity firms and 40 investors in private equity from 11 countries.

5. assess the GP's approach to managing and disclosing material incidents at the GP and portfolio companies.

- During the life of a fund, as per the ESG Disclosure Framework for Private Equity, a GP should seek to disclose information sufficient to enable an LP that has expressed an interest in ESG management to:

    1. establish if a GP is acting in a manner consistent with the GP's investment policies, processes, and agreed-upon fund terms regarding ESG management.
    2. understand positive and negative ESG-related developments that may impact portfolio companies in the fund.
    3. determine if responses to GP and portfolio company incidents and incident reporting are consistent with relevant investment terms, the fund's policies, and the LP-stated objectives regarding incident disclosure.

- As indicated in our response to Question 2.b., in November 2015, the PRI also published an LP Responsible Investment Due Diligence Questionnaire, which builds upon the ESG Disclosure Framework for Private Equity and provides a detailed list of questions that LPs can ask GPs pre-commitment.

Question 2.d. Is access to such data expensive? If so, please specify.

- No. See above.

- We note that the cost implications are in relation to the collection and processing of the underlying information rather than accessing it. As the process for ESG diligence and reporting becomes more standardised and GPs and their portfolio companies increasingly integrate them throughout their operations, these costs will become less important compared to the benefits of mitigating the risks and identifying the opportunities.

Question 2.e. What factors may prevent or discourage companies from disclosing such data?

- Confidentiality obligations are always important to take into account and may in certain circumstances limit the information that can be disclosed outside of the portfolio company. In situations where disclosure may be damaging to the portfolio company, fiduciary duties to portfolio companies may also need to be considered.

- According to the Invest Europe Professional Standards Handbook, the GP should seek transparency in its relationship with LPs by ensuring that all LPs receive all significant information regarding the fund in a clear and timely manner, provided that communicating such information is permitted by law. The GP should not breach confidentiality obligations binding on it but should seek to be relieved of such obligations if they prevent proper reporting to LPs.

- Certain LPs and types of investor will require custom-made information, or information presented in a different way, to satisfy their own tax, regulatory, commercial or responsible investment policy (including information in line with the ESG Disclosure Framework – see above) obligations. As explained previously, GPs should be receptive to such requests – which are typically at the investors' expense - but should also take care not to compromise fiduciary duties to portfolio companies (and thereby their other investors).

- Finally, the GP should also pay attention to local transparency requirements in considering the information made available on its website or otherwise.

Question 2.f. What is the main rationale for companies to publish such information? Please indicate all the relevant issues. (multiple choice)

From a portfolio company perspective:

a), d), and e) tend to be relevant for most companies; b) only for some; and c) is of course critical as companies will comply with whatever legal or regulatory requirements to publish are applicable to them.

From a GP point of view:

a), b), c), d), e), and f) - for example, sound governance practice (internal communication and transparency)

- All of the factors identified play a role in encouraging publication of ESG information. The importance of each may vary according to the circumstances.
- Invest Europe believes that it is important for our industry that the GP demonstrates to its wider stakeholder community sound ESG practices and standards that are both appropriate and proportionate to its own business and encourages a similar approach at its portfolio companies.

Question 2.g. Is there sufficient accountability for the disclosure by companies of such information?

- As professional investors LPs hold GPs accountable for their disclosure and actively engage with the GPs in discussing material reported. The close relationship between LPs and GPs facilitates this accountability.

Question 2.h. What are the best practices as regards internal corporate governance processes to ensure proper reliability of the disclosed information?

There are a number of common practices:

- third party certification of the ESG information disclosed;
- collection processes that are in line with existing financial reporting procedures with the same managers in charge; and
- the use of a structured reporting tool.

Question 2.i. What is the role of specific ESG investment instruments, like green bonds?

- To match "green savings" and "green investment opportunities".
- It also helps investors identify investment opportunities that match their responsible investment policies and environmental risk standards.

3. Integrating ESG information into risk assessment models of institutional investors and asset managers

Question 3.a. What should an appropriate long-term risk assessment methodology look like? Please indicate some examples of good practice.

Not applicable.

Question 3.b. Are there specific barriers, other than those of a regulatory nature (see question 9) for investors to integrate medium-to long-term risk indicators, including ESG matters in their risk assessment? If so, please indicate what you consider to be the main barriers.

- Expertise is the primary limitation. In the short term one could probably also include lack of experience and know-how within the organisation and the need to recruit more specific competence.
- ESG long-term risk assessment may be more difficult: the relationship between individual behaviours and global long-term environmental and social impacts.

4. Integration of ESG aspects in financial incentives

Question 4.a. When selecting and remunerating asset managers, how do institutional investors take into account asset managers' integration of ESG issues into investment strategies? What are the best practices in this area?

- The private equity investment model is there to build long-term sustainable value. This will not be possible if ESG matters are not considered and an integrated part of the operational value creation and preservation agenda.
- As explained throughout this consultation response, ESG forms an integrated part of the investment decision and value creation strategy, and the assessment of the responsible investment policies for compliance with the investor's own expectations is a part of the decision process for many.

Selection of asset managers

- LPs increasingly include responsible investment in their due diligence and the outcomes will to a greater or lesser extent be a factor in their selection of managers.

Remuneration

- ESG secures both long-term value creation and a GP's licence to operate: in both cases it accordingly has an impact on carried interest long-term entitlement and performance (although, strictly speaking, currently only financial returns affect the carry). There is no need to elaborate additional incentive instruments.
- Private equity manager remuneration is based primarily on incentives aligned to the return made by investors. As a sound ESG approach enhances the value of the business and enables it to identify ESG opportunities and address ESG risks, the implementation of ESG is rewarded through the greater success of the business. In other words, ESG's positive contribution to long-term performance will translate into better investment returns and hence remuneration for managers.

Question 4.b. Is ESG performance and active asset ownership taken into account in the remuneration of the executives and/or board members of institutional investors? What are the best practices in this area?

Not applicable.

5. Capacity of institutional investors

Question 5.a. Do you think that the lack of scale or the lack of skills and resources of some institutional investors may affect their ability to integrate ESG factors in investment decision-making and engage on such issues? If so, how? Please provide evidence if possible.

- Institutional investors are constantly improving their knowledge thanks to the work of regional and global organisations (PRI, GRI, Global Compact, CDP, Integrated Reporting, etc.). However, there remain contrasts between jurisdictions and between investors as to their level of engagement with these issues.

- While the situation will vary from one investor to another, generally speaking investment managers at institutional investors (whether they invest into listed securities or private equity funds) have more of a financial background rather than an operational one and will have less experience in understanding how companies operate and how value is created through the different processes. Hence, they will also have less understanding of ESG factors as such. At most institutional investors ESG matters will not be integrated but will be dealt with by the person responsible for ESG.

- Overall, larger organisations can deploy more resources and more specialised resources. Invest Europe and other organisations are addressing this through the development and dissemination of industry standards (for example, the Invest Europe Professional Standards Handbook) and tools (such as questionnaires) to better empower smaller organisations and specifically those with limited resources.

Question 5.b. Please indicate measures/practices that have contributed to enhance institutional investors' capacity and ability to integrate ESG factors in investment decision-making and engage on such issues.

- As the pan-European association for the private equity, venture capital and infrastructure industry, Invest Europe has been doing a lot to promote and increase members' awareness, and to facilitate the integration of responsible investment and ESG issues. Together with our sister associations across the EU and indeed also the world, we will continue to bolster this important cause by highlighting best practice and disseminating guidance through the publication of guides and other materials, the development of training courses and through the organisation of workshops and other events.

- Most of this work is done under the umbrella of the Invest Europe Professional Standards Committee and its Responsible Investment Roundtable.

1. Professional Standards Committee and Responsible Investment Roundtable

   The Invest Europe Professional Standards Committee develops and maintains strong guidelines and working practices for the industry. The Committee also makes direct recommendations to the Invest Europe Board of Directors on professional standards and responsible investment issues.

   The Invest Europe Responsible Investment Roundtable, set up in 2013, is a permanent forum dedicated to responsible investment practices and environmental, social and governance issues in Europe's private equity industry.

   A sub-committee of the Invest Europe Professional Standards Committee, the Roundtable aims to promote responsible investment practices and the consideration of ESG issues within the Invest Europe membership and the broader private equity community.

   The Roundtable encourages the open exchange of ideas and promotes informed discussion about responsible investment practices and ESG issues in European private equity to better enable industry participants to understand, adopt and implement existing and emerging practices.

   In terms of concrete output, the Roundtable is keen to generate materials that disseminate responsible investment practice from the leading firms to others and find a way to share the experiences of people focused on the topic with those that are only now coming up the curve. Examples include the production of a Responsible Investment Bibliography (available here) and a GP ESG DDQ (close to being finalised soon).

2. The organisation of an annual training course dedicated to responsible investment

   The Invest Europe Handbook of Professional Standards is used extensively in Invest Europe training courses, which supply first class tuition to all industry participants and practitioners, including new entrants as well as seasoned veterans.

   For several years in a row, Invest Europe organises an annual training course with a particular focus on responsible investment. The Integrating Responsible Investment Master Class focuses on understanding and integrating responsible investment in the daily operations of a fund. The emphasis is on practical examples, discussion of case studies and day-to-day challenges.

   Issues covered during the course include:

   - Responsible investment and conduct of business, including GP-level ESG integration, what constitutes a good ESG policy, putting a framework in place to translate principles into practice;
   - Integrating ESG factors in investment, due diligence, including environmental, health and safety, social, governance, and litigation risk aspects;

- Integrating responsible investment into fundraising including: what questions LPs ask, what requirements LPs may have, how can a GP prove and explain its responsible investment strategy, what to put into marketing documentation and legal agreements, data room, website; and
- Integrating responsible investment into monitoring and reporting: What to expect from and how to effectively monitor portfolio companies on ESG? How to effectively disclose ESG information to your LPs? How do LPs monitor GPs?

3. The organisation of ESG workshops

   Over the last five years Invest Europe, in close cooperation with the Responsible Investment Roundtable and national private equity and venture capital associations across the EU, has organised a series of ESG workshops and seminars in several cities, including London, Munich, Frankfurt, Amsterdam and Stockholm. The last one took place in Warsaw in February 2015 and was organised in cooperation with PSIK, the Polish Private Equity and Venture Capital Association.

   In 2013 and 2014 Invest Europe also organised a Responsible Investment Summit in Brussels, bringing together industry practitioners and policymakers to discuss ESG and responsible investment.

6. Internal governance and accountability of the institutional investor

Question 6.a. To what extent can good internal governance of institutional investors, such as mechanisms aiming to align interests between beneficiaries, board and key executives, influence their ability and willingness to integrate ESG factors in investment decision-making and engage on these issues? Please provide evidence or good practices if possible.

Not applicable.

Question 6.b. Do beneficiaries of pension funds and other institutional investors with long-term liabilities obtain sufficient and clear information about how the fund or investor is managing ESG risks? Can they give their opinion/be consulted on these aspects? Please provide examples of good practice.

- Private equity is increasing its focus on and the information provided to its investors on ESG topics. As noted above, the Handbook specifically identifies this as a key issue. Investors in private equity can and do have substantial access to ESG information from GPs that are incorporating ESG risks and opportunities into their investment processes. The development of standards and frameworks for reporting, such as the Invest Europe Investor Reporting Guidelines, a consensus document of GPs and LPs, enhances the exchanges.

- Further, as investment into private equity funds is often based on a direct relationship between the GP and its LPs, we believe this asset class provides a very direct way for long-term investors to obtain ESG information, often in addition to the standard disclosures, ensuring the specific needs of investors are addressed. As the fund investment is a private transaction, investors can agree the specific information exchanges and ESG focus that concerns them in the contractual documents establishing the fund. As the Handbook makes clear, information provision is a key topic to agree up-front between the manager and its investors. We also note that direct dialogue often takes place between the fund manager and their investors after investment.

Question 6.c. Are beneficiaries interested in matters referred to above? Please provide evidence if possible.

Not applicable.

7. The role of other service providers

Question 7.a. Is there sufficient long-term oriented, reliable and relevant external investment research? Are there barriers to good quality external investment research on ESG risks and opportunities? If so, please explain. What role, if any, do financial incentives or conflicts of interests of some service providers play?

- Not only trade associations but also international institutions and independent parties regularly produce studies, reports and/or other tools on responsible investment and ESG in private equity.

  An overview is set out in the Invest Europe Responsible Investment Bibliography, available here.

Question 7.b. To what extent do investment banks, investments analysts and brokers provide information on medium-to long-term company performance, including corporate governance and corporate sustainability factors, when they make, buy, sell and hold recommendations to investors?

Not applicable.

Question 7.c. To what extent do investment consultants consider the asset managers' approach to ESG issues and active asset ownership when advising institutional investors about the selection of asset managers?

- This is an increasingly important part of the assessment process.
- The Invest Europe Professional Standards Handbook makes the integration of ESG into the overall investment process a responsibility of all private equity firms.

Question 7.d. To what extent do proxy advisors consider medium-to long term performance of companies, including ESG performance, in their voting recommendations?

Not applicable.

Question 7.e. To what extent do credit rating agencies take medium-to long term performance of companies, including ESG performance, into account in their ratings?

Not applicable.

Question 7.f. What are the best practices as regards independent external assurance (for example auditor review) for the disclosure by companies of material medium- to long-term risks and opportunities, particularly ESG issues?

Not applicable.

8. The role of non-professional investors

Question 8.a. Do you know of initiatives that led to more sustainable and responsible investment from non-professional investors? Please provide details about them.

- Although this is not of immediate relevance to the private equity industry (which deals predominantly with institutional investors), it is worth noting that there is a growing impact investment market. While still mainly funded by institutional investors, family offices and semi-professional investors, retail investors are for example increasingly investing via crowdfunding platforms and are beginning to ask for more impact-oriented investment products. The French 90-10 funds (albeit also driven by tax incentives) are one such example.

9. Legal or regulatory constraints

Question 9.a. Are there legal or regulatory constraints likely to significantly and unduly prevent or discourage investors from taking a long-term view in their investment strategies and decisions and from investing in a sustainable way? If so, please provide details.

- Private equity is designed as a long-term investment activity. Lacking the liquidity of the public markets, investment strategies in the industry center around building long-term value.
- Prudential requirements imposed by European regulators can have a significant impact on private equity funds' ability to raise capital from institutional investors and therefore the industry's ability to support the long-term development of sustainable investment and European economic activity.
- There is an extensive network of EU regulatory measures that apply to institutional investors, often intended to ensure the prudential soundness of the institution and to ensure financial stability. But legislation such as Solvency II, CRD IV/CRR or IORPD will also have a major impact on the investment decisions of those investors. They will, in effect, shape their willingness to act as suppliers of capital to particular asset types: prudential capital charges, for example, effectively change the anticipated net return to the investor from a particular investment.
- Solvency II provides a very good example of the influence that such investor regulation can have and of the weakness of an approach to long-term assets that is founded on a methodology designed for liquid assets. While the 39% risk weighting for insurers' investments into private equity was a welcome improvement from EIOPA's original proposal, significant concerns remain that this does not reflect the risk insurers face when investing in our asset class and may act as an artificial barrier to their investments.
- The experience of Solvency II highlighted serious difficulties in applying a 'market-consistent' approach to the determination of the risk associated with long-term asset classes, overstating in our view the risk that institutional investors face from such assets and thereby discouraging the commitment of capital to them. Where changes can be made easily (for example to the Solvency II Delegated Acts) or where further Level 1 legislation is necessary for other reasons (for example amendments to CRD/CRR to implement further recommendations from the Basel Committee) <u>prudential capital requirements should be amended</u> to promote rather than discourage the commitment of capital to private equity funds, and through them to European businesses. Joined up thinking is essential.

Question 9.b. Do you believe that there are any barriers to the understanding by institutional investors and asset managers of their fiduciary duties that would not enable them to appropriately take ESG factors into account in their investment decisions? Please explain.

Not applicable.

10. Others

Question 10.a. Are you aware of any other incentives or obstacle(s) with a significant impact? If so, which ones?

Not applicable.

Question 10.b. Would you consider further increase in sustainable investments if market or regulatory conditions for sustainable investment would be more favourable? If so, please provide estimations, if possible.

- European venture capital managers in particular actively support the development of new and innovative businesses. These managers are often at the forefront of supporting earlier stage developments. Any improvement in regulatory or other business conditions supporting the development of sustainable investment will help to attract additional capital to the area and encourage investors and managers to focus their efforts on these areas.