

PGGM Responsible Investing in Private Equity

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1. Introduction

On behalf of its clients, PGGM Investments (PGGM) manages private equity investments. PGGM recognizes the impact private equity investments may have on the environment and society and vice versa. This guideline addresses PGGM's management of environmental, social and governance (ESG) issues with regard to the private equity investments. The guideline is part of PGGM Investments' Responsible Investment Framework. The Responsible Investment Implementation Framework consists of a number of specific implementation guidelines. The framework and the underlying implementation guidelines are part of the policy framework for responsible investment and are a more detailed elaboration of the PGGM Beliefs and Foundations for Responsible Investment. The Implementation Guideline on Exclusions is applicable to the private equity investments.

The rationale for a separate responsible investment guideline for private equity is that private equity investments, due to the active ownership model, are well suited to manage ESG opportunities and risks. However, limited partners such as PGGM (LPs) have limited influence with regard to managing ESG risks and opportunities during the course of a commitment. Therefore, agreeing ESG investment standards prior to the commitment or investment in a fund is important. This warrants the need for a guideline and due diligence procedures on ESG issues within our private equity investments.

The scope of this guideline is all private equity investments that PGGM manages on behalf of its clients. The guideline makes a distinction between coinvestments, fund investments and secondaries. The PGGM Responsible Investing in Private Equity) will be effective as of September the 1st of 2012 and the implementation of the guideline will start after that date. It should be noted that the implementation of this guideline differs between investments before and after the effective date. For the first, we will use our influence to engage with general partners (GPs) and LPs while respecting existing contracts. Over time, the guideline will cover all private equity investments due to the limited lifetime and holding period of current investments. PGGM follows relevant developments closely and will update the guideline when

necessary. This guideline does not confer any rights to any third parties. We will report periodically on the progress made in implementing this guideline.

2. Vision on ESG in private equity

PGGM believes that ESG factors can have a material impact on the financial performance of the private equity investments. PGGM sees it as its responsibility to capture the value and mitigate the risks related to ESG factors. Within private equity, PGGM believes that ESG factors can have a material impact on portfolio companies and thereby, ultimately, the riskadjusted return in three ways:

1. ESG issues can enhance revenue

For example: integrating environmental and social factors in innovation and product development may lead to discovering new sources of revenue and penetrating new markets (e.g. through certified products), enhance brand value or result in a price premium. This can improve customer loyalty and increase product differentiation.

2. ESG issues can reduce costs

For example: focusing on ecoefficiencies in operations, by minimizing natural resource use and waste, can lead to cost savings. The sustainability profile of a company can lower the cost to attract and retain employees. Sustainability may also lead to lower cost of capital for portfolio companies.

3. ESG issues can reduce risk

For example: A sustainability leader may lower regulatory risk and have lower cost adapting to new ESG regulation. Assessing ESG factors may also lead to discovering liabilities that would otherwise be uncovered. Managing ESG risks can also avoid reputational risk. Furthermore, socioeconomic and environmental megatrends may be a risk to a company's operations or access to markets. Focusing on ESG factors could also lead to lower supply chain risk by securing longterm sourcing of energy, water and other input materials.

Environment	Social	Governance
A stable climate • By reducing greenhouse gas emissions	Respect for human rights (incl. labour rights) and empowerment • Eg, no child labour, freedom of association	Adequate shareholder rights • Eg, annual shareholders' meeting, nomination directors
A responsible use of scarce natural resources • Eg, efficient water use, conservation of biodiversity	Adequate access to basic needs • Eg, health care, nutrition	Effective board structure and proper risk management • Eg, two/one tier, independent directors, strategy, composition, remuneration, risk management
A clean and healthy environment • Eg, reducing waste and pollution, recycling	Local socio-economic development • Eg, creating local employment, transferring knowledge	Accountability • Eg, disclosure, culture & practice, anti-corruption and bribery

Figure 1. Sustainability 3x3 (source: PGGM)

Material ESG factors in private equity

PGGM defines 'material ESG factors' as factors which have a significant financial impact on the underlying investment. PGGM may invest through private equity in all sectors worldwide (except those sectors/products listed in the Implementation Guideline on Exclusions). It is, therefore, not possible to identify ESG factors that are material to all private equity investments. Per sector and per investment, ESG factors need to be identified and assessed. Reputational risks for LPs, GPs and portfolio companies resulting from ESG factors should also be considered. ESG factors include, for example, but are not limited to those referenced in figure 1. the Sustainability 3x3.

3. Objective

The objective of this guideline is to ensure that PGGM, the GPs and portfolio companies structurally and systematically take material environmental and social issues into account in their activities and to promote international best practice with regard to the corporate governance of the portfolio companies and the governance of the funds in which PGGM is directly or indirectly invested. The ways to approach ESG issues are illustrated by PGGM's Sustainability Stairway (figure 2.) and set forth the expectations PGGM has with regard to the ESG performance of private equity investments. PGGM considers objectives a, b and c as minimum requirements.

Portfolio companies, in which PGGM is directly or indirectly invested:

- will have to comply with PGGM's Implementation Guideline on Exclusions
- will have to comply with all applicable environmental and social (such as health, safety, labor) laws and regulations (Legal compliance)

- will have to, where relevant, assess material environmental and social risks of their operations and work over time towards relevant international best practice standards to mitigate environmental and social risks with targets and timelines for improvement and adhere over time to best practice with regard to corporate governance. This can mean that PGGM may invest in portfolio companies with weak ESG practices as long as ESG shortcomings are addressed and resolved during the investment period. International best practices include among others the IFC Performance Standards, OECD Principles of Corporate Governance, OECD Guidelines for Multinational Enterprises, and UN Global Compact (Voluntary standards);
- are expected, where appropriate, to work over time to realize potential value through improving ESG performance and operational efficiency, such as ecoefficiencies (Process efficiency).

Portfolio companies in which PGGM is directly or indirectly invested are encouraged:

- to identify, where appropriate, opportunities for developing or offering products or services that can positively contribute to solving societal challenges, such as climate change, loss of biodiversity and social inequity (Product sustainability).
- to form a strategy over time on how its core business model can create growth and innovation while at the same time create societal benefits (Shared value).

PGGM may also search for opportunities within the objectives 'product sustainability' and 'shared value' by establishing separate private equity mandates with the intent to create social added value. Within PGGM, such investments are labeled targeted ESG investments and are annually reported on in the PGGM Responsible Investment Report.

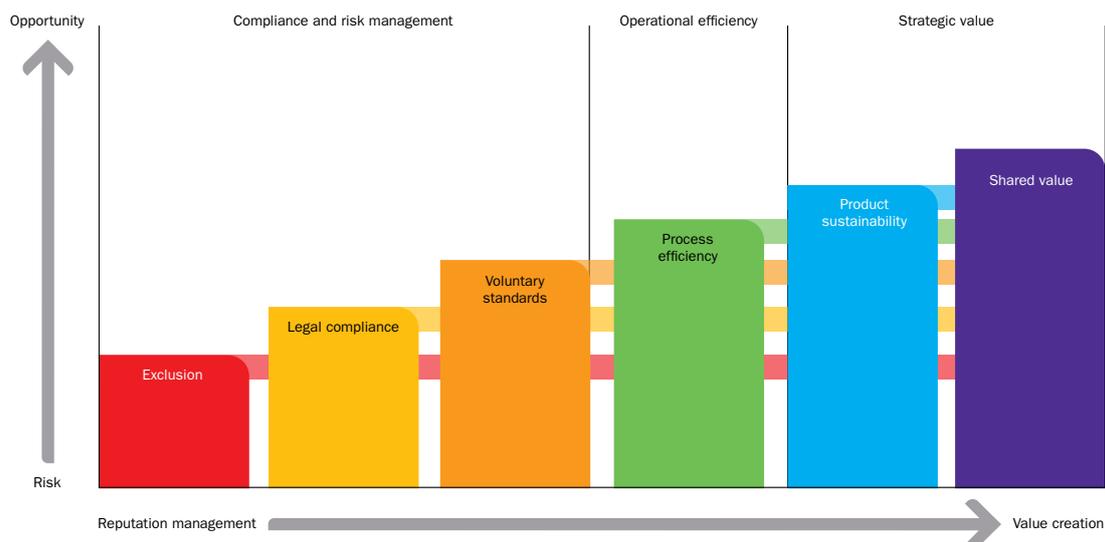


Figure 2. Sustainability Stairway (source: PGGM)

4. Implementation

It is PGGM's strategy to (i) structurally integrate material ESG factors in the investment processes, (ii) realize strong governance of the investments, and (iii) strive for better ESG performance by the companies that are part of the private equity investments. This means, among other things, that we integrate ESG factors into our decision making process before selecting an investment, monitor and engage with private equity funds and portfolio companies with the aim of improving the ESG performance of portfolio companies and set minimum ESG requirements for the investments.

All private equity investment managers at PGGM will be made aware of this guideline and given appropriate training to ensure that the investment managers have all skills necessary to implement this guideline in their investment decisions.

The GPs and portfolio companies we commit to and invest in are primarily responsible for the management of these ESG issues. Hence, we aim to select GPs and portfolio companies who are conscious of ESG factors, are committed to develop sustainably and to manage ESG issues within their business activities. We will actively explain our guideline and encourage GPs and portfolio companies to improve the ESG performance of their investments and to report on improvements. When choosing between comparable investments, we select the investment with the better ESG practices and performance.

4.1 Application to coinvestments

Selection and investment

For the selection of coinvestments, PGGM will:

- require application of the objectives as set forth in paragraph '3. Objective';
- perform an assessment of ESG risks and opportunities and rate these on a scale of high, medium and low (see Figure 3.);
- assess a company's existing ESG policies, management system and reporting in relation to the level of ESG risk the company faces;
- benchmark performance on and management of ESG issues against relevant international best practices (as stated in objective C depending on sector and geography), to determine any ESG shortcomings and the level of monitoring and engagement required; and where shortcomings have been identified, agree on an ESG action plan with targets and timelines with the GP who we are co-investing with, and the company.

Monitoring and engagement

For monitoring and engagement of coinvestments, PGGM will:

- on a structural basis, monitor the companies PGGM invest in and periodically discuss with the management of these companies or the GP their ESG performance and progress made in the agreed action plans;
- require disclosure on ESG factors and part of periodic review meetings where appropriate and possible; and require timely monitoring and disclosure of ESG incidents and the remediating actions taken in this regard.

Risk categorization	
Risk category	Description
High	Activities with potential significant adverse environmental or social impacts which are diverse, irreversible or unprecedented, or with significant risks for business integrity/governance issues.
Medium	Activities with potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures, or with risks for business integrity/governance issues that are of concern.
Low	Activities with minimal or no adverse environmental or social impacts, e.g. professional service companies, education or health projects with no construction, technical assistance, institutional development, human resource projects, or with low risks for business integrity/governance issues.

Figure 3. Risk categorization

4.2 Application to fund investments

Selection and investment

For the selection of funds, PGGM will:

- assess if a GP is able to invest in line with the objectives as set forth in paragraph '3. Objective';
- assess if a GP structurally integrates ESG factors in all its investment decisions to identify ESG risks and opportunities and has an ESG management system in place;
- assess a GP's engagement with portfolio companies and processes to remediate identified ESG short comings;
- assess a GP's periodic and incident reporting on ESG issues to LPs; and
- rate a private equity fund's ESG risks on a scale of high, medium, or low risk.

The level of detail and sophistication that PGGM requires of a GP's ESG integration approach and management system will depend on the ESG risk profile of the fund. PGGM considers private equity funds that expect to have or have >15% of their portfolio companies in high risk sectors (according to the risk categorization for co-investments) as high risk private equity funds.

PGGM does not exclude a fund if the GP does not meet all requirements during the due diligence process (except if the GP is not able to accommodate our Implementation Guideline on Exclusions). If the GP has at least a clear vision regarding material ESG issues and has the willingness and capacity to implement the necessary steps for further improvement early in the life of the fund, PGGM will still consider investing.

Monitoring and engagement

For monitoring and engagement of funds, PGGM will:

- on a structural basis, monitor the funds we invest in and periodically meet with the management of these funds;
- make ESG part of the reporting requirements for our GPs and part of the periodic review meetings; and
- require timely monitoring and reporting of ESG incidents and the remediating actions that the GP has taken in this regard.

Fund governance

For fund investments, PGGM reviews among others the alignment of interest between LPs and the GP, the governance model and management framework of the GP, and the transparency of the fund and GP. PGGM reviews funds in relation to the ILPA Private Equity Principles.

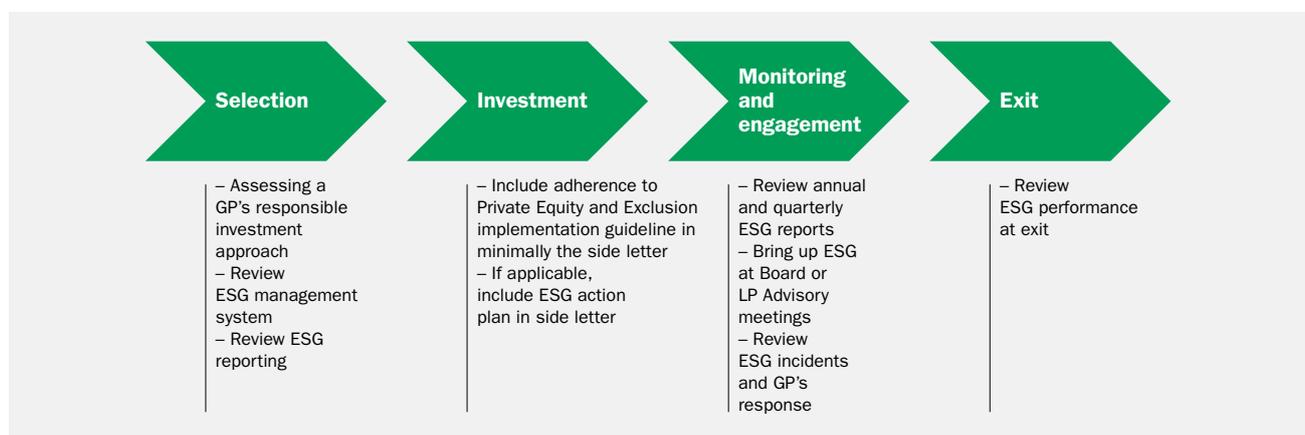


Figure 4. ESG investment cycle for funds

4.3 Application to secondaries

Selection and investment

For the selection of secondary investments, PGGM will:

- assess the extent to which the secondary portfolio is in line with the objectives as set forth in paragraph '3. Objective', and check all underlying portfolio companies in the secondary transaction for any violations, since for secondary investments, we cannot renegotiate existing fund documents to include any ESG issues;
- rate the profile of the underlying portfolio companies' ESG risks on a scale of high, medium, and low risk;
- in 'stapled' secondary transactions, require the GP to adopt an ESG policy, according to which it will separately verify old and new investee companies. In case of current portfolio companies, if any major E&S issues are discovered, these should be remediated. For investments in new portfolio companies, PGGM will review a GP's practices similarly to our practice in fund investments.

Monitoring and engagement

For monitoring and engagement of secondary investments, PGGM will:

- on a structural basis, monitor the funds we invest in and periodically meet with the management of these funds;
- make ESG part of the reporting requirements for our GPs and part of the periodic review meetings as far as possible.

For more information on PGGM Investments' Responsible Investment Implementation Framework please contact our Responsible Investment department, +31 30 277 99 11 or visit our website www.pggm.com

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