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The PEI Responsible Investment Forum is the longest running and largest private equity conference focused on bringing together GPs and LPs to discuss ESG and market trends. Sancroft Consultant, and Responsible Investment lead, Isabella Stanbrook shares her highlights from this year's Forum.

Most discussed thematic ESG topics:

Plastics

There is currently no perfect solution to addressing plastics use in business. This however has not prevented companies from beginning to act in this space. Momentum in the value chain can be seen through the setting of commitments on using recycled content, or innovative initiatives to reduce plastics use. An interesting example outlined was HP's ink and toner cartridge free recycling programme which has the combined benefits of reducing technology waste, and increasing the return and subscription rates. One of the panellists even cited examples of initiatives by private equity firms themselves, such as Coller Capital and Palatine banning single use plastics in the office.

The legislative climate around plastics, packaging, and resource usage has also intensified. As our Chairman Lord Deben highlighted, regulation will be necessary to create a level playing field and give structure as society moves towards being non-recycling free. The EU and the UK are both starting to commit to regulatory action, ramping up the so-called 'war on waste'. The EU Commission has proposed a ban on single use plastics, including cotton buds and straws, and has further asked for the financial burden of cleaning up ocean plastic to be shifted to manufacturers.[1] At a domestic level, the UK has followed up its world leading microbead ban[2] with a series of legislative steps and progressive government consultations to tackle issues around plastics and packaging.

This means there will increasingly be a need for investment into how to recycle, and for new alternatives to plastics. The demand signals are already starting, and have no doubt contributed to the development of two of the funds speaking at the Forum. The first is Circularity Capital, a specialist

[1] https://www.reuters.com/article/us-europe-environment-plastics/eu-moves-to-ban-single-use-plastics-idUSKCN1IT160
[2] https://www.theguardian.com/environment/2018/jan/09/plastic-microbeads-ban-enters-force-in-uk

private equity firm founded to deliver value for investors from the opportunities created by the circular economy[3]. The second is Creolus, the first fund to invest only in plastics alternatives. The business community should see the plastics agenda as an opportunity to create value and encourage innovation. The circular economy does make business sense, especially when considering elements such as resource price volatility and scarcity, but a holistic response is needed to this system problem.

For more information on this topic, Sancroft has published the following insights:

- A discussion with our Chairman, Lord Deben, and Sancroft Advisor, Alison Hampton, on investor interest in the current plastics agenda
- Overcoming the scourge of packaging and plastic waste: three areas of innovation likely to see growth

Human rights and modern slavery in supply chains and direct operations

Modern slavery continues to be one of the most discussed social issues. This is driven by the increasing legal and regulatory frameworks in this area, leading to growing expectations and international focus on business action and accountability for impacts on human rights. This includes legislation such as the 2015 UK Modern Slavery Act and France's 2017 Corporate Duty of Vigilance Law, requiring businesses within a certain threshold to disclose the steps they are taking to tackle issues such as forced labour in their operations and supply chains. We are seeing similar legislation being discussed in Australia, Canada, Hong Kong, Switzerland and the Netherlands. We are also seeing more benchmarks comparing company performance on human rights such as the report ranking the first year UK modern slavery statements of the FTSE 100, the first open and public benchmark of corporate human rights performance, and most recently KnowTheChain's 2018 ranking of 40 ICT companies on efforts to address forced labour in supply chains.

The evolving developments in law, regulation and NGO initiatives around the world mean companies will need to keep up to speed with changes, carefully navigating what is required of them now and in the coming years.

[3] What is a circular economy? https://www.ellenmacarthurfoundation.org/circular-economy. Also interesting, and linked to this is the Cradle to Cradle design concept.

For more information on these issues, you might be interested to read:

- Sancroft's insights on modern slavery: Modern Slavery: taking centre stage and Why there are no excuses for businesses not to act on modern slavery in 2018
- PRI's 2017 report on managing ESG risk in the supply chains of private companies and assets, which looks at environmental and governance issues in the supply chain, as well as the social aspect.

Diversity and Inclusion

There continues to be mounting evidence of the financial benefits of diversity in business. The recent McKinsey study reinforces the link between a company having ethnically, culturally and gender diverse teams, and financial performance. Not only does a diverse team allow for a company to innovate in a fast-changing corporate environment but recognising the importance of diversity and inclusion is also an indicator of a responsible business. With research showing that the younger generation want to work for companies that they consider to be responsible, diversity and inclusion programmes will be a contributing factor to businesses attracting and retaining the best staff in an increasingly competitive labour market.

The discussion was not only centred around the importance of D&I in portfolio companies but also in the private equity industry. According to a recent BVCA study, 30% of all junior staff in private equity are women, however, this goes down to 15% at mid-level and to 6% at senior level. The challenge is not just attracting women to the sector, but to retain them. Suggestions for how private equity firms might improve the gender diversity of their teams include:

- Recruiting outside of the normal specifications, from non-traditional backgrounds. Using recruiters outside of the PE sector, and requesting more female candidates.
- Introducing mentoring programmes, support networks and skills building workshops.
- Adopting basic policies around maternity and paternity leave, telecommuting and flexi-time, and sick and care days.
- Targeting women while still in education, not just early in their career.
- Measuring your performance – what gets measured gets done: join industry initiatives such as Level 20, which has 20% as the goal of senior women working in the European private equity industry by 2020.

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Climate Change

This is a rapidly evolving issue, and its importance will only increase over time. As such, there is a need for awareness raising both at the house level and amongst portfolio companies. It is essential for investment professionals to get up to speed with the science of climate change so that LPs feel confident that it is being carefully considered in their appraisals, especially on infrastructure investments. PE firms will also increasingly be expected to speak to their portfolio companies about climate change, and request risk and opportunity analysis. With growing demands for data on climate change, LPs and GPs will need to be clear about why they are asking for this information, and what they will do with it. This will be crucial in ensuring that the focus remains on reducing impact rather than simply an exercise in collecting emissions data and number crunching.

The Taskforce for Climate-related Financial Disclosures (TCFD) was highlighted as a good framework for taking a more holistic approach to tackling climate change, allowing for the identification of opportunities and risks. There are some private equity firms that are already looking to the TCFD for inspiration on how to establish and implement processes. The uptake has so far been relatively low which is perhaps unsurprising due to how new the TCFD is. That said, the view is that the TCFD will in time become a mandatory reporting requirement and could be implemented into EU regulation.

Do responsible investments create value for investors?

Martin Skancke, chair of the PRI Board, opened the conference with a keynote in which he emphasised the importance of ESG being integrated into mainstream investment processes, not just being a sideshow. This theme was picked up in the panel on ESG value creation, with one of the LP panellists making the interesting observation that ESG integration is like the investment J curve. Implementing a limited ESG programme is not likely to add value and may even detract value, as in this scenario it is not likely to have focused on the material issues. If done in half measure, a firm is paying for the cost of the programme, without benefiting from the value. A firm has to move up the experience curve to reach the stage at which ESG is integrated with the deal team and is adding value. As such, it is contingent on LPs to find out which firms are doing ESG well: who has really integrated ESG, where on the J curve is the GP, and how long have they been on the learning curve? These points resonated with the findings of Sancroft advisor Alison Hampton in her Master's dissertation on how private equity engages on ESG with portfolio companies, which was presented in the academic update session on the second day. There was a general consensus that LPs in Scandinavia, Holland, Germany and Australia are increasingly aware of whether GPs are truly integrating ESG into their practices, or simply using it as a window dressing. The US is also catching up in this respect. LPs have the goal of achieving better long-term returns, and with ESG being part of this, GPs can expect ever increasing scrutiny of their ESG programmes.

The launch of PRI's new guidance on LP monitoring and GP reporting practices on ESG

At the Forum, PRI launched new guidance on ESG monitoring, reporting and dialogue in private equity. As outlined by PRI, 'The aim of this guidance is to support an exchange of information, underpinned by dialogue, that will keep LPs informed about the ESG characteristics of their private equity investments and the responsible investment practices of their investment managers.' It has been in development for over a year and is the product of extensive consultation. It is the culmination of a PRI ESG guidance evolution since 2013, with earlier documents including: the LP responsible investment due diligence questionnaire (DDQ) and Incorporating responsible investment requirements into private equity fund terms.

Aspirations for the guidance shared by panellists:

- Bring structure to an unstructured area by creating a common template so that there are less competing and differing formats and requirements from LPs – even if LPs have differing goals. It is not yet clear whether GPs would adopt this as their reporting format, but it is certainly useful in working towards a more consistent approach.
- Give the ability for better comparison and knowledge sharing across portfolio companies – to identify common challenges and best practices across a portfolio. With the improved use of data, it may in time allow for comparison between private and public companies of a similar size.
- Contribute to increased transparency: private equity can be an area of discomfort for certain investors, and transparency will help to develop trust in the sector.

Regulatory update: The development of ESG regulation

A PRI study examining financial regulation on ESG globally found that since the financial crisis the regulation that exists in relation to ESG has more than trebled, and this trend does not appear to be slowing. Policy makers are increasingly of the view that the financial market should be more aligned with long term financial development. The regulation emerging falls into two categories. The first is soft law, which often requires companies to disclose and report on their activities, such as the UK's

2015 Modern Slavery Act. Although this is considered soft law, organisations should not underestimate the risk and legal consequences associated with them. The second is hard law, such as those regulating bribery and corruption.

Due to this rapid proliferation in regulation, the piecemeal efforts do not always fit within the broader framework. This is slowly beginning to be addressed and is the start of a very significant change. For instance, in January 2018 the EU High-Level Group on Sustainable Finance (HLEG) published its final report setting out strategic recommendations for a financial system that supports sustainable investments. HLEG made 100 recommendations, and the EU is taken 30 of them forward. The first regulations arising from the recommendations could be enacted as soon as the end of 2019, and therefore these warrant review and serious attention now.

Deal teams and portfolio companies will need support in thinking about these risks as part of due diligence and ownership. This needs to be driven by the identification of material and legal risks. For instance, anti-bribery and corruption will almost always be an issue that needs attention, whereas forced labour legislation currently only exists in certain jurisdictions. Private equity firms should be a resource for portfolio companies, helping them to identify what new and emerging issues they need to respond to.

ESG issues subject to regulatory advancements:
E: rationalisation of regulation around climate change, including climate risk and carbon reporting; renewed focus on plastics and the circular economy; and greater enforcement of EHS laws.
S: gender pay; equal pay; worker minimum pay; worker welfare; forced labour and human trafficking
G: continued focus on anti-bribery and corruption – portfolio companies would be expected to have their own policies and processes in this regard; there is no longer any leniency on tax evasion; trade law; and corporate governance structures.

Creating a culture of social impact investing, keynote delivered by Elizabeth Corley

In December 2016, the UK government set up an independent Advisory Group chaired by Elizabeth Corley (Vice Chair of Allianz Global Investors) to answer an important question: ‘How can the providers of savings, pensions and investments engage with individuals to enable them to support more easily the things they care about through their savings and investment choices?’ The Advisory Group published this fascinating report ‘Growing a Culture of Social Impact Investing in the UK’ in November 2017. In early 2018, the Prime Minister commissioned the Implementation Taskforce to bring to life the recommendations set out in this report. For further information on this initiative or how to get involved, please follow the link above.