

PwC's dialogue with private equity investors reveals growing interest in responsible investment, and finds a need to not only bridge the gap in understanding between investors and managers, but also to demonstrate the value

Bridging the gap: Aligning the Responsible Investment interests of Limited Partners and General Partners



88%

of LPs believe there is added value in responsible investment

71%

of LPs would decline to participate in a GP's fundraising on ESG grounds

18%

of LPs have withdrawn from an investment or withheld capital on ESG grounds

97%

of LPs believe responsible investment will increase in importance over the next two years

Contents



01

Foreword



02

Understanding the LP perspective



03

Exploring the highlights



04

Responsible Investment is gaining momentum



05

How LPs approach RI in private equity



06

Importance and value still open for debate



07

Defining a way forward



08

Encouraging dialogue



09

Participants

Foreword

The growing need to demonstrate responsible investment practices is an important influence on business behaviour in society. Responsible investment (RI) is no different to any other investment decision; it is guided by the principles that managing exposure to environmental, social and governance (ESG) risk issues and identifying opportunities to implement improvements in these areas will protect and increase value. It leads to a natural selection, choosing businesses deemed to be more sustainable and less likely to suffer operational or reputational concerns, or fall foul of regulation.

This report describes the results of our engagement with Limited Partners (LPs) to explore their perspective. It's quite clear that responsible investment currently plays a significant role in their investment decisions with

- 71% of the LPs interviewed saying they would decline to participate in a General Partner's (GPs) fundraising, or would turn down a co-investment, on ESG grounds
- 18% of LPs interviewed having withdrawn from an investment or withheld capital on ESG grounds

And that it will continue to do so in the foreseeable future, with 97% expecting responsible investment to increase in importance over the next two years. For GPs then, it is critical to get this right, to satisfy the growing expectations of the LPs.

It is a relatively new area, though, that's still finding its way. It's clear that discomfort remains between LPs and GPs on how to achieve their responsible investment objectives, and that their expectations and approaches are yet to align. It's a gap that feels destined to be bridged – with 88% of LPs interviewed believing there is added value in responsible investment, there is a sense of continued optimism around it and willingness to pursue it.

Many of the comments and findings in this research (and in previous PwC research) indicate a disconnect in views, particularly on ESG data needs, to support decisions. It would be easy to say that more discussion is needed between LPs and GPs to define a single approach, to avoid numerous onerous data collection exercises, and a better understanding of the objectives of both sides. But, LPs and GPs have already embarked on this journey and developed the ESG Disclosure Framework – launched in 2013, for reporting

ESG information. (Work on an LP due diligence questionnaire is also now underway through the Principles of Responsible Investment (PRI).)

When we talked to LPs they were generally clear on what they wanted from GPs but there was little sense that the ESG Disclosure Framework is the final piece of the information jigsaw – in fact, 47% said they never use it. Developing a process that works for everyone is still very much work in progress. To many, such initiatives may feel idealistic or like an onerous layer of administration, but to an industry where there is a growing belief that RI is a driver of value, they are not to be taken lightly. It was clear from our dialogue with LPs that there is greater emphasis on quantifying the value that RI creates; 74% of respondents indicated that they would find this very useful whilst only 19% currently attempt to do this.

I am sure debate will follow with GPs to understand the cost and resource implications involved and to reach a practical solution that works for both. It is evident, though, that it takes more than debate - both GPs and LPs need to commit to adopting and implementing proposals to secure a mutually acceptable way forward.



Malcolm Preston

Malcolm Preston
PwC, Global Sustainability
Leader

Understanding the LP perspective

Responsible investment is rapidly becoming a mainstream concern within the investment industry. The dramatic growth in the number of investors who have adopted the Principles for Responsible Investment (PRI) is only the latest indicator of the increased attention the sector is paying to the integration of environmental, social and governance (ESG) factors into investment management.



Responsible investment principles (see box, ‘Responsible investment defined’) were first applied within listed equity, but they are being adapted to other asset classes, including private equity. Earlier studies, including from PwC, have examined how private equity fund managers (the GPs) are approaching responsible investment and ESG management.

Indeed, in our last study, GPs cited investor pressure as the second most important driver for their ESG activities (after

risk management).¹ 85% of GPs said at least some of their investors, or Limited Partners (LPs), had shown interest in responsible investment, and 79% believed that interest was set to grow.

In our engagement since then with private equity stakeholders on both sides of the market, we have found not only considerable uncertainty about how best to pursue responsible investment, but also imperfect communication and understanding between GPs and LPs around the issue.

To complement our earlier research, we therefore decided to explore how LPs are approaching responsible investment in their private equity allocations. The headline findings reinforce what we have already heard from GPs: responsible investment is important, and is expected to become more so.

“The trend in the market seems clear. Asset class after asset class has been added in terms of ESG considerations. Now we can see increased interest and commitment in the private equity sphere, although much remains to be done.”

Sixth Swedish National Pension Fund – AP6, Sweden

¹ PwC, Putting a price on value, 2013. (see pwc.com/sustainability)



About the research

For our latest research into how the private equity industry is embracing responsible investment, we sought the views of the institutional investors who are the sector's source of capital. PwC's responsible investment specialists interviewed a sample of 60 Limited Partners (LPs) in 14 countries, which collectively allocate around \$500 billion to private equity fund managers, or General Partners (GPs).

We identified a universe of LPs diversified by geography, size and type. However, participation in the research was voluntary so the sample is likely to be skewed towards those LPs who are relatively advanced in their approach to responsible investment, and therefore their management of environmental, social and governance (ESG) issues. While most (63%) were PRI signatories, a significant proportion were not. We also found limited engagement from LPs based in Asia, reflecting the emerging nature of responsible investment in that part of the world.

Responsible investment defined

Responsible investment is an approach to investment that acknowledges the relevance of environmental, social and governance (ESG) factors alongside traditional financial metrics. It is based on the belief that addressing ESG issues will protect value and enhance portfolio returns, especially over the longer term.

It is somewhat of a catch-all concept that has absorbed a number of earlier approaches, such as ethical investing, socially responsible investing, sustainable investing, impact investing and triple-bottom line investing. Responsible investing correspondingly encompasses a range of strategies.

Responsible investors may choose to exclude entire sectors they consider unsustainable or unethical, or they may seek out companies with better ESG performance than their peers. Some investors look to invest in companies with measurable, positive environmental or social impacts. Increasingly, responsible investors seek to supplement their existing investment processes with ESG analysis.

A fuller discussion can be found at www.unpri.org/introducing-responsible-investment.



Exploring the highlights

Figure 1: Participant profile: by type of investor

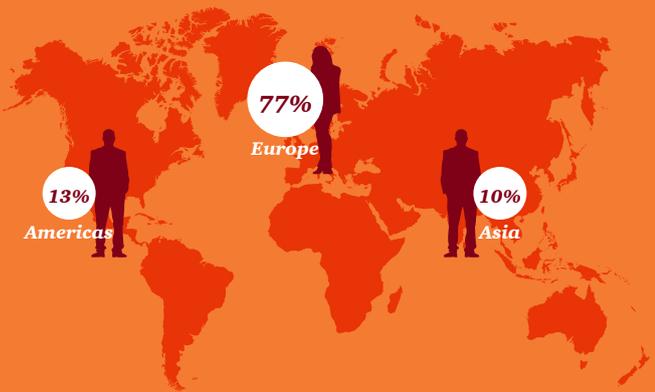
Question: LP type



Source: PwC Global Private Equity LP Dialogue 2015
No. responses: 60

Figure 2: Participant profile: by geography

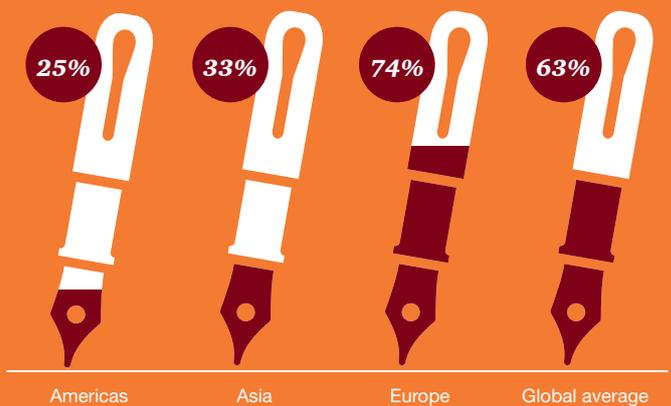
Question: Where is your country of incorporation?



Source: PwC Global Private Equity LP Dialogue 2015
No. responses: 60

Figure 3: Participant profile: by who's signed up to the PRI

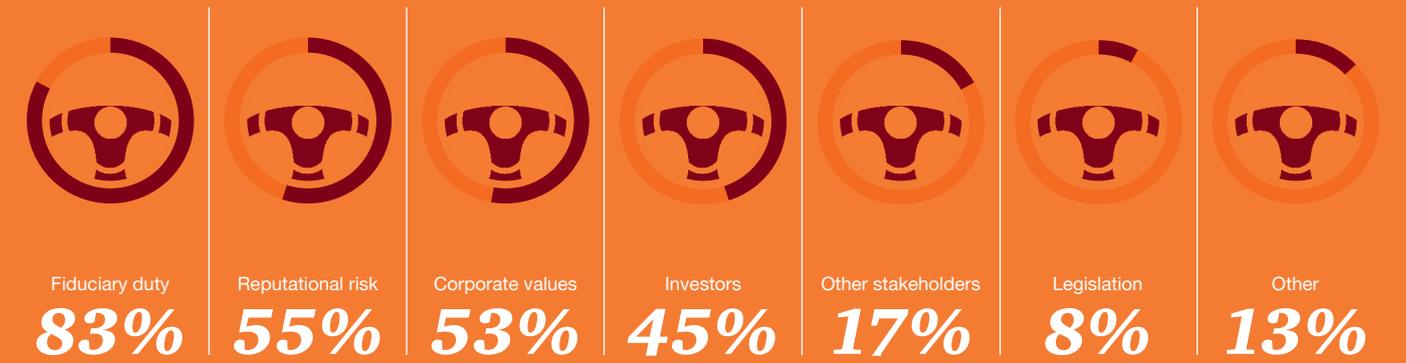
Question: Are you a signatory of UN PRI?



Source: PwC Global Private Equity LP Dialogue 2015
No. responses: 60

Figure 4: What are your top three drivers? (% of LPs who put each driver in their top three)

Question: What are the top 3 drivers of responsible investment for you?



Source: PwC Global Private Equity LP Dialogue 2015
No. responses: 51

Figure 5: Belief in the added value of responsible investment

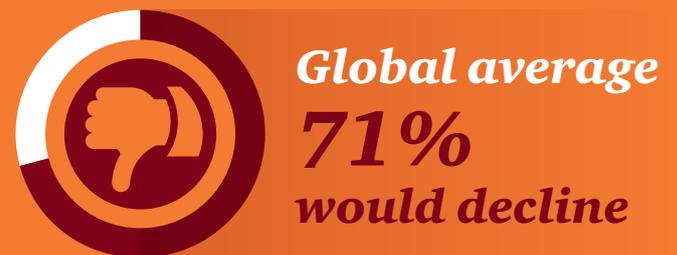
Question: Do you think that responsible investment adds financial value in private equity?



Source: PwC Global Private Equity LP Dialogue 2015
No. responses: 60

Figure 6: ESG issues are a key driver in declining opportunities to invest

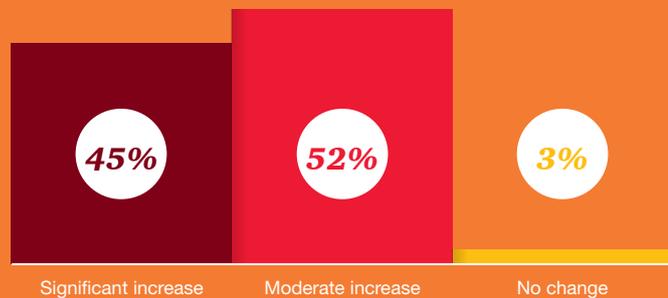
Question: Would the results of your ESG assessment alone result in an investment being declined?



Source: PwC Global Private Equity LP Dialogue 2015
No. responses: 58

Figure 7: Importance of responsible investment expected to increase

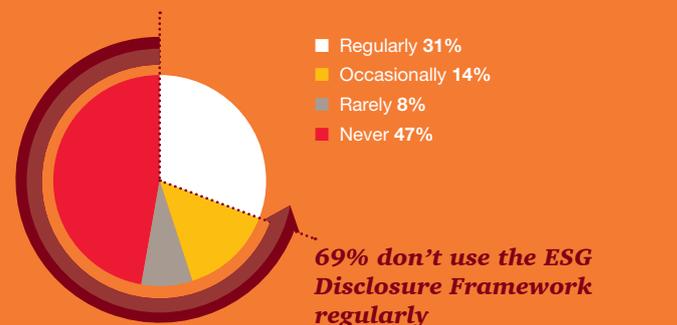
Question: Do you think that responsible investment will increase or decrease in importance over the next 2 years?



Source: PwC Global Private Equity LP Dialogue 2015
No. responses: 58

Figure 8: Adoption of the ESG Disclosure Framework is mixed

Question: Do you use the ESG Disclosure Framework?



Source: PwC Global Private Equity LP Dialogue 2015
No. responses: 51

Responsible Investment is gaining momentum

We interviewed 60 LPs and no fewer than 83% have responsible investment policies in place that apply to their private equity investments. Almost all (97%) believe that responsible investment will increase in importance over the next two years.

“A company that is well managed will have a better exit value – good management of ESG is like having a “quality label” in a sense; it is an indicator of good management and therefore better exit values.”

Kommunal Landspensjonskasse (KLP), Norway

These responsible investment policies are already having an effect in practice. More than two-thirds (71%) of the LPs interviewed said they would decline to participate in a GP’s fundraising, or turn down a co-investment, on ESG grounds (see Figure 9: Responsible investment is driving behaviour). These grounds might include a reluctance by a GP to introduce RI policies or processes, or a history of investing in unethical or unsustainable sectors, e.g. the defence or tobacco sectors. The same number say that they impose ESG criteria as a condition of allocating capital to GPs.

Figure 9: Responsible investment is driving behaviour

Question:

- a) Would the results of your ESG assessment alone result in an investment being declined?
- b) Do you think that responsible investment adds financial value in private equity?

Agreed would decline to participate in a GP’s fundraising or turn down a co-investment on ESG grounds

71%

Believe that better management of ESG factors will either improve returns or reduce risk

83%

Source: PwC Global Private Equity LP Dialogue 2015

No. responses: 58 (to first question) and 60 (to second question).

“In France, we anticipate that new regulation, requiring greater disclosure by institutional investors around how they are taking ESG issues into account, will be an additional driver for the responsible investment agenda.”

Emilie Bobin, Senior Manager, PwC France



“Business as usual and ESG are becoming increasingly linked. We see increasing awareness and reporting of ESG issues from our GPs.”

Ardian, France.



“Ongoing corporate governance regulation and the response of investors and government-led institutions, such as the Government Pension Investment Fund, is sending a clear signal to Japanese LPs of the growing significance of responsible investment to the investment community.”

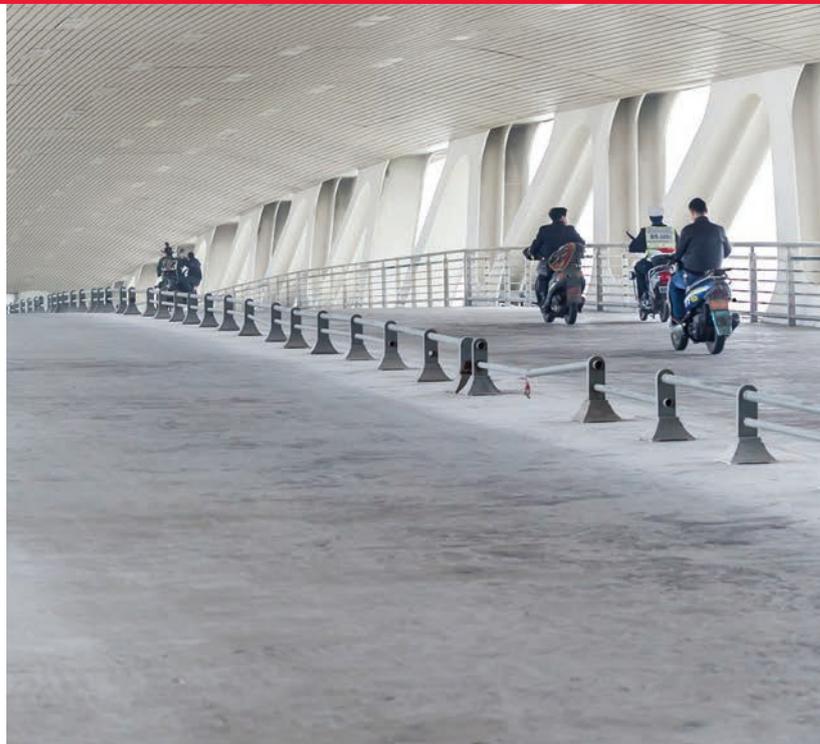
Masataka Mitsuhashi, Partner, PwC Japan



We asked LPs what lies behind their application of responsible investment practices to private equity. Fully 83% believe that better management of ESG factors will either improve returns or reduce risk, meaning that ESG management is part of their fiduciary duty. ‘Corporate values’ was cited as a top-three driver by 53%, and 45% mentioned pressure from investors. Reputational risk was ranked as a top 3 driver by just over half of LPs.

Unsurprisingly, differences emerged between LPs in the more mature investment markets of Western Europe and North America, and those elsewhere. Belief that responsible investment adds value was lower in emerging markets (at 67% compared with 91%) and LPs there placed a greater emphasis on legal and regulatory drivers.

However, it is our view that jurisdictions in emerging markets are likely to follow more mature markets in their uptake of responsible investment, partly as a function of growing awareness, and



partly as private equity fund-raising becomes increasingly globalised. As non-OECD GPs seek investment from developed country LPs, and as non-OECD LPs participate in developed country private equity funds, responsible investment practices are likely to become more widely disseminated.

“Right now, responsible investment is very much a Europe-driven agenda, however, we are seeing greater numbers of non-European investors taking this topic seriously.”

Bregal Private Equity, UK

How LPs approach Responsible Investment in private equity

For all the rapid progress in the evolution of responsible investment, the field is still immature and changing fast. Nowhere is this truer than in private equity, where both limited partners and general partners are grappling with how best to address ESG issues in their investments.

The conversations that PwC's responsible investment specialists conducted with LPs provide fascinating insights into how these investors are putting responsible investment policies – already in place at more than four-fifths of them – into practice.

Key findings include:

There is more focus on governance than on environmental or social issues, especially in emerging markets

Of the three pillars of ESG, governance is perhaps best understood by investors, and the link to value – especially to the risk of destruction of value by poorly governed companies – is clearest. As one LP put it, “Governance and control is often a key factor

in the negotiating process for direct private equity and co-investment deals. There have been deals dropped where the fund could not gain sufficient assurance on the governance of the investment.”

Most effort on ESG management is made ahead of investment

Almost all (97%) of LPs interviewed carry out an ESG assessment of a GP's approach to RI before allocating funds to a GP. Most of these assessments are subjective or qualitative, but one third (32%) assign a quantified ESG weighting to the allocation decision. One LP gives four ESG-related questions – whether a GP has an RI policy, carries out ESG due diligence processes, conducts ESG reporting, and monitors ESG performance – a

total 10% weighting in the investment decision. Another LP successfully uses an online platform where over 70% of its GPs answer 60 ESG-related questions covering the GP's commitment to ESG as a firm and as an investor, as well as the GP's public activity on responsible investment.

ESG conditions are set by 71% of LPs interviewed as a condition of allocation. These are usually set out in side-letters, as inclusion of such terms in a Limited Partner Agreement would require unanimity among the LPs. Exclusions – requirements that a GP does not invest in a certain sector or geography – are the most common example of conditions being set. (Tobacco, alcohol and weapons are the most often cited exclusions).



“Governance is most often targeted first, as it is relatively simple compared to environmental or social issues. This is a natural progression in the evolution of responsible investment.”

Sudhir Singh, Partner, PwC India



Another example is the requirement by some LPs for their GPs to have signed the PRI.

There is recognition that LPs’ engagement with ESG matters declines once they have committed to a fund

One in five LPs receives reports quarterly on ESG issues, with 39% only receiving annual updates. Some LPs note that they have limited time and resources for monitoring GPs, and therefore tend to prioritise discussions around financial performance.

Others indicate that once invested, they have less room for manoeuvre even if adverse ESG information were to come to light. Indeed fewer than one in five LPs interviewed

(18%) has withdrawn from an investment or withheld capital on ESG grounds. This reflects the difficulty and high costs of exiting a fund once capital is committed, and suggests that pre-investment ESG due diligence activities, as well as proactive dialogue during the investment, are generally successful.

LPs vary in how they allocate responsibility internally for responsible investment

Some LPs have dedicated responsible investment staff – ranging from one or two to teams of 20-plus – enabling the development of deep specialist knowledge on the subject. These LPs take the view that responsible investment is a topic which requires expertise

and is sufficiently important to warrant the deployment of full time resources.

Other LPs believe that awareness and incorporation of responsible investing should be every employee’s responsibility. As one LP puts it, “the importance of responsible investment is drilled into every employee that we have, so that there is no need for full-time resources solely focused on ESG”. Another notes that its integration of responsible investment practices throughout its team reflects its view that ESG analysis “is a standard component of due diligence and should not be viewed as a separate add-on”.

Importance and value still open for debate

Our discussions with LPs show clearly that there is a strong belief that pursuing responsible investment has the potential to add value – whether from improved portfolio returns, or in terms of reduced risk. But what they also reveal is a lack of hard evidence, uncertainty around the quantification of the benefits of responsible investment, and a lack of clarity around how best to communicate between LPs and GPs on ESG issues.

“Initially, reputational risk mitigation was seen as the main reason for considering ESG factors. Then, investors recognised that ESG factors can pose investment risks. There is now increasing focus on the opportunity to enhance returns and create positive impact from ESG integration.”

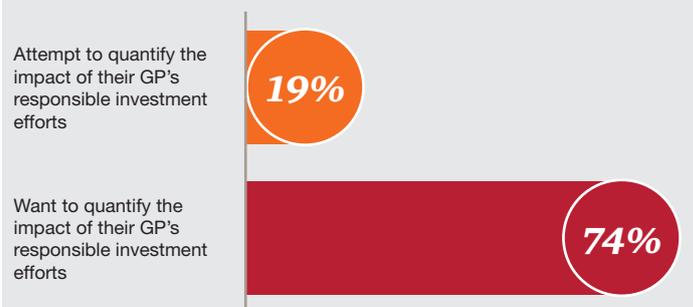
Partners Group, Switzerland

Some investors still question whether ESG management adds value

The vast majority of the LPs we interviewed believe responsible investment adds value – but the evidence is not as clear-cut as responsible investment advocates would like. Numerous studies have demonstrated correlations between ESG management and improved shareholder returns, typically in listed equities.² But correlation is not the same as causation, and some investors remain to be convinced. As one major LP puts it: “There is absolutely no proof of responsible investment increasing returns.”

Figure 10: Quantifying the impact

Question: Do you quantify the positive impacts your responsible investment requirements have made to an investment?



Source: PwC Global Private Equity LP Dialogue 2015

No. responses: 54 (to first question) and 39 (to second question)

Few investors or managers attempt to quantify the value added by ESG management

Only one-fifth of LPs attempt to quantify the impact of their GPs' responsible investment efforts, although three-quarters would like to see this done

(see Figure 10: Quantifying the impact). Such quantification that does take place is often limited to relatively “low-hanging fruit”, such as cost savings from energy efficiency or improved staff retention from greater employee engagement.

² For example, see “From the Stockholder to the Stakeholder, How Sustainability Can Drive Financial Outperformance”, Clark, Feiner & Viehs. Smith School of Enterprise and the Environment and Arabesque Asset Management (2014)

This means confusion exists regarding fiduciary duty

Both of these points have implications for how institutional investors interpret their responsibilities to their beneficiaries – their fiduciary duty, as it is known in common law jurisdictions, such as the US and the UK, or similar obligations in civil law countries. Some LPs argued that if managing ESG issues adds value, then it is clearly part of investors' fiduciary duty to do so. Others argued that if it instead merely imposes costs, without adding value, then fiduciary duty can be invoked as an argument not to dedicate resources to ESG management (for more on this, read the box: The fiduciary duty debate).

And LPs and GPs are struggling to communicate effectively around responsible investment, risking misaligned outcomes

Our conversations with LPs reveal limited formal ESG reporting, with most reports being qualitative rather than quantitative. While LPs consider reporting by GPs a useful indicator that the latter are addressing ESG issues, there is limited evidence that LPs interrogate these reports particularly thoroughly. LPs also express themselves unsure of what information to demand, and are reluctant

The fiduciary duty debate

Both supporters and opponents of responsible investment have invoked fiduciary duty to justify whether or not to address ESG issues in the investment process. Its definition – a legal duty to act in another party's interest – is straightforward. Its interpretation is anything but.

It has long been assumed by investors, often with reference to the 1985 Cowan vs Scargill case in the UK, that fiduciary duty rules out considering so called 'non-financial' issues when investing on behalf of third parties. However, that position – that short-term financial returns should be prioritised over all else – has been increasingly challenged. As long ago as 2005, a landmark report written by law firm Freshfields argued that: "Integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions."³

In 2014, the UK Law Commission published an extensive study into the question, which concluded that, where trustees consider ESG issues to be material, they should take them into account.⁴ And, while financial considerations should be trustees' predominant concern, they also have leeway to consider non-financial concerns that might be shared by beneficiaries. The UK government is in the process of consulting on the implementation of the Commission's findings.

While fiduciary duty is technically a common law concept, other legal systems impose similar obligations on those managing investments for third parties, and have seen similar arguments made against considering ESG issues.

But many of those studying the question are increasingly of the view that the legal interpretation of fiduciary duty is not the barrier to the integration of ESG that it once was and that, in most jurisdictions, the relevant law and regulations are sufficiently clear that non-financial issues can be taken into account by investors. Instead, other barriers, such as limited understanding among pension fund trustees and other investment professionals, are more important obstacles to the wider uptake of responsible investment practices.

To explore these issues further, the PRI Secretariat is conducting an international project to examine the role of fiduciary duty in impeding ESG integration, and in framing investment objectives that take into account wider social and environmental impacts. It is due to produce a report in September 2015.

to impose costs on GPs by requiring onerous reporting. Some confess that they would struggle to analyse large volumes of ESG information in any event.

Our work with GPs, meanwhile, suggests that some are frustrated by a lack of standardisation in the information requests, and suspect that some requests are more about box-ticking than gaining real insights into ESG management. While 44% of

LPs make regular or occasional use of the ESG Disclosure Framework (a document drawn up by investors and fund managers to guide GP reporting on ESG issues), many are unfamiliar with it, while other LPs do not consider that it suits their needs.

³ A legal framework for the integration of environmental, social and governance issues into institutional investment, Freshfield Bruckhaus Deringer, 2005

⁴ Fiduciary Duties of Investment Intermediaries, Law Commission, 2014

Defining a way forward

It comes as no surprise that there is a lack of consensus around responsible investment in private equity. Even in asset classes where investors have greater experience of ESG management, such as listed equity, opinions remain divided over its importance and its efficacy.

“ESG provides an additional lens into the investment. It enhances investment analysis and highlights issues that might be missed using traditional approaches.”

BlackRock, USA

But we believe that, while the evidence can be debated, ESG management adds significant value in private equity as in other asset classes. We believe it provides an additional layer of analysis that helps investors spot risks and opportunities. ESG management is often a proxy for high quality management more broadly, whether in companies or investment funds. Companies, and investors, who seek to do the right thing tend to be rewarded with motivated staff and loyal customers.

A growing body of academic research is teasing out the links between material ESG issues and shareholder value.⁵ And our work on ESG valuation pathways is demonstrating how clients can derive financial value from ESG initiatives (see box, Identifying and quantifying value from ESG activity).

Identifying and quantifying value from ESG activity

There is broad agreement that ESG initiatives create value, both for society at large and for shareholders. But putting a figure to that value can prove difficult for a number of reasons:

- ESG value could be derived from intangible assets that are hard to quantify (such as reputation);
- the pathway between ESG activity and value (whether from cost savings, revenue generation or value at risk) is poorly understood; and
- it is unclear how the outputs of ESG value quantification could be incorporated into investment criteria.

We have noted a growing appetite to better understand the value from ESG activity to either inform capital allocation decisions based on return on ESG investment, to support the business case for continued investment in ESG activity or to evidence additional value from ESG activity in company valuation. We are currently working with large blue-chip companies to apply sustainability valuation techniques to their ESG activities. We are also adapting those techniques to apply them, cost effectively, to the smaller firms in which private equity firms typically invest. This will allow us to define common ESG value pathways that can be replicated across portfolios.

The process involves identifying those ESG activities that have high materiality in terms of value, where a clear pathway to value protection or creation can be identified, alongside sufficient data to allow measurement. These pathways can then be used to collect management information from disparate business functions and assess the impact to cash flows so that ESG value can be quantified and reported. Once the initial work is done, these pathways can be uncovered within other portfolio companies, allowing the GP to build up a comprehensive view of ESG added value.

⁵ For example, see “Corporate Sustainability: First Evidence on Materiality”, Khan, Serafeim, and Yoon, Harvard Business School (2015).

“Clear and attributable evidence that ESG activities add financial value should convince those who believe that their fiduciary duty constrains them from taking ESG issues into account.”

Phil Case, Director, PwC UK



Indeed, private equity is arguably better aligned with responsible investment practices than other asset classes. Private equity investors tend to take majority or large minority stakes in companies, providing them with significant leverage over management. They also typically make relatively long-term investments, over five years or longer, giving them the time to reap the benefits of improved ESG performance.

In addition to the business case, pressure is growing from a number of quarters that will encourage, and potentially compel, both LPs and GPs to make greater efforts to address ESG issues. Since the financial crisis, investors are under greater scrutiny regarding their social utility. Regulators, policymakers, NGOs and the general public expect investors and their advisers to behave responsibly and with regard to more than simply financial return.

That societal pressure could yet find legal expression. It has been reported that an environmental law firm in the UK is planning a fiduciary duty test case, taking a pension fund to court to establish whether it should be obliged to take climate change into account in its investments.⁶

But we acknowledge that there are challenges, for LPs especially, in managing ESG issues in private equity. First,



compared with large, publicly listed companies, there tends to be little public ESG information available on the mid-market companies in which private equity funds typically invest. This makes it difficult for LPs to assess, independently of their fund managers, the ESG performance of their private equity holdings.

Second, LPs are typically not resourced to the extent they can readily analyse large volumes of ESG data, even if GPs were to provide it. Furthermore, the number of portfolio companies involved can be large, especially if an LP invests in funds-of-funds.

Nonetheless, it is PwC's view that there are practical steps that LPs can and should take to ensure that their private equity holdings are managed

“We see responsible investment as being very relevant to the private equity industry because we can really have an impact on portfolio companies, and support sustainable development and innovations.”

Finnish Central Church Fund, Finland

responsibly, and in a fashion that will allow the LP to capture the risk/return benefits of effective ESG management. For example, it would be worthwhile adopting the ESG Disclosure Framework – at least for a trial period. Many of the issues discussed in this report would likely be resolved with more widespread commitment to implement it.

⁶ “Could a rock-star backed fiduciary duty/climate change legal test case ‘surprise’ be on its way?”, Hugh Whelan, www.responsible-investor.com, 14 October 2014

“Ensuring compliance with regulations is only one aspect - many investors are now also seeking to differentiate themselves by going the ‘extra mile’ and integrating ESG in their entire investment cycle.”

Fredrik Franke, Sustainability leader, PwC Sweden



“Effective management of financially material ESG risks should support the fund’s requirement to protect returns over the long term.”

West Midlands Pension Fund,
UK

At a time when the value of responsible investment is increasingly recognised and interest is growing from both GPs and LPs, it’s important for LPs to consider:

- **Clarifying your approach to responsible investment**
By agreeing your responsible investment agenda, developing a clear position or policy, and communicating it, you’ll be able to clearly set out your thinking, and expectations, on responsible investment and ESG management for GPs. This might take the form of an explicit reference to ESG management in investment policy statements or ESG disclosures in annual reports.
- **Being clear from the outset**
Increasingly, LPs require prospective GPs to demonstrate how they manage ESG issues. Building responsible investment and ESG requirements into the manager selection process makes the objective clear. As many GPs have ESG policies in place and specialist staff, a review and discussion would enable

the LP to assess their ESG credentials, and ask the GP to demonstrate how ESG considerations are included in the investment process, such as how an ESG concern was presented to the GP’s investment committee.

- **Exploring the value in collaborating with likeminded LPs**
By sharing best practice with other likeminded LPs, you’ll be able to agree a way forward that streamlines the process for GPs. This has clear benefits for the GP as it avoids the proliferation of requirements and side letters which, in large numbers, become hard to manage. But it also means that LPs will receive all the information they request in a timely way.
- **Encouraging your GPs to feedback on how RI adds value**
Regular reporting from GPs helps to illustrate how they are addressing responsible investment and deriving value from it. They should be able to articulate how sustainability principles fit into their approach to

investment. But process is the starting point; performance is the goal. In an ideal world, LPs should include ESG metrics in their performance assessments, and they should encourage their GPs to move to a point where they can demonstrate the value added by their responsible investment activities.

- **Work together with GPs to calculate the value**
LPs and GPs have a vested interest in quantifying the value from responsible investment. For many industries, not just private equity, looking at the wider (so called) “non-financial” impacts is a new concept and within PE, it’s very much an emerging field. However, efforts are underway to assign value generated by ESG initiatives (see box, Identifying and quantifying value from ESG activity on page 14) and it makes sense for both LPs and GPs to work together to achieve this common goal and develop a standard approach to the value calculation.

“We see a variety of approaches to assessing ESG performance in the market. Both LPs and GPs would benefit from more consistency and standardization.”

Don Reed, Managing Director, PwC US



Encouraging dialogue

We recognise that responsible investment is an evolving area. In researching the LP perspective, it's been fascinating to explore and understand the drivers for both GPs and LPs to achieve their responsible investment objectives. We've facilitated useful discussion and hope that this report will be a catalyst to further dialogue.

If you would like to discuss any of the issues raised in *Bridging the gap: Aligning the Responsible Investment interests of LPs and GPs* please speak to your regular PwC contact or one of the following:

Global

Malcolm Preston
Global Sustainability leader
PwC (UK)
+44 20 7213 2502
malcolm.h.preston@uk.pwc.com

China

Paul Ngai
PwC (China)
+86 10 6533 8310
paul.ps.ngai@cn.pwc.com

Denmark

Anne-Louise Thon Schur
PwC (Denmark)
+45 5051 7630
anne-louise.thon.schur@dk.pwc.com

Finland

Sirpa Juutinen
PwC (Finland)
+358 40 578 2615
sirpa.juutinen@fi.pwc.com

France

Sylvain Lambert
PwC (France)
+33 1 5657 8083
sylvain.lambert@fr.pwc.com

Emilie Bobin

PwC (France)
+ 33 1 5657 8660
emilie.bobin@fr.pwc.com

Hong Kong

Hannah Routh
PwC (Hong Kong)
+852 2289 2968
hannah.routh@hk.pwc.com

India

Yasir Ahmad
PwC (India)
+91 124 3306026
ahmad.yasir@in.pwc.com

Japan

Masataka Mitsuhashi
PwC (Japan)
+81 90 8805 7565
masataka.mitsuhashi@jp.pwc.com

Luxembourg

Laurent Rouach
PwC (Luxembourg)
+352 49 48 48 4111
laurent.rouach@lu.pwc.com

Norway

Magnus Gravem
PwC (Norway)
+47 474 07 585
magnus.gravem@no.pwc.com

South East Asia

Andrew Chan
PwC (Malaysia)
+603 2173 0348
andrew.wk.chan@my.pwc.com

Spain

Maria Luz Castilla Porquet
PwC (Spain)
+34 932 537 005
mariluz.castilla@es.pwc.com

Sweden

Fredrik Franke
PwC (Sweden)
+46 709 29 12 97
fredrik.franke@se.pwc.com

Kristofer Dreiman
PwC (Sweden)
+46 102 12 94 88
kristofer.dreiman@se.pwc.com

Switzerland

Konstantin Meier
PwC (Switzerland)
+41 58 792 1456
konstantin.meier@ch.pwc.com

UK

Phil Case
PwC (UK)
+44 20 721 24166
philip.v.case@uk.pwc.com

Stephanie Chang

PwC (UK)
+44 20 780 46515
stephanie.y.chang@uk.pwc.com

USA

Don Reed
PwC (USA)
+01 617 530 4403
donald.j.reed@us.pwc.com

Lauren Koopman

PwC (USA)
+01 646 471 5328
lauren.k.koopman@us.pwc.com

Participants

We would like to thank all our participants, including:

Aberdeen Asset Management, UK

Access Capital Partners, France

Adveq Management AG, Switzerland

AG2R La Mondiale, France

APG Asset Management, the Netherlands

Ardian, France

Argentum Asset Management, Norway

BlackRock, USA

BPI France, France

Bregal Private Equity Partners, UK

BT Pension Scheme, UK

California State Teachers' Retirement System, USA

Coller Capital, UK

EDF Invest, France

Elo Mutual Pension Insurance Company, Finland

Etera Mutual Pension Insurance Company, Finland

F&C Asset Management, UK

Florida State Board of Administration, USA

Hermes GPE, UK

Hermes & Hermes Holding Co Ltd, British Virgin Islands

Idinvest Partners, France

Ilmarinen Mutual Pension Insurance Company, Finland

Industriens Pension, Denmark

Kommunal Landspensjonskasse (KLP), Norway

Kumpulan Wang Persaraan, Malaysia

LGT Capital Partners AG, Switzerland

Nordea Investment Management, Finland

Nordea Liv & Pension, Denmark

OFI Asset Management, France

Opplysningsvesenets Fond, Norway

Pantheon Ventures, UK

Partners Group, Switzerland

PenSam Liv, Denmark

PGGM, the Netherlands

PKA Pension, Denmark

Realdania, Denmark

Second Swedish National Pension Fund - AP2, Sweden

Sembrador Capital, Chile

Seventh Swedish National Pension Fund - AP7, Sweden

Sixth Swedish National Pension Fund - AP6, Sweden

Sparebankstiftelsen DNB, Norway

State of Wisconsin Investment Board, USA

Storebrand International Private Equity 2015 Limited, Norway

Swedfund International AB, Sweden

The Central Church Fund of Finland, Finland

The Church Pension Fund, USA

Universities Superannuation Scheme, UK

Veritas Pension Insurance Company, Finland

Wellcome Trust, UK

West Midlands Pension Fund, UK

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 195,000 people who are committed to delivering quality in assurance, tax and advisory services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwC does not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

www.pwc.com/sustainability

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.
©2015 PwC. All rights reserved.