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UN Principles for Responsible Investment (UNPRI): A Guide for Private Equity Fund Managers

Executive Summary

The following paper outlines the UN Principles for Responsible Investment (UNPRI) and its implications for private equity funds. It also introduces the new UNPRI framework that will come into effect in 2013, and how this new report will have an impact on private equity funds. The paper finishes with a set of possible recommendations that private equity fund managers should take into consideration as guidelines like the UNPRI and US PEGCC guidelines for responsible investment are gaining increased presence and importance in the financial services sector.

Implications of UNPRI on Private Equity

The UNPRI is rapidly becoming the global standard in responsible investing. From an initial six signatories in 2006, the principles have ballooned to over 1,000 signatories in 2012. This guide will help you understand this framework and how it will affect your fund's investments:

- Environmental, social and governance (ESG) management platforms are currently a differentiator for general partners (GP) but are fast becoming the new baseline in fund management as limited partners' (LP) expectations increase.
- Beyond LPs expectations, GPs should consider other stakeholders who may have an interest in ESG performance. Companies that integrate ESG into their overall strategy will choose to partner with a GP who views it as a key performance indicator (KPI) rather than a GP who does not.
- Funds which sign the PRI have a competitive advantage as a result of access to resources provided by being a UNPRI signatory.

Background on the UNPRI

History: Acknowledging the influence which environmental, social, and governance (ESG) issues have on investment performance, the United Nations Secretary-General invited a group of the largest institutional investors, as well as experts from the investment industry, intergovernmental/governmental organizations, civil society and academia to convene in 2006 to develop guidelines for responsible investment. As of July 2012, over 1000 investment institutions have since become signatories, "with assets under management [of] approximately US$ 30 trillion."[1]

The Principles:
1. Incorporate ESG issues into investment analysis and decision-making processes
2. Be active owners and incorporate ESG issues into ownership policies and practices
3. Seek appropriate disclosure on ESG issues by the entities in which are invested
4. Promote acceptance/implementation of the Principles within the investment industry
5. Work together to enhance effectiveness in implementing the Principles
6. Report on activities and progress towards implementing the Principles

Committee responsible for overseeing:
The Principals for Responsible Investments (PRI) Advisory Council is the governing body of the United Nations Principals for Responsible Investment (UNPRI). Councilmembers are elected by PRI signatories, and includes both asset owners and non-asset owners.

[1] UNPRI: http://www.unpri.org/about/

The UNPRI has a Steering Committee to oversee work plans and includes signatories, non-signatories and represents private equity houses, asset owners, asset managers and industry associations.[2] The representatives in the Steering Committee come from the following companies:[3]

Table 1: UNPRI Steering Committee

Actis	Blue Wolf Capital mgmt	CDC	KKR	PREVI
AlpInvest	CalPERS	Cinven	MNServices	PRI
APG	CalSTRS	Doughty Hanson	NZSF	Robeco
ATP	CBID Capital	First Reserve	Pantheon	UN Global Compact
AXA Private Equity	CBUS	IDFC	PGGM	USS

LPs like the Universities Superannuation Scheme (USS) and PGGM, both UNPRI Steering Committee representatives, actively endorse the PRI guidelines. David Russell of the UK's USS emphasizes that the firm "views environmental, social, and governance risks in a private equity general partner's portfolio as material to [their] own investment decisions."[4]

Dutch pension administrator PGGM's Tim van der Weide also highlights the company's commitment to the UNPRI and responsible investment policies by noting that "as long term investors, management of environmental, social, and governance issues is important to PGGM for both financial and social reasons. Our clients and their beneficiaries ask us about these issues and we want to be at the leading edge of responsible investing."[5]

The 2013 UNPRI Framework

Beginning with the 2013 report, there will be a substantial update to the PRI survey and reporting framework that assess signatories' implementation of the guidelines. This update will affect new and current signatories and a broad range of financial service providers, including PE fund managers.

Some differences between the previous and new framework include:

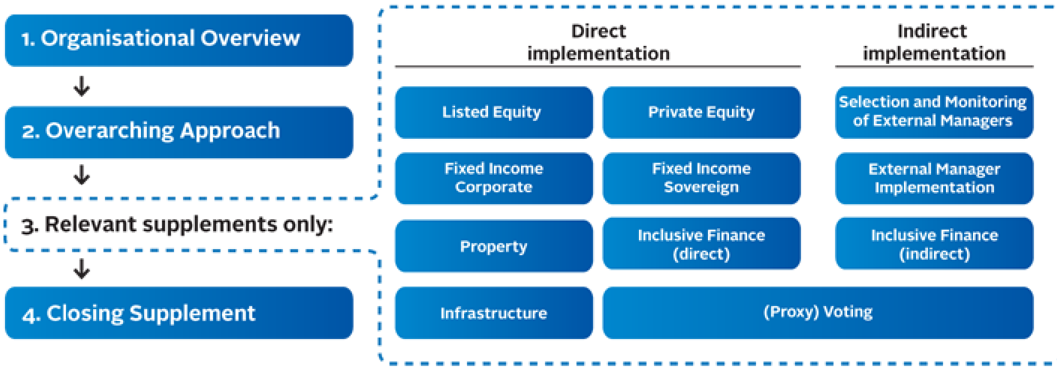
- A shift from self-assessment to self-reporting: Instead of asking signatories to report subjectively on the extent to which they believe they are implementing each Principle (for example, "small", "moderate", or "large"), they must now provide quantitative and qualitative data to demonstrate this much more objectively.
- Disclosure of mandatory indicators: The PRI Advisory Council agreed that from 2013, all investor signatories will be required to publish a set of mandatory indicators that are considered core to responsible investment implementation. Only non-commercially sensitive questions will be mandatory.
- Asset-class specific: The new framework provides a much deeper and more holistic focus on asset classes beyond equities to better capture the different approaches to responsible investment in each one (there are dedicated supplements for seven asset classes).

[2] UNPRI: http://www.unpri.org/files/PRI_Guide_for_Limited_Partners_First_Edition.pdf
[3] UNPRI: http://www.unpri.org/files/PRI%20PE%20Steering%20Ctee%20list.pdf
[4] ESG in Private Equity: *A Joint Study by Malk Sustainability Partners and the Environmental Defense Fund*, 2012.
[5] Ibid

- Direct and indirect implementation: The new framework offers a much better distinction between indirect implementation (mostly done by asset owners) and direct implementation (typically done by investment managers and by a number of larger asset owners).[6]

Also, the previous framework was organized by Principle while the new framework will be organized by implementation approach and asset class (the graph below demonstrates this) but will still cover the content of the Principles. There will be a mixture of both free text and closed ended questions (to accommodate for signatories that wish to respond in different ways). The new framework, once implemented in 2013, will include both voluntary and mandatory indicators.

New Framework reporting structure:



- Outputs from the Reporting Framework:
  - Individual responsible investment (RI) reports as a transparency tool (from 2012)
  - Individual assessment reports as a feedback and evaluation tool (from 2013)
  - Aggregated Report on Progress as a tool to measure the PRI's progress (from 2013)
  - Online data query tool (considered for 2014)[7]

A pilot reporting framework began this year to experiment with the new survey structure. There will not be any assessment of the results from this pilot.

Criticisms of UNPRI:

- Some criticize UNPRI as being negligent to membership standards because only few signatories have been de-listed for "failing to respond to an annual survey on their implementation of the principles."[8] Others criticize UNPRI because some signatories are still investing in countries with poor human rights credibility.
  - The new framework is intended to strengthen the PRI accountability by increasing transparency and clarifying assessment objects
- Relative to the percentage of European signatories, few US firms are represented by the UNPRI. North American and Oceanic companies make up only 18% (each) of the signatory base, although their proportion of total global investment is greater.[9]
- Challenges include obtaining companies' and funds' real environmental, social and governance performance, as many may choose to be more secretive.
- Legitimacy and implementation are also issues. Signatories are required to complete an assessment report of their ESG issues but they are not required to disclose the outcome of these reports.[10]

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[6] UNPRI: http://www.unpri.org/files/2012.06.07%20RF%20Pilot%20FAQ_Web.pdf
[7] UNPRI: http://www.unpri.org/reporting/outputs.php
[8] http://www.ft.com/cms/s/0/35bf44fa-5c9c-11e0-ab7c-00144feab49a.html#axzz1yATDJdz0
[9] http://economics.ouls.ox.ac.uk/14213/1/wpg09-09.pdf

- Only "one in four (24%) signatories monitor their external managers to a large extent on their performance on ESG issues, while 9% do not monitor at all"[11]
- But this will change once the new framework is implemented in 2013. There will be a set of mandatory questions signatories will have to publish.

- Similar to the US Private Equity Growth Capital Council's (PEGCC) guidelines for responsible investment, there are no legal or regulatory sanctions for not complying with these principles.

Other General Information:

- 84% of investment managers who have signed PRI have a RI policy that applies to PE
- 88% of private equity fund signatories also have RI policies [12]
- The percentage of signatories that requested ESG information from companies through tailored surveys increased from 27% to 34% between 2010 and 2011.[13]

Private Equity and UNPRI

Previously, the reporting framework was a type of self-assessment where PE funds responded subjectively to how well they were implementing the Principles into their management and investments. The new framework will require private equity firms to provide factual/narrative information regarding the steps it has taken to follow these Principles. Also, under the new reporting framework, private equity funds will be required to report on an asset class-specific supplement, regarding two main topics: engagement and incorporation. This means that PE funds will be asked to report on issues that apply directly to private equity funds such as the pre investment and post investment process and communication/reporting. PE fund managers should be aware that the new framework will require them to provide more quantitative evidence of their commitment to the Principles.

Examples of questions that PE funds will have to report on include: "How do you exercise influence over portfolio companies", "Who was responsible for reviewing ESG risk and/or opportunities during the pre-investment processes in the reporting year and what are the three top environmental, social and governance areas you focused on?", "What is the proportion of your portfolio companies that have made a formal commitment to integrate ESG factors into their policies and operations?" and "Please describe the nature of ESG-related information you disclose to your investors."[14]

- According to UNPRI's guide for limited partner's and responsible investment, LP's should[15]:
  1. Develop a policy statement that defines its approach to responsible investment in private equity
  2. Share their RI policy and implementation tools with other LPs and GPs
  3. Seek input on its ESG policies from other LPs, GPs, investment consultants, and in-house teams with experience integrating ESG issues in public equities and private markets
  4. **Ensure that staff, consultants, service providers, intermediaries and GPs are aware of their approach to responsible investment, and obtain relevant training and/or have access to sources of expertise**
  5. **Include ESG criteria in their mandates with intermediaries (such as investment consultants and funds of funds) or service providers acting on their behalf in the fund selection, due diligence or monitoring processes**

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10 http://economics.ouls.ox.ac.uk/14213/1/wpg09-09.pdf
11 PRI Report on Progress: http://www.unpri.org/publications/2011_report_on_progress.pdf
12 Ibid
13 Ibid
14 UNPRI: http://www.unpri.org/files/2012.04.16%20Reporting%20Framework%202012%20All%20indicators.pdf
15 UNPRI: http://www.unpri.org/files/lp_guide_2.pdf

6. Determine whether GPs, intermediaries and service providers are able to integrate adequately ESG factors by assessing their policies, history/experiences, systems and/or access to relevant expertise
7. Give due regard to ESG criteria in their internal due diligence and fund selection processes (including developing investment analysis criteria or a section in the investment recommendation report assessing a GP's ESG approach)
8. Work with other LPs in the same fund to provide input on a GP's ESG policies and implementation
9. Encourage a GP to use the limited partner advisory committee and annual general meeting (or similar fund governance bodies) to provide regular information on ESG integration to seek the LP's input
10. Provide a GP with a statement explaining its PRI commitments and responsible investment policy, and request information on how the GP plans to address these commitments within the fund

- Examples of GP's working with LP's & portfolio companies to implement RI into private equity:
  1. The New Zealand Superannuation Fund and Direct Capital Partners (DCIV): [16]
     - Discussed including ESG conditions in the investment contract and created an investment mandate that includes a commitment from DCIV to monitor and report to LP's on the portfolio companies
     - PRI Steering Group assisted in dialogue between GP and LP
  2. KKR and Alliance Boots:[17]
     - Value Created: Saved $2 million in fuel costs by reducing miles driven
  3. TPG and Caesars Entertainment:[18]
     - $775 K annual cost savings by energy reduction and water conservation

Other Sets of Guidelines for Responsible Investment

Other than the UNPRI, other guidelines exist that call on private equity funds to take environmental, public health, governance, safety, and social issues into consideration. Although these other guidelines are not as comprehensive or widely recognized as the UNPRI, they provide a framework for responsible investing and a way for private equity funds to signal their commitment to incorporating ESG issues into their investments.

- US Private Equity Growth Capital Council's (US PEGCC) guidelines[19]
  - In 2009, US PEGCC adopted its guidelines from UNPRI
  - Becoming a "signatory" to the US PEGCC's guidelines simply allows funds to say that they follow such guidelines. The PEGCC does not monitor the implementation of the guidelines in their signatories' portfolios.
  - The guidelines are voluntary, and members are not required to follow these standards. Any firm (member or non-member of PEGCC can adopt the guidelines.
  - Although PEC members are required to pay a membership fee, there is no additional annual subscription fee to be a signatory of the US PEGCC RI guidelines, as there is for signatories of the UNPRI.
- British Private Equity and Venture Capital Association (BVCA)

[16] UNPRI: http://www.unpri.org/files/PE%20case%20studies%20FINAL.pdf
[17] Ibid
[18] Ibid
[19] http://www.pegcc.org/newsroom/press-releases/private-equity-council-members-adopt-guidelines-for-responsible-investment/

- In 2008, BVCA established a Responsible Investment Advisory Board[20]
  - Provides practical advice to members
- In 2011, BVCA released a RI guide to improve firms' understanding of incorporating ESG issues into their investments.[21]

Actions to Consider

Private equity funds should consider developing a responsible investment framework by adopting RI guidelines, such as those developed by the UNPRI or US PEGCC, since these principles are becoming increasingly material to ensuring a strong ROI and winning business.

Limited partners need to take ESG issues into account when evaluating general partners by asking them questions like: "How do you look at ESG issues in your own due diligence? How do you look at these issues when you're managing an asset?" and "What are your views on ESG-related protocols including the UNPRI and the US PEGCC's RI Guidelines?"[22] Similarly, GPs should involve their LPs in discussions about responsible investment, as LPs are now "consistently expressing interest in ESG management from a risk management perspective."[23]

Principles like the UNPRI and the US PEGCC's guidelines to responsible investment are fast becoming the norm. Private equity funds that take these guidelines to heart will not only maintain an advantage in the financial services industry but also reap reputational benefits, add value to their portfolio companies, and obtain access to resources that will help them further integrate ESG issues into their investments.

If you would like to learn more about how we can help your private equity fund integrate responsible investment policies into your operations, visit http://www.malksp.com/industries/private-equity/.

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[20] BVCA: http://www.bvca.co.uk/assets/features/show/BVCAGuidetoResponsibleInvestment
[21] Ibid
[22] ESG in Private Equity: *A Joint Study by Malk Sustainability Partners and the Environmental Defense Fund*, 2012.
[23] Ibid

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Private Equity PRI Signatories			
21 Partners	CapVest Partners LLP	Hermes GPE	Panoramic Growth Equity
3i Group plc	Capzanine	Holland Private Equity B.V.	Pantheon Ventures
A Plus Finance SAS	Cartesian Capital Group	Holland Venture Partners	Parish Capital Advisors LLP
Abenex Capital	Catalyst Investment Managers Pty Ltd	IDFC	Partech International
Abraaj Capital	CDC Entreprises	Idinvest Partners	Partners Group
Access Capital Partners	CDC Group plc	Impax Asset Management	Performa Investimentos Ltda.
Actera Group	Cerea Gestion	Investindustrial Advisors Limited	Permira Holdings Limited
Actis	CHAMP Private Equity	Iris Capital	Portland Private Equity
Activa Capital	Cinven	Ironbridge Capital	Portobello Capital
Adams Street Partners LLC	Citizen Capital	IWL Partners	Praesidian Capital
AddVenture	Clessidra SGR S.p.A.	Kendall Court Capital Partners Ltd	Pragma Capital
Adveq	Cordiant	Kohlberg Kravis Roberts & Co, LLP	Private Equity Partners SGR S.p.A.
Allegro Funds Pty Ltd	Corpfin Capital Asesores, S.A., S.G.E.C.R.	Latour Capital Management	Priveq Advisory AB
Alpha Private Equity Fund 6 Mgmt Co SARL	Credit Agricole Private Equity	LBO France	Quay Partners
AlpInvest Partners B.V.	CRP Companhia de Participações	Leon CVM Capital Management	Royal Bafokeng Holdings (Pty) Ltd
Alto Invest	Dansk Vaekstkapital	Leopard Capital	Satori Capital, L.L.C.
Anacacia Capital	Darby Private Equity	Limestone Investment Management	Serengeti Capital Partners Ltd.
Antin Infrastructure Partners	Dasos Capital Oy	Lunar Capital Management	Silverfleet Capital Partners LLP
APAX PARTNERS LLP	DGF Investimentos	Matrix Asset Management Inc.	Squadron Capital
Apax Partners MidMarket SAS	Direct Capital Limited	MCH PRIVATE EQUITY INVESTMENTS, SGECR, SAU	Stafford Timberland Limited
Arcano Group	Doughty Hanson & Co	Mercapital	Stratus
ARCH Capital Management Co. Ltd.	Earth Capital Partners LLP	Meridiam Infrastructure Managers Sàrl	Taurus Funds Management Pty Limited
Ark Alternative Advisors Co., Ltd.	Edmond de Rothschild Investment Prtns	MSS Capital	Terra Firma Capital Partners
Astorg Partners	Endeavour Capital Limited	MSW Capital Gestão de Recursos Ltda.	TorreyCove Capital Partners LLC
Auda International L.P.	EQT	MVision Private Equity Advisers	Totem Investimentos
Aureos Capital Ltd	Equator, LLC	N +1 Capital Privado S.G.E.C.R., S.A.U.	Triton Advisers Limited
AXA Private Equity	Eurazeo	NewQuest Capital Partners	Truffle Capital
Azulis Capital	Eurazeo PME	NewWorld Capital Group, LLC	UI Gestion
Baird Capital Partners Europe Limited	Falcon Investment Advisors, LLC	NEXPAR	Vantage Capital
Baltcap	FIR Capital Partners	NiXEN Partners	VantagePoint Capital Partners
BC Partners	First Reserve	North Sky Capital	Weinberg Capital Partners
Berkeley Partners LLP	Fondinvest Capital	NSG Capital	Westmount Pacific LLC
Blue Wolf Capital Management	Global Environment Fund	Obviam AG	XAnge Private Equity
Bridges Ventures	Global Private Equity	Orchid Asia Hong Kong Mgmt Co Lmtd	
BTS Investment Advisors Ltd.	Growth Capital Partners LLP	PAI Partners	
Cap Decisif Management	Hamilton Lane	Palero Capital GmbH	
Capital Dynamics	Harith General Partners	Pampa Capital Management LLP	

*Some private equity fund UNPRI signatories as of 2012 (http://www.unpri.org/privateequity/)