

SUSTAINABILITY IN THE PRIVATE FUND OF FUNDS MARKET

KEY INSIGHTS FROM ARDIAN'S GP
ENGAGEMENT PROGRAM

ARDIAN

APPROACH AND METHODOLOGY

APPROACH

At Ardian, we put Sustainability at the heart of our daily business to make a positive impact on society while generating excellent financial returns. For more than a decade, Ardian has implemented its Responsible Investment approach across all activities. This comprehensive Sustainability program is led by a team of 5 Sustainability experts working hand in hand with Ardian’s investment professionals.

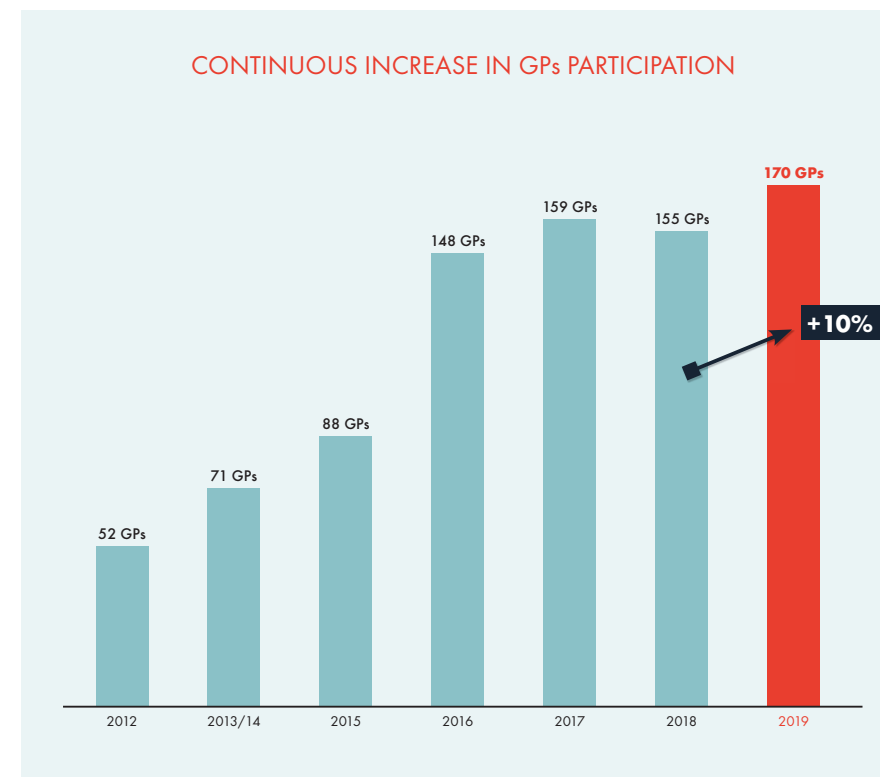
Since 2011, Ardian has developed and implemented a **tailored Responsible Investment approach** for its Fund of Funds activity. Right from due diligence, GPs ESG practices are systematically analyzed and account for **10% of the investment decision** for primary transactions. Our monitoring program is the cornerstone of our approach. We believe that **engaging with our GPs and supporting their progress** in the field of Sustainability over time is key to driving positive changes within the private investment sector and to leveraging its scale in order to better serve the society at large. The data collected over the years give us a **unique perspective of the industry’s approach to integrating ESG at GP level and into the investment process**.

This document presents key highlights and results from our latest Sustainability engagement campaign.

METHODOLOGY

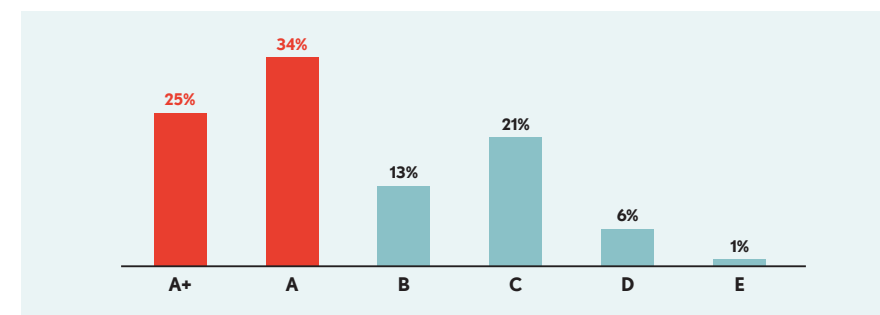
- Each survey is composed of 40 questions that assess the GPs approach to ESG integration at the corporate level and in their investment process.
- Based on their answers, we assign GPs a score (A+, A, B, C, D, E). Each GP receives a scorecard, showing their individual performance and benchmarking it against the rest of the portfolio. We also highlight their strengths and areas for improvement.
- We believe providing feedback is key. It allows us to engage directly with GPs in our portfolio and support their efforts to integrate ESG into their investment lifecycle. To aid this process, we identify and share best practices across the portfolio and provide insights on market trends.
- Individual GPs’ answers are confidential. We communicate only the consolidated findings.

KEY FIGURES



Participation: 170 GPs (+10% since 2018).

c.90% of the Fund of Funds portfolio Net Asset Value covered.



59% of the portfolio NAV covered by good and top ESG performers (A+ and A).

A UNIQUE VIEW OF PRIVATE EQUITY'S PROGRESS ON ESG

Ardian has been monitoring ESG performance in its Fund of Funds portfolio since 2011. **Benoît Verbrugghe, Member of the Executive Committee** and **Candice Brenet, Head of Sustainability**, discuss the changes revealed by the company's long-running annual monitoring campaign.

Why did you start monitoring ESG performance in your Fund of Funds portfolio?

Benoît Verbrugghe: When we established our sustainability program in 2009, we wanted to incorporate ESG factors into all our investment activities and since Fund of Funds was such a major area for Ardian, we included a systematic ESG analysis in the due diligence process. We also considered how to improve our post-investment practices given the limitations of the secondary business. We decided the most effective role for us as an LP would be to raise awareness, start a conversation with GPs in our Fund of Funds portfolio on ESG integration, and monitor progress over time. That's what led us to develop the annual survey in 2011.

Candice Brenet: We were probably the first to start asking these questions and we received a limited response to start with. Back in 2011, some GPs refused to take part and in many cases, we struggled to find people who could complete the questionnaire. GPs weren't structured in the way they are now – the investment managers didn't deal with ESG matters so usually, it fell to the investor relations team. That first year we got 50 responses, but by 2019 we were up to 170, representing 90% of our portfolio NAV. The scale of our monitoring program is unique in the industry.

What are the biggest changes you've seen in the decade you've been running the survey?

BV: We've seen increasing maturity in the way GPs incorporate ESG into their investment process – almost all of them now use it as part of their due diligence, for example. Another major shift is that many managers now have hired Sustainability specialists, which was very rare when we started. Overall, their awareness of ESG and their commitment to integrating it into their investment approach and the way they run their management company has improved drastically.

“**Awareness of ESG issues and their integration in the investment process has improved drastically.**”

Benoît Verbrugghe

CB: Information is provided more regularly, and the level of detail regarding ESG practices has greatly improved over time. The pressure that led to this change originally came from sophisticated investors at pension funds and state organizations in places like the Netherlands, France and the Nordics. But the interesting thing is that although European GPs were the clear leaders in sustainability a decade ago, over the past two to three years we've seen the US catching up very quickly.



BENOÎT VERBRUGGHE
MEMBER OF THE EXECUTIVE COMMITTEE



CANDICE BRENET
HEAD OF SUSTAINABILITY

How do you use the results of the survey to spread awareness of best practices in the industry?

BV: After each survey, we create an individual scorecard for each manager on their ESG practices that ranks them against their peers and highlights their strengths as well as areas for improvement. We offer them follow-up calls to discuss our findings. Given the size of our portfolio, we have a good view of market practice and the trends in ESG. GPs value the fact that we have our own experience as a GP in implementing ESG in our investments as well as this broad overview of how the industry is evolving.

CB: Over the past couple of years, we've received a lot of positive comments from GPs about the feedback we provide. As a major Fund of Funds investor, we believe our role is to engage with GPs to improve their practices and offer constructive help and advice. Many GPs appreciate that and see our approach as positive rather than punitive. In fact, we've even been approached by some of them asking if they can use their Ardian scorecard in their presentations to investors and potential investors. This proves that the monitoring work we do strengthens Ardian's credibility as a manager and an investor.

Do you see a link in your findings between ESG performance and financial returns?

BV: There's a correlation but it's difficult to prove any causation. GPs that we regard internally as top performers in financial terms tend to have good ESG scores. But this is largely because these institutions are normally the biggest and most established players in Europe and the US and as such they face the greatest pressure from institutions to show strong ESG performance. Don't forget also that the biggest GPs are the ones that can dedicate significant resources to hiring specialists to address ESG issues.

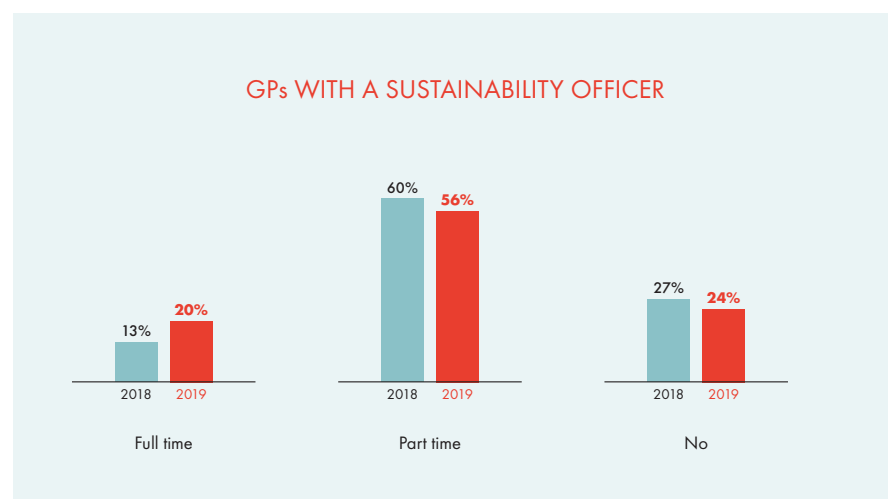
“**Our role is to engage with GPs in order to improve their practices and offer constructive help and advice.**”

Candice Brenet

CB: We think the same mindset that helps firms perform well financially will also help them score well on ESG issues. By that I mean openness to new trends and a keen awareness of how society's expectations are changing. I can't prove why sustainability excellence and strong financial performance are linked, but I'm not surprised that they are.

MORE GPs ARE STRUCTURING THEIR ESG ACTIVITIES AND DEDICATING RESOURCES TO THEM

There is a global trend to structure sustainability-related activities in private investment companies.



76% of GPs in our survey **now have a designated officer**, up from 73% last year. But the number with a member of staff devoted to this role full-time is rising much more quickly, from 13% a year ago to 20% this time. A small number of GPs have established full-time internal ESG teams.



More than a quarter of participating GPs now have an ESG dedicated board of governance, an increase of 10% points in two years. A further **9%** say **they are in the process of forming a Responsible Investment or ESG board** (up 5 points).

KEY FIGURES AT GP LEVEL

ENVIRONMENT

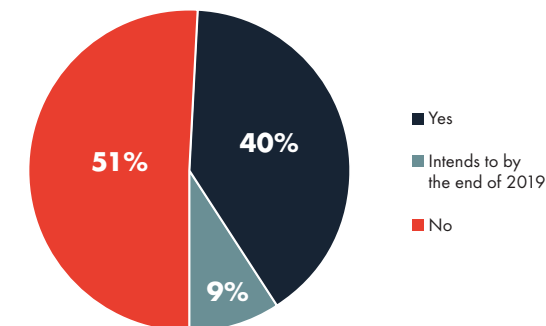
GPs are increasingly undertaking environment-related initiatives: **70%** of them do, up from 57% two years ago and 62% last year.

- > assess carbon footprint within the past 5 years
- > reduce greenhouse emission
- > encourage green transportation
- > reduce consumption of water
- > reduce consumption of energy
- > reduce consumption of furniture

DIVERSITY: SIGNIFICANT ROOM FOR IMPROVEMENT

70% GPs employ more than **30%** women in their total workforce.

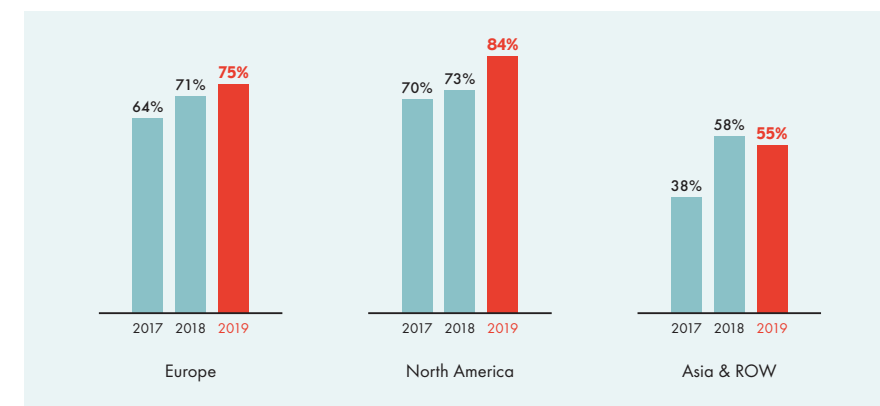
Only **10%** GPs employ more than **30%** women at executive positions.



GPs WITH FORMALIZED DIVERSITY POLICY AND GUIDELINES

PHILANTHROPY: A GROWING ENGAGEMENT

76% deploy philanthropy initiatives (up from 70% last year).





INVESTMENT LEVEL

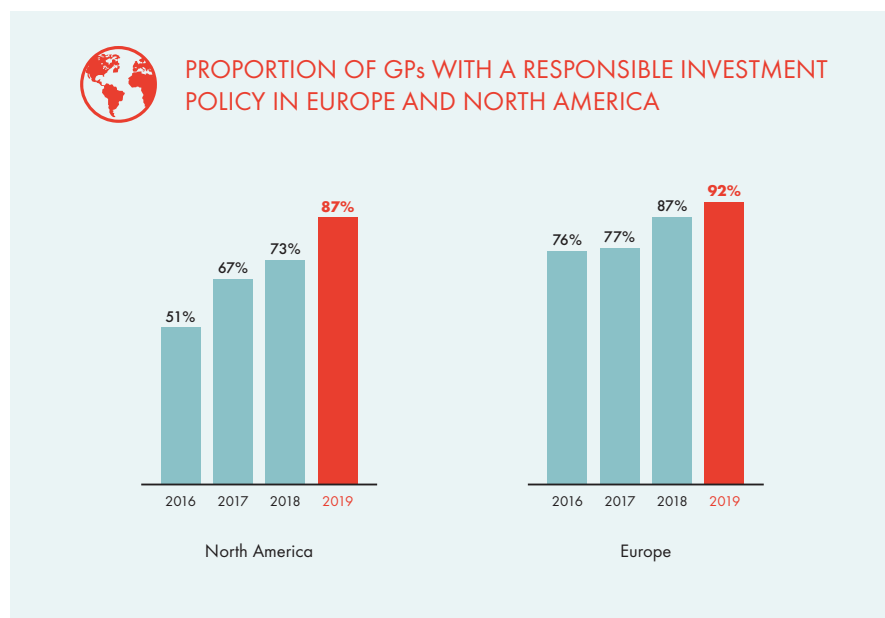
GPs' Investment Practices:
How the managers in our portfolio
incorporate ESG into their investment process

Our annual survey of the ESG performance of GPs in our Fund of Funds portfolio shows the steady increase over recent years in the number of managers that have made ESG considerations a central part of each stage of the investment process.

ESG INTEGRATION IS NOW MAINSTREAM

87% of GPs have a formal responsible investment policy, up 9% from the past year.

The proportion is highest in Europe, at **92%**, although the rate of adoption is significantly faster in North America (see chart). Among GPs based in Asia, **77%** have a formal Responsible Investment policy.



54% of GPs that took part in our survey have set up sustainability objectives, up from 41% last year. **80%** have set at least three objectives, indicating a commitment to implement a comprehensive ambitious policy.

Most GP objectives focus on the investment process, specifically ESG monitoring of portfolio companies and incorporating ESG considerations into their due diligence and investment decisions.

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THE PRE-INVESTMENT PHASE

These considerations are now routinely included in most GPs' pre-investment processes. More GPs are moving from considering ESG issues on a case-by-case basis to incorporating them into their due diligence systematically.

In 2019, **85%** of GPs systematically integrated ESG factors during due diligence.

Sectoral exclusion is becoming a mainstream practice, demonstrating that GPs see this as an important way to manage reputational risks. The most commonly banned sectors are weapons and pornography, followed by gambling and alcoholic beverages.

Other sectors that some GPs avoid relate to environmental threats (chemicals, herbicides, the coal industry, nuclear power, endangered species) or ethical concerns (animal testing, human cloning, genetic modification, life termination, prostitution).

Our results show that fund managers also rely on expert consultants to assess the sustainability of companies' business model, as well as their strengths and areas of improvement on ESG issues.

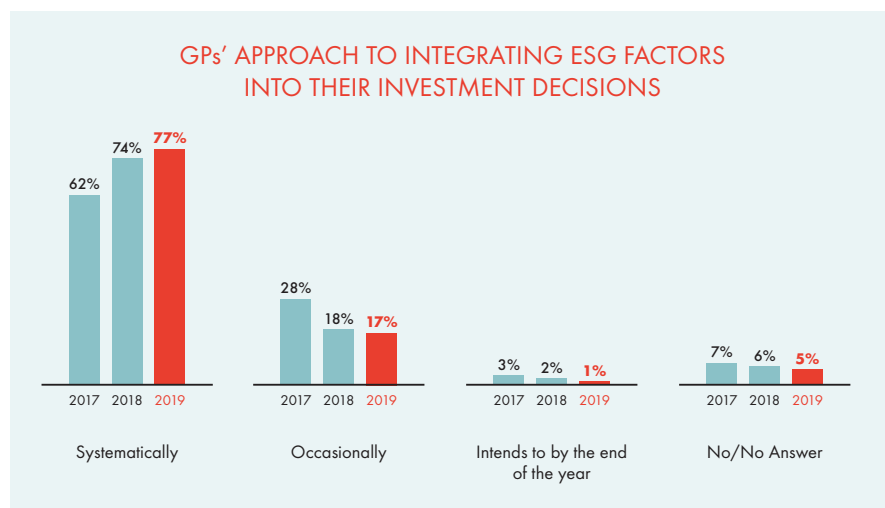
In 2019, **47%** of GPs who assess ESG during the pre-investment process appointed specialist consultants to carry out ESG due diligence.

Some 26% of GPs that say they assess ESG before investing do not have a formal process for doing so.

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THE INVESTMENT DECISION

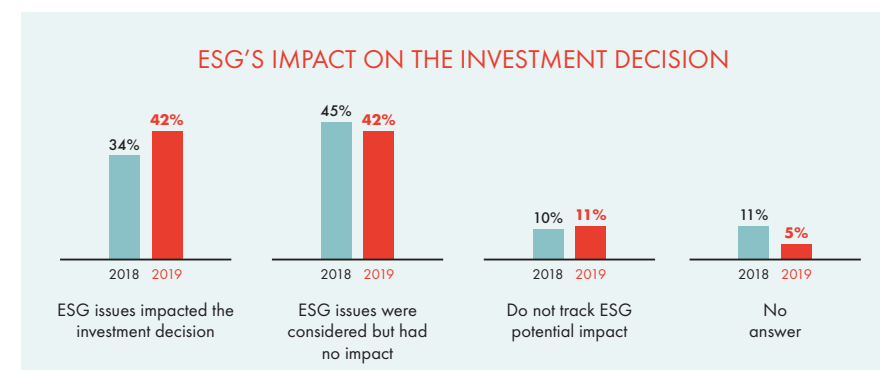
Our long-run survey data show a similar trend in the investment decision as we observe in the pre-investment phase: a growing proportion of GPs are considering ESG factors for every transaction, while the proportion doing so on an ad hoc basis continues to shrink.



When making investment decisions, the most popular methods in 2019 to assess ESG issues were **discussion of ESG when relevant/informal** for **94%**, **ESG section in investment memos** for **65%**, **ESG objectives in the 100-day Plan** for 35% and **ESG rating in investment memos** for 11%.

We have found strong evidence that ESG issues are **becoming strategically significant** when GPs decide which investments to make. The proportion reporting that ESG considerations have had **an impact on their investment decisions** climbed 8% points to **42%** in our 2019 survey.

It is also striking that in cases where ESG issues have had an impact, they are increasingly likely to act as a “deal breaker”. This reinforces our view that among some GPs at least, ESG factors are now regarded as **a fundamental determinant** when assessing an investment’s risk profile.



How ESG's impact affected the outcome in 2019: it helped **identify risks and/or opportunities for value creation** for **82%**, **led to abandonment of potential investments** for **69%**, impacted the investment in terms of price for 25%, impacted the terms of the shareholder agreement for 31%.

In most cases, considering ESG factors helped **to identify risks or opportunities for value creation**. However, the biggest change we observed from 2018 was the increase in the proportion of GPs that said **ESG issues had prompted them to abandon transactions**.

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THE HOLDING PERIOD

77% of GPs say they monitor the ESG performance of their investee companies during the holding period, mostly through informal discussion with the management.

Among GPs that carry out formal ESG assessments, we have observed a shift in their preferred method with a decline in the use of standalone ESG monitoring questionnaires (down 16% points from 2018), coupled with an increase in the number of GPs that now include an ESG section in their broader monitoring memos (up 11 points). This suggests that among these GPs, ESG monitoring **has been incorporated into their routine process of engagement** with management teams.

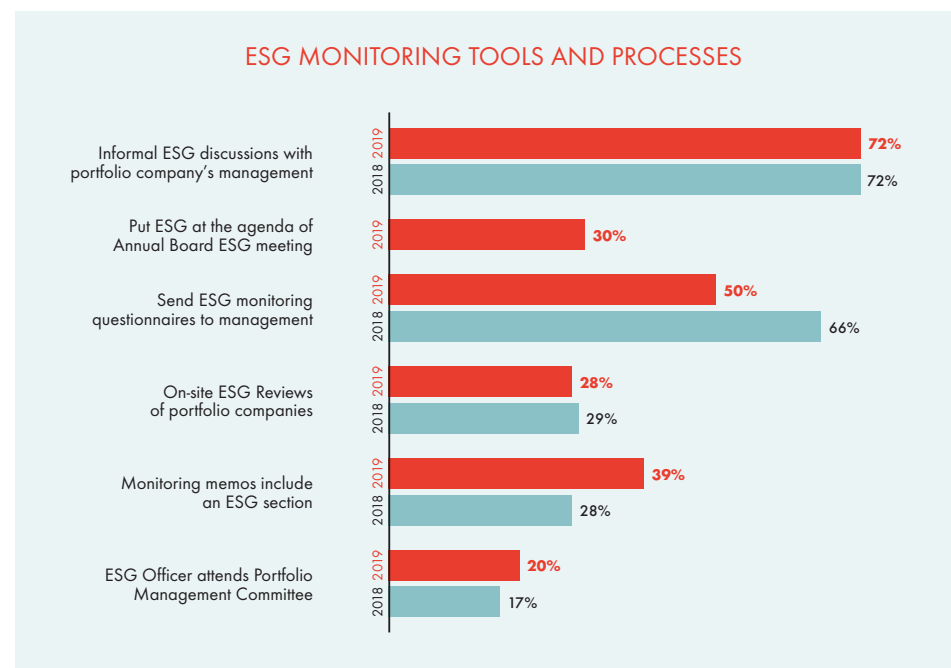
We can also see some evidence that the United Nations Sustainable Development Goals - launched in 2015 - are gaining some traction as a reference point among GPs when considering ESG issues. Some **19%** already **refer to the SDGs in their monitoring** and a further 9% intend to do so by the end of 2019. This figure highlights the growing ambition of GPs to demonstrate the impact of their portfolio companies on society and the environment.

72% of GPs in our survey say **they are actively engaging** with their portfolio companies to discuss ESG issues and share knowledge and best practices (up 6 points), although only 15% provided details about the form their engagement takes.

Informal or “light touch” engagement is the commonest approach, for example taking part in the approval of ESG-related decisions at the board.

In **20%** of cases, informal discussion is **the only form of engagement** that GPs pursue.

Formal engagement with portfolio companies remains relatively uncommon but is **gaining in popularity**, through activities such as portfolio-wide seminars or webinars and joint participation in conferences and roundtables.



One of our GPs says:

“ **As a long-term investor, we are committed to working hand in hand with our portfolio companies to improve ESG awareness and performance through tailored roadmaps. We have mapped our portfolio against the UN SDGs framework to assess its impact on society, both actual and potential.** ”



THE UN'S 17 SUSTAINABLE DEVELOPMENT GOALS

Also known as 'Global Goals', UN SDGs help to focus on what needs to be achieved and measured in order to address global challenges. Designed by the UN General Assembly and adopted by 193 states, the UN SDGs shape the debate by providing the framework used by more than 65% of PE investors when an additional 71% of businesses have already planned how they will engage with the SDGs.

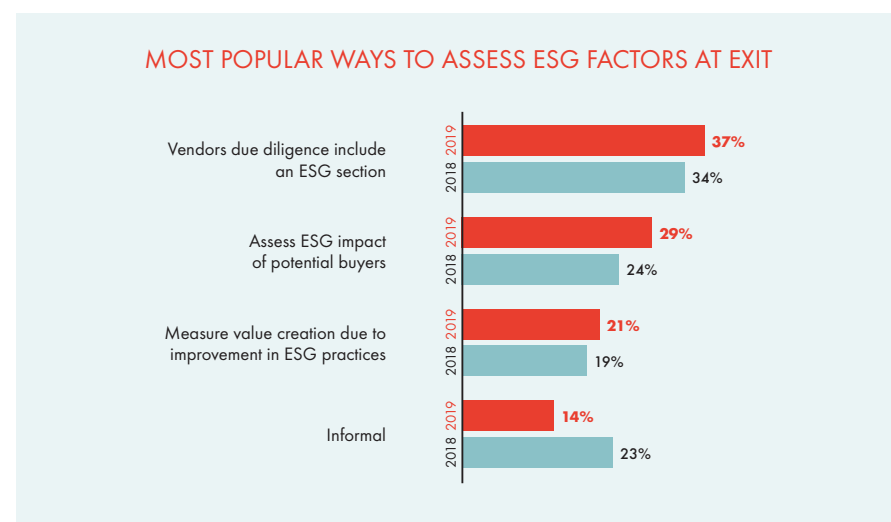
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ESG CONSIDERATIONS AT EXIT

Our surveys show that GPs are least likely to consider ESG issues when they exit an investment.

The overwhelming majority do so in the pre-investment phase, and more than three-quarters during the holding period. When selling an investment, however, only **67% consider ESG issues** either systematically or on an ad hoc basis.

In 2019, **22%** of GPs **systematically integrated ESG factors** into their exits.



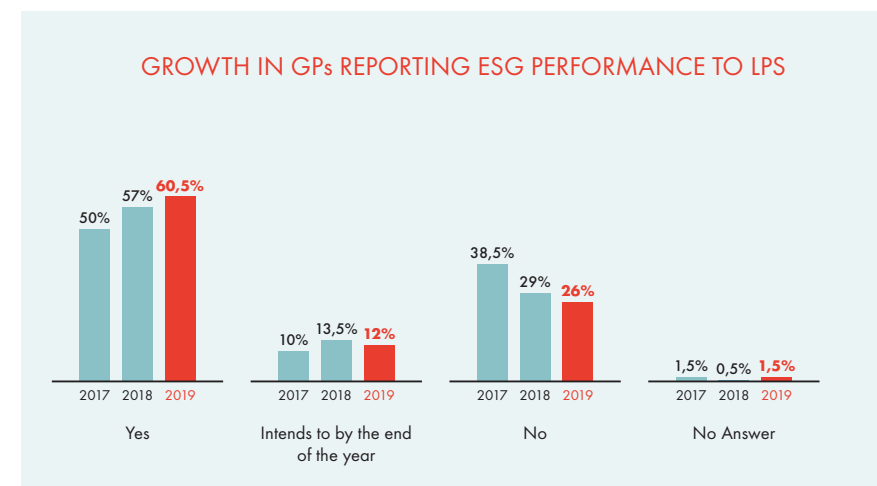
Although the proportion of GPs that consider ESG issues at exit remains relatively low, those that do fall into this group **are making increasing use of formal assessment tools**. This suggests that GPs that assess ESG factors on exit are becoming increasingly committed to this practice.

Popular approaches at exit are to include ESG sections in vendor due diligence documents, assess the ESG impact of potential buyers and **measure the value created during the holding period** thanks to ESG initiatives.

We also note that **31%** of GPs say **they have some form of profit-sharing scheme** on exit that includes most or all employees. This proportion was up 12 points since 2018.

GPs' ESG REPORTING PRACTICES

A growing proportion of GPs now include an ESG section in their reporting to LPs, increasing their level of transparency on their portfolio ESG performance.



In terms of frequency, **56%** of GPs say **they report once a year** to LPs on ESG performance, up from 45% in 2017.

To know more about sustainability in our investment activities, visit our website: www.ardian.com

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