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Responsible Investment in Private Equity

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1. Introduction

As a long-term investor, PGGM Vermogensbeheer B.V. (PGGM Investments, hereinafter PGGM) is committed to investing responsibly. PGGM manages its clients' Private Equity investments in order to contribute towards a stable pension for their participants while also taking into consideration its impact on the world. PGGM recognizes that environmental, social, and governance (ESG) factors have a material impact on the financial performance of the portfolio, especially in the longer term. As such, integrating ESG issues into investment analysis and decision-making processes is part of its fiduciary duty.

This guideline addresses PGGM's management of ESG issues with regard to Private Equity. The guideline is a further refinement of PGGM's Responsible Investment Framework and its implementation guidelines and the relevant fund prospectus and ancillary documentation. In addition, the obligations arising from compliance with legislation and regulations apply. The guidelines cover all investments made by Private Equity, effective as of 1 January 2021.

2. Investment strategy & approach

On behalf of PGGM's clients, the Private Equity seeks investments in three areas:

1. **Primary fund investments:**
Commitments (as limited partner or 'LP') to funds being raised by private equity managers (the general partner or 'GP'). PGGM private equity combines top-down macro and segment analysis with bottom-up manager selection through extensive due diligence to identify funds that are expected to provide attractive risk adjusted returns and fit portfolio construction criteria.

2. **Co-Investments:**
Minority equity stakes in companies alongside private equity managers. PGGM private equity is regularly invited by GPs in the initial stages of a potential acquisition to co-underwrite an investment in a company or, alternatively, to co-invest in the syndication stage. PGGM private equity does not seek to lead transactions but rather to support a lead investor. PGGM private equity constructs a portfolio in accordance with the desired client allocation, investment restrictions, and the investment guidelines of the clients.

3. **Secondary fund investments ('secondaries'):**
Acquiring interests in existing private equity funds or portfolios from other limited partners or owners of private equity investments. As a part of the fund has normally already been drawn and invested, this allows for more rapid deployment of capital with shorter lock up of capital and/or rebalancing of the portfolios.

Portfolio companies are analysed and monitored on their strategic and financial merits as well as their ESG performance. The latter is expected to help reduce investment and reputational risks or increase (expected) returns of the portfolio.

By having in place a transparent responsible investment guideline for Private Equity, as further outlined in this document, and by actively taking into account ESG-related performance in investment decisions, Private Equity believes that it offers a positive contribution that is best practice and in line with the clients' stated objectives.

PGGM private equity teams aim is to be fully compliant with obligations arising from (ESG) legislation, regulations, and our stewardship responsibilities. The relevant standards, codes of conduct or (inter)national initiatives or legislation that apply and have an impact on implementation are discussed below. For more detailed information please see PGGM Investments website.

In addition to implementing clients' policies and complying with rules and regulations, PGGM private equity believes that climate change, diversity, equity and inclusion ('DEI') are important topics in the private equity industry. PGGM private equity, therefore, aims to actively seek for and contribute to solutions that increase private equity's positive impact on climate change and DEI.

3. Implementation

3.a ESG-integration

PGGM defines ESG integration as systematically taking into account those ESG factors that have a material effect on investment risk and return. Across its entire portfolio PGGM uses the Materiality Map of the Sustainable Accounting Standards Board (SASB) as the framework to identify material ESG issues per sector. Similarly, Private Equity takes SASB Materiality Map into account when analysing ESG risks and opportunities in the investment process. ESG risks are defined as risks for the financial returns from material ESG factors.

PGGM private equity has integrated ESG considerations into the investment and portfolio management process. The ESG integration process covers the whole portfolio and it is organized around the different investment stages: selection, commitment, and ownership.

1. The Selection Stage

In the selection stage, PGGM private equity assesses whether the investment partners will treat ESG risks and opportunities appropriately and in line with PGGM's responsible investment strategies and beliefs.

The first step in this stage is to screen country and sector risks within the underlying companies in a GP's portfolio. This quantitatively assesses ESG risks in portfolio companies and gives directional insights into material ESG risks in the GP's strategy. Data on country and sector risks are from Sustainalytics and MSCI respectively. The former is updated every quarter while the latter is updated once a year.

The second step is to assess a GP's capabilities to manage ESG risks and opportunities. During the due diligence phase, PGGM private equity uses an ESG Integration Assessment questionnaire to score GPs. This questionnaire is filled in by the deal teams of PGGM private equity based on desk research and interviews with the GP. The scoring of GPs is summarized within the final investment proposal ('FIP'), the document upon which the relevant Investment Committee(s) takes a decision on whether or not to make a commitment. The ESG analysis in the FIP also serves as an important input for the ownership stage.

2. The Commitment Stage

PGGM private equity looks for GPs who demonstrate a willingness and commitment to improve on their approach towards ESG on the areas covered in the ESG Integration Assessment questionnaire. Language is included in the legal documentation with the GP which ensures that PGGM private equity implements the exclusion list and ESG-related actions.

In addition, the GPs are asked to report on incidents, such as accidents with severe physical injury, major environmental pollution, or legally established misappropriation of funds, in order to help track ESG incidents in the portfolio and ensure that GPs will follow up on these.

In terms of reporting requirements, PGGM private equity promotes a standardised ESG reporting template which was developed together with AlpInvest Partners, APG, and MN.

3. The Ownership Stage

In the ownership stage, PGGM private equity actively monitors and engages with GPs on ESG integration. The engagement takes place at least once per year with every GP for which we committed to their latest fund. The purpose of engagement is to discuss ESG progress and goals going forward and share best practices.

To monitor ESG performance in the private equity portfolio, the team prepares an internal ESG monitoring report every quarter. The key ESG performance indicator is the GP score derived from the ESG Integration Assessment questionnaire. Updates of the scores are aligned with the engagement schedule. ESG incidents are discussed in weekly team meetings and ESG engagement goals and progress are discussed in formal fund and co-investment monitoring meetings (semi-)annually.

The PGGM Private Equity portfolio comprises many companies that operate in a diverse set of countries and sectors, which gives it exposure to a broad variety of ESG risks and opportunities. ESG is integrated in the investment strategy and approach to help reduce ESG-related investment and reputational risks or increase (expected) returns of the portfolio. The PE team invests in diverse sectors so all ESG factors could potentially have a negative influence on the value of the portfolio. The PE team therefore takes SASB into account to identify material ESG factors at sector level and in some cases, additional due diligence reports from GPs.

Transitional and physical risks deriving from climate change are considered a sub-set of ESG risks and are therefore covered by the ESG integration process of Private Equity. To manage both transitional and physical risks, the PE team evaluates GPs based on the climate-related due diligence questions in the ESG Integration Assessment questionnaire.

While encouraging our GPs to disclose a variety of ESG KPIs for portfolio companies such as GHG emissions, PGGM private equity also requires DEI data explicitly and seeks continuous improvement in collecting such data.

3.b Impact

In addition to a better-performing portfolio, Private Equity seeks to enhance the positive impact of its investments and to minimize adverse impacts even when they do not directly affect the financial performance.

1. Positive impact: investing in the SDGs

In 2016 PGGM and APG defined Sustainable Development Investments (SDIs) as "investments that yield market-rate financial returns while generating a positive social and/or environmental impact" (i.e. contribute to the Sustainable Development Goals). In 2020 Australian Super, British Colombia Investment Management Corporation joined APG and PGGM in the SDI-Asset Owner Platform which owns a taxonomy of products and services (solutions) that contribute to the SDGs. With a set of decision rules the taxonomy forms the basis for the classification of investments as 'SDI'.

PGGM main client's ambition is to increase the SDI volume to 20% of the total portfolio by 2025. The effort to measure portfolio companies' real-world impact, however, is currently limited to seven focus SDGs: #2 (zero hunger), #3 (good health and wellbeing), #6 (clean water and sanitation), #7 (affordable and clean energy), #11 (sustainable cities and communities), #12 (responsible consumption and production) and #13 (climate action).

To estimate and monitor the impact on these focus SDGs, the indicators suggested by the Working Group on SDG impact measurement of the DNB-facilitated Sustainable Finance Platform are used.

In response to this ambition on SDGs, PGGM private equity established a specialised SDG team to invest in solutions that create positive societal returns. The team builds upon the above-mentioned ESG process while focusing on impact creation and measurement. There are three impact-specific ESG considerations under this mandate:

1. SDG focus themes

PGGM private equity's SDG team pursues investments in companies or fund managers that contribute to the largestclient's ambition to increase the SDI volume, with the main focus on the seven SDGs listed above.

2. Substantial contribution

The positive contribution to one or more of the selected SDGs must be substantial, defined as meeting at least one of the criteria in the table below. Driven by the different nature of fund investments and co-investments, these criteria differ for the two investment types. As fund commitments tend to have a large blind pool component, a judgment on the substantiality criteria is made based on the GP's relevant track record and the go-forward strategy.

3. Measurable tangible impacts

For an investment to classify as an SDI, its positive impact should be tangible and measurable. The PGGM private equity SDG team measures the impact of its investments on an annual basis, using the SDG impact measurement to measure the impact of SDIs in private equity.

2. Adverse impact: Minimise negative impact

The social and environmental impact of the capital entrusted to PGGM by its clients is significant. PGGM can stimulate a positive contribution to a sustainable world and has the responsibility to minimise adverse impact. Adverse impacts refers to negative impacts (harm) to individuals, workers, communities and the environment.

As from 1 January 2022 at the latest, PGGM shall avoid new investments in companies that are in very severe violation of the OECD Guidelines for Multinational Enterprises (hereinafter OECD guidelines) and/or the UN Global Compact principles. When feasible, PGGM shall undertake best efforts to divest existing exposures to these companies all together and/or shall engage with the companies, or a selection thereof, that are in (very) severe violation of the OECD guidelines and/or the UN Global Compact principles.

Based on its high likelihood and severity, climate change as a driver of adverse impact its prioritized. Clients of PGGM have committed themselves to the Dutch Climate agreement[1] and to the Paris Climate Agreement to align policies consistent with the objective to limit the global temperature rise to a maximum of 1.5 °C. The ambition is to have a climate neutral investment portfolio by 2050 - in line with the ambition of the European Union and the Paris objectives.

1 In Dutch "Klimaatakkoord"

Fund investment	Co-investment
Is over 50% of the fund expected to contribute to one or more SDGs?	Does over 50% of turnover of the investee contribute to SDGs based on the relevant taxonomy?
Is a significant share of the fund expected to have a decisive impact on a focus area, based on the investment strategy?	Does the investee's product or service make a decisive contribution the focus area (e.g. through large market share/unique product or service)?
Does the GP demonstrate transformational leadership in PE investing in solutions?	Does the investee contribute to the focus area by acknowledged transformational leadership in its industry (as judged by reliable external parties)?

PGGM private equity is committed to improving data quality in the coming years by collecting standardised carbon data from its GPs. The method of collecting such data is to be aligned with that of PGGM. The results of carbon footprint measurement will serve as a baseline for subsequent climate change engagement with GPs.

3.c Stewardship (engagement, voting, shareholder litigation)

PGGM private equity actively uses its influence as an LP to achieve improvements in the ESG field, thereby contributing to the quality, sustainability and continuity of companies and markets. PGGM sees it as its responsibility to engage with market parties and companies about their policies and activities. In this way, it attempts to realise ESG-related improvements. If PGGM is also shareholder in a specific company, it applies customized voting principles, written down in the [PGGM Voting Guidelines].

PGGM private equity engages with GPs on their policies and activities as well as with the broader private equity market on ESG standards. PE regularly engages in collaborative activities such as working groups with industry players through Institutional Limited Partners Association (ILPA), and by being a signatory to UN PRI. The commitments it makes through these collaborations are incorporated into each new investment, as and when relevant.

Engagement is undertaken to influence ESG practices and/or improve ESG disclosure to improve positive impact and/or mitigate negative impact. PGGM private equity engages with every active manager on ESG at least once per year. The engagement results, developments and follow-up actions are monitored in internal quarterly ESG reports. The key indicator of measuring success is by tracking the improvement of ESG scores derived from the ESG Integration Assessment questionnaire.

1. Fund investment

ESG engagement topics are based on the ESG Integration Assessment questionnaire. The assessment covers seven topics of ESG integration at GPs: policy, governance, involvement in industry initiatives, investment process, ownership or monitoring, reporting, and overall interest. PGGM private equity engages with GPs on ESG based on their maturity on these topics. Engagement topics also derive from climate change, DEI, and sector risks of the underlying portfolio.

2. Co-investment

In addition to engagement on the GP level for fund investments, PGGM private equity engages with GPs on specific companies where it co-invested in. This is based on the ESG risks and opportunities identified in the selection stage of the co-investment and updated when relevant. Material ESG risks are monitored during the holding period through ESG engagement with GPs.

3.d Exclusion

The [PGGM Implementation Guidelines on Exclusion] are applicable to the investments in all asset classes, including Private Equity. PGGM’s Exclusion List consists of a list of specific product-related listed companies as well as government bonds from sanctioned countries which PGGM refrains from investing in. The PGGM-wide product-based Exclusion List consists of companies engaged in controversial weapons, tobacco, tar sands as well as thermal coal utilities and mining companies.

By excluding companies on the basis of the above elements, PGGM seeks to prevent PGGM-managed investments contributing financially to practices incompatible with the standards and values of PGGM, its clients and their beneficiaries.

Exclusion rights are included in the side letters for PGGM’s commitments to private equity funds. If a manager violates the policy, actions will be taken to remediate the violation.

4. Transparency

Each quarter the Private Equity team provides an update of its responsible investment activities in the clients' quarterly report. This includes information regarding stewardship activities, impact investing and integration of ESG-factors in its investment decisions. Also, any relevant negative impacts and our monitoring of these impacts are reported. In addition, the team contributes to PGGM Investments annual Integrated report and report on its responsible investment activities in the Principles of Responsible Investment (PRI) annual survey.

In addition to contributing to PGGM's reports and surveys, PGGM private equity publishes an Annual Responsible Investment Report. This report is publicly available and it discloses key KPIs, results and goals related to ESG of PGGM private equity.

5. Annex

Please note that there is an Annex applicable for this ESG-guideline. This Annex forms an integral part of this ESG-guideline and may be updated from time to time. The applicable Annex is available on our website.

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