Integrating ESG Holistically In Private Equity: A Strategic Approach

ABOUT THIS PAPER

Integrating ESG Holistically In Private Equity: A Strategic Approach builds on a previous publication, *SASB and Private Markets*, to demonstrate how investors can leverage SASB Standards as a foundational cornerstone in building a ESG strategy for private equity.

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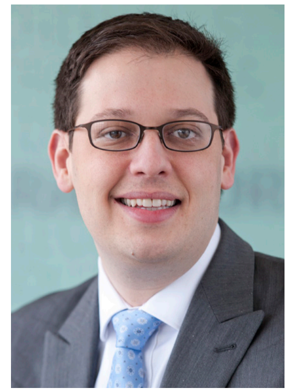
PREFACE



As Covid-19 began its rapid spread in the USA in March 2020, I began, like many others, adjusting to the new reality of sheltering in place. With many aspects of typical day-to-day life no longer accessible, I restarted a long-dormant meditation practice to spark ideas for self-improvement. I found Dr. Dan Siegel, a clinical professor of psychiatry at UCLA School of Medicine, the founding co-director of the Mindful Awareness Research Center at UCLA, and the creator of a course called *Mastering Presence: Being & Becoming Aware*. He asserts that, in the field of interpersonal neurobiology, the linking of differentiated parts is the basis for well-being. He describes the components of well-being as resembling a fruit salad as opposed to a smoothie, in that each differentiated part maintains its integrity while also being meaningfully linked, creating interconnections with synergistic effects.

After receiving countless questions from confused LPs and GPs about the various guidance and actors that have proliferated the ESG space over recent years, I have been searching for more effective ways to guide them to integrate ESG in a relevant and cost effective way. The fruit salad analogy struck me as uniquely applicable to the complex, open ecosystem of organizations that today represent and influence ESG integration. In this report, I set out to effectively link some of the differentiated parts of the ecosystem and apply them to a conventional private equity investment process. I hope this report provides useful insight to help investors understand these interconnections and apply them to their ESG integration journey.

Jeff Cohen, CAIA
Director of Capital Markets Integration
Head of Private Investment Initiatives

EXECUTIVE SUMMARY

True signs of an industry's maturation are twofold. First, the number of participants in the industry rapidly grows as more businesses find use in the marketplace, credibly adding value to the industry as a whole. Second, participants' work in the industry becomes increasingly interconnected as products and services develop and vie for competitive differentiation. The state of ESG and its increasing embeddedness in capital markets certainly reflects these two markers of maturation. ESG has matured into and continues to evolve as a complex open ecosystem, which is both encouraging for the progress of the work and increasingly difficult to navigate.

In this report, we look at the ESG ecosystem through the lens of a private equity investor, with the goal of helping investors apply the leading ESG principles, tools, and resources to their investment process holistically and cost-effectively.

To do so, the ecosystem as a whole will be described, then refined down to those considerations most likely to be relevant to private equity investors. This refined view demonstrates where standards, like those developed by SASB, serve as a fundamental building block or useful addition to an ESG-integrated investment program. This report will benefit those investors seeking to use information about the effects of sustainability issues on companies to enhance enterprise value creation. It will also help investors who want to use that information to assess, and manage and communicate companies' contributions to societal and environmental outcomes.

Key applications of—and interconnections between—ESG ecosystem actors and SASB will be demonstrated conceptually using the hypothetical company AgriCo, and applied using real case studies from general partners (GPs) currently integrating ESG across various phases of the deal and fund lifecycle. Users of this report will find that there is no prescriptive application of the principles, tools, and resources within the ESG ecosystem. The specific risks and opportunities of investee companies will vary across an investor's portfolio. However, in identifying the underlying utility of key ESG actors and the synergistic effects of their application, investors may find a clearer path toward effective ESG integration.

INTRODUCTION

In the face of 21st century risks and opportunities, investor expectations are evolving and ESG integration is becoming the norm in private markets. SASB Standards can help investors, managers, and their portfolio companies lay the essential groundwork for a versatile, multifaceted approach to ESG investing.

ESG AND PRIVATE MARKETS

As certainly as two important trends—sustainability and the continued growth of inflows to private capital—have converged, so has the seeming complexity of the ESG ecosystem increased. A previous paper, ***SASB and Private Markets***, details how SASB Standards can support the integration of key environmental, social, and governance (ESG) considerations throughout each stage of a traditional closed-end fund lifecycle. SASB's unique focus on financial materiality can help private equity investors use ESG information to more effectively assess a firm's top-line or bottom-line growth and promote the flow of information between assets, portfolio companies, general partners (GPs) and limited partners (LPs).

Getting Started

This paper is primarily intended for private equity investors looking to integrate or evaluate ESG considerations into the management of a private equity fund lifecycle. If your organization has only recently committed to—or has just begun evaluating—ESG integration, a preliminary step may be to develop and formalize a thoughtful ESG policy that informs key activities and defines how ESG integration supports and builds on the firm's investment strategy. The importance of this step is discussed in the paper ***SASB and Private Markets***, which also includes links to helpful resources.

Beyond their applicability to assessing business-relevant ESG risks and opportunities, SASB Standards can also serve as a foundational building block for private equity investors at any stage of their ESG journey. The standards align with and directly support other leading sustainability initiatives serving portfolio companies, GPs and LPs. As GPs continue to mature their approach and learn to harness the value of ESG integration throughout the fund lifecycle, SASB Standards can help find clarity in a global and open ESG ecosystem.

A GROWING SYSTEM OF SOLUTIONS

As capital markets increasingly recognize the important links between sustainability performance and financial outcomes, a thriving ecosystem of organizations and initiatives has developed to provide a wide range of sustainability-related information, analytics, and other solutions. Arguably, such complexity is a necessary precondition to building a sophisticated marketplace. The ecosystem consists of numerous interconnected parts that, as a whole, exhibit properties not characteristic of the individual constituents. Furthermore, its diverse range of independent, interacting components ensure there are multiple pathways through which the system itself can evolve. The number and type of constituents influencing the field has enriched and improved ESG in application while creating an unintentional obfuscation of simple steps forward for those seeking to integrate ESG into investment programs. In reality, the solutions and tools available to investors come from dedicated ESG-focused organizations and organizations with other primary business models that recognize ESG's relevance to various types use cases and investment strategies.

Two primary forces shape this dynamic, growing market:

- Investors and their clients seek to understand how sustainability issues affect a company's financial and operating performance, and
- Other stakeholder groups seek to understand how a company's actions impact broader society.

While not mutually exclusive, these two forces suggest dual perspectives on risk and opportunities—one focused on the financially material ESG risks and opportunities facing a given company, and the other focused on the company's impact on the challenges facing the world at large. Both perspectives may add value in the context of a given investment strategy. As such, a challenge for GPs is to navigate what might seem like a crowded and confusing landscape, discern which organizations and initiatives are most relevant for their firm, and apply them effectively. By leveraging relevant components of the field, a GP can fulfill its fiduciary responsibilities to its LPs and effectively communicate with a broader set of stakeholders.

A DEEPER DIVE

The ESG ecosystem is comprised of a myriad of nonprofit and for-profit frameworks, standard setters, data services, coalitions, rating agencies, assurance providers, and other initiatives. Many attempts have been made to demystify and clarify the ESG space using ecosystem mapping. The **World Economic Forum's (WEF) map**, for example, identifies nine organizational categories, which collectively contain more than 50 specific organizations. Similarly, ReGenerate, a UK-based NGO, has developed a **purpose-driven business ecosystem map** highlighting key players that aim to directly achieve improved environmental and societal outcomes. Meanwhile, Canadian consultancy Millani has developed a market map (see Figure 1) that highlights key players—including ESG-focused initiatives—in global capital markets.

Figure 1. Example Market Map of ESG Ecosystem, Developed by Millani

While all valuable, these maps capture snapshots of inherently dynamic forces, and may hold discrepancies in nomenclature that lead to confusion and inconsistent characterizations of ESG players. Existing ecosystem maps serve different facets of capital markets, and thus characterize initiatives according to different applications. For instance, the Millani map identifies SASB as part of Reporting frameworks & standards. Standards such as those set by SASB are different from frameworks and serve a different purpose in the ecosystem which will be discussed in the next section.

Further, the Regenerate map is intended for use by business leaders looking to start, grow, or advance a mission-driven business. As such, it includes funding sources as a key area of focus. Meanwhile, the WEF map is focused solely on ESG reporting, seeking to enhance understanding among public sector, private sector, and civil society actors. In the former map, CDP (formerly the Carbon Disclosure Project) is considered an "impact measurement and reporting" initiative, whereas in the latter it is categorized as a "specialized data provider" both of which are accurate depending on the audience for the map and application.

As these maps reflect, the size and complexity of the ESG ecosystem system can be attributed in part to the varying needs of different stakeholders and the initiatives designed to meet them. Attempts to define the entire system can help support a general understanding, but a more refined lens is required to unlock practical application for specific market actors.

A CURATED VIEW

Based on extensive market feedback, SASB has identified key ESG initiatives that are most relevant to private equity investors. This perspective focuses on three primary groups—investor-led coalitions, ESG frameworks, and disclosure standards (see Table 1)—and identifies a small portion of initiatives within these groups that can clarify for GPs how to effectively manage ESG factors to protect and create value.

- **Coalitions** such as the UN Principles for Responsible Investment (PRI) and Impact Management Project (IMP) help build mutual understanding among the global investment community of the interrelationships between economic, social, and environmental systems and their implications for financial risk and return as well as outcomes and impacts. They disseminate information to support organizations in identifying and addressing common challenges. Meanwhile, other investor-led initiatives have also offered valuable and substantive contributions to private equity investors, including SASB-aligned insights on how those investors might approach ESG factors such as the **LP Responsible Investment DDQ**. (See "Key Private Equity Resources Sidebar").
- **Frameworks** such as the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the United Nations Sustainable Development

Key Private Equity Resources

The following resources will be discussed in more detail in the "ESG in the Investment Process" section below.

- British Private Equity and Venture Capital Association (BVCA), **Responsible Investment Toolkit**
- Commonwealth Development Corporation Group (CDC Group or CDC), **ESG Toolkit for Fund Managers**
- Institutional Limited Partners Association (ILPA), **Due Diligence Questionnaire**

Goals (SDGs) establish useful conceptual schema for identifying and evaluating the ESG-related risks and opportunities businesses face, as well as the positive and negative impacts their operations may have on the world.

- Finally, **standards**, such as those developed by SASB, provide specific requirements for the disclosure of ESG information, empowering decision makers with consistent, comparable, reliable data. Other standards, such as those provided by the **Global Reporting Initiative** and the **GHG Protocol** can also be useful tools for private equity investors.

Table 1. Categorization of Key ESG Initiatives

Categorization	Definition
Coalitions	An association of organizations seeking to achieve outlined goals or address certain challenges.
Frameworks	A set of concepts and principles that provide structure for thinking and communicating about broad ESG topics. General frameworks are industry-agnostic.
Standards	Specific, replicable, and detailed requirements for what should be reported for each ESG topic. In other words, standards make frameworks actionable by providing comparable, consistent, reliable information. Standards can be industry-specific.

SASB OVERVIEW: THE UTILITY OF SUSTAINABILITY ACCOUNTING STANDARDS

Investor interest in sustainability-related information has been steadily increasing in recent years. In fact, according to a **Morgan Stanley survey** of 110 global institutional asset owners, 95 percent are integrating or considering integrating sustainable investing in all or part of their portfolios. Importantly, these investors do not view ESG integration solely as a way to achieve more positive environmental and social impacts. Rather, 80 percent agree that companies with ESG practices may be better long-term investments. Overall, the survey also identified a lack of quality data as the most significant barrier to sustainable investing.[1]

Addressing the need for decision-useful, investor-focused ESG data, **SASB Standards** identify industry-specific risks and opportunities related to ESG matters and provide associated metrics that companies can use to measure, manage, and communicate their performance in a consistent, comparable, and reliable way. The full universe of ESG issues can be broad and include many key issues relevant to non-investor stakeholders. By zeroing in on the subset of ESG factors most likely to have material financial impacts on companies in a given industry—and which are therefore most important to investors—SASB Standards enable a focused approach to corporate sustainability. When companies manage these issues effectively, they can unlock value that is mutually beneficial to the business, its shareholders, and society more broadly.

Since the Standards were codified in late 2018, global capital markets have increasingly demonstrated their support for SASB's approach. (See "Investor Support for SASB"). Perhaps most visibly, public statements from **Canada Pension Plan Investment Board**, **BlackRock** and **State Street Global Advisors** have demonstrated high-profile interest in data from SASB-aligned disclosure. However, these anecdotal examples are an indicator of much broader market support. For example, in a **Morrow Sodali survey** of 41 global institutional investors

1 Morgan Stanley, *Sustainable Signals: Asset Owners See Sustainability as Core to the Future of Investing* (May 27, 2020).

with $26 trillion in assets under management (AUM), 81 percent of respondents recommend that companies use SASB Standards to best communicate their ESG information.[2]

As an increasingly large swath of the global investment community heightens its expectations around ESG disclosure, its collective influence is likely to have a domino effect that spreads throughout capital markets. For example, as more and more publicly traded firms request sustainability data from vendors, private businesses held by GPs will be subject to data requests that demonstrate how they are managing ESG factors of interest to investors. Private companies that manage these issues and collect related data not only satisfy their customers, but also help preserve or drive enterprise value for their own business. In this regard, SASB Standards serve as more than just a disclosure and reporting exercise. When companies and investors effectively factor ESG risks and opportunities into their valuations, they actively contribute to markets that are more efficient, more resilient, and capable of sustainable economic growth.

Integration of SASB to Facilitate Use for Private Equity Investors

The following organizations directly integrate SASB Standards into their products and platforms, creating ease of data collection, monitoring insights, scoring methodologies, and useful benchmarking:

Apex Group, AssetMetrix, Burgiss, Mercatus, Preqin, RepRisk, TruValue Labs, and others.

Investor Support for SASB

As of October 2020, more than 170 investor organizations formally support SASB through the SASB Investor Advisory Group, SASB Alliance, and/or through SASB licensing programs. These leading asset owners and managers are headquartered in 24 countries around the world and manage more than $55 trillion in assets.

2 Morrow Sodali, *Institutional Investor Survey 2020* (March 10, 2020).

ACHIEVING ESG CLARITY

In the following section, we will review the components of the ESG ecosystem applicable to private equity investors and discuss SASB's rationalizing effect to bring the great work of these organizations to life. By realizing the connections between ESG ecosystem players, each with their own unique utility, private equity investors can find clarity in the elements of the system that best serve their needs. Notably, many of the actors in the ecosystem detailed below do not require a financial commitment from GPs.

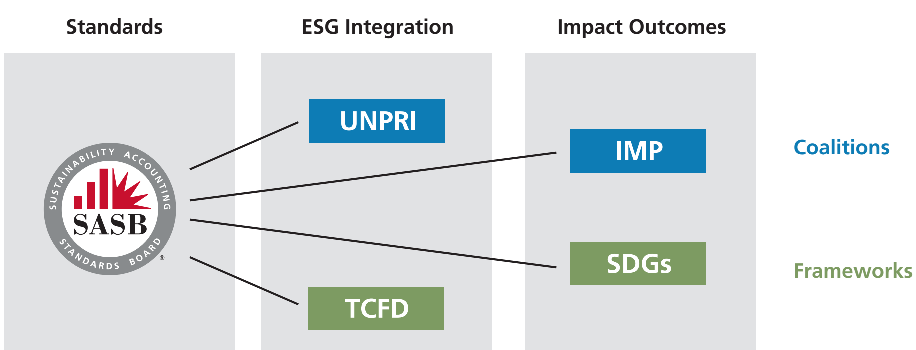
SASB STANDARDS: ESG ECOSYSTEM BEDROCK

Given SASB Standards' sharpened focus on the subset of ESG issues most closely tied to a company's ability to protect and create long-term value, the Standards can serve as a useful starting point—and, indeed, a foundational cornerstone—in building an effective, tailored approach to ESG integration. GPs and LPs will find that SASB Standards are well-aligned with and mutually supportive of the ESG initiatives most relevant in private equity.

The following is a non-exhaustive selection of players in the ESG ecosystem and an identification of many, but not all, key points of alignment and important linkages among them (see Figure 2). This selection focuses on:

- How ESG integration influences risk and return
  - » Task Force on Climate-related Financial Disclosures (TCFD)
  - » Principles for Responsible Investment (PRI)
- How ESG integration influences social and environmental outcomes and impacts
  - » Impact Management Project (IMP)
  - » Sustainable Development Goals (SDGs)

Figure 2. Important and Interrelated ESG Solutions for Private Equity



RISK AND RETURN

The United Nations Principles for Responsible Investment (PRI)

KEY INTERCONNECTIONS:

- SASB Standards add actionable data to PRI Principles and align with critical pieces of PRI guidance

PRI is an international network of investor signatories committed to incorporating ESG factors into their investment and ownership decisions. SASB Standards help investors fulfill PRI signatory commitments by making key PRI Principles more actionable and by complementing PRI tools and guidance, such as those for due diligence and monitoring and reporting.[3]

Specifically, SASB Standards can be a useful tool to help investors—including private equity investors—put the first three of the six Principles for Responsible Investment into practice. (See Table 2).

Getting Started with PRI

Asset owners, investment managers, and their professional service partners can publicly demonstrate their commitment to including ESG factors in investment decision making by signing the Principles for Responsible Investment. Interested organizations must **complete an application** and pay an annual fee (scaled to assets under management), which gives them access to exclusive events, resources, data, networking, and expertise.

Table 2. How SASB Standards Help Investors Put PRI Principles Into Practice

PRI Principle	SASB Application
We will incorporate ESG issues into investment analysis and decision-making processes.	SASB Standards can serve as the basis for determining which ESG issues are most likely to have material financial implications and thus may merit assessment during due diligence.
We will be active owners and incorporate ESG issues into our ownership policies and practices.	For GPs with control positions or means of influence, identifying and/or enacting strategies to manage ESG risks and opportunities identified by SASB Standards have the potential to protect or create enterprise value, and may lead to constructive dialogue with portfolio companies around these issues.
We will seek appropriate disclosure on ESG issues by the entities in which we invest.	With direct ties to operating and financial performance, SASB data and disclosure can facilitate insights that will allow for ongoing monitoring and communication throughout the investment chain.

In addition, SASB Standards directly apply to key elements of PRI's **Limited Partners' Responsible Investment Due Diligence Questionnaire**, which was informed by the BVCA's collaboratively developed **ESG Disclosure Framework,** and has been adopted by the Institutional Limited Partners Association (ILPA). This is a tool developed to understand and evaluate GP's processes for integrating ESG factors into their investment processes. Deal teams conducting due diligence on ESG factors likely to affect business strategy or operational efficiency in a given industry can leverage SASB Standards, which are well aligned with the PRI's guidance.

Furthermore, PRI's **ESG Monitoring, Reporting and Dialogue in Private Equity** guidance articulates opportunities to enhance communication about ESG factors among LPs, GPs, and portfolio companies. The previous paper, **SASB and Private Markets**, highlights how SASB

3 Natasha Buckley, "Using SASB to implement PRI monitoring and disclosure resources for private equity" (Sept. 26, 2019).

Standards can provide a foundation for such communication, addressing key elements of PRI's guidance such as the risk and opportunity profiles of portfolio companies, how those challenges are managed, and the value of that management approach. In addition to beneficial resources on where ESG issues effect risk and return, PRI is increasingly providing insights on outcomes and impacts.

The Task Force on Climate-related Financial Disclosures (TCFD)

KEY INTERCONNECTIONS:

- PRI issued guidance to help GPs implement the TCFD recommendations in accordance with the PRI reporting framework
- SASB Standards add accountability to and enhance the comparability of the principles-based TCFD recommendations

The TCFD was established by the Financial Stability Board (FSB) in 2015 to address a market need for consistent, comparable, clear, and reliable corporate disclosure of climate-related information. By developing recommendations for such disclosure, which the TCFD released in June 2017, the FSB aimed to ensure more stable, resilient markets over the medium and long term by facilitating a smoother transition—with less abrupt price adjustments—to a lower-carbon and climate-resilient economy. Since the release of the TCFD recommendations, more than 1,000 organizations[4] have publicly expressed their support, including global financial firms responsible for assets in excess of $100 trillion.[5]

TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

Getting Started with TCFD

Portfolio companies, GPs, and LPs can benefit from using the TCFD recommendations to add focus and structure to their thinking about the climate-related risks and opportunities they face. PRI's **Technical Guide: TCFD for Private Equity General Partners** can provide a useful starting point for GPs, while SASB and CDSB's **TCFD Implementation Guide** can help portfolio companies begin their implementation journey. Investment organizations can also publicly **declare their support** for the TCFD recommendations. Private equity investors and their portfolio companies can freely incorporate TCFD into their work without any formal commitments, official certifications, membership dues or other requirements.

The TCFD recommendations focus on four key pillars of disclosure that can help companies and investors more effectively assess and manage the climate-related risks and opportunities they face:

- Governance
- Strategy
- Risk Management
- Metrics & Targets

4 TCFD, "TCFD Supporters," TCFD website, accessed August 13, 2020.

5 TCFD, *2019 Status Report* (June 2019).

SASB Standards are among the most frequently referenced tools in the TCFD recommendations and can play a critical role in each of the four TCFD pillars. Although SASB Standards are designed to capture an array of sustainability risks and opportunities across multiple dimensions, climate-related risk is the most prevalent. SASB research has found that climate change is likely to have material financial impacts on companies in 68 out of 77 industries. To evaluate these risks, investors can leverage SASB Standards to help understand climate's industry-specific impacts on portfolio companies and more effectively assess their efforts to oversee and manage those risks. Indeed, Metrics & Targets serve as the core of the TCFD's disclosure recommendations because they shed important light on the effectiveness of a company's approach to the other three pillars.

Meanwhile, PRI's **Technical Guide: TCFD for Private Equity General Partners** can help guide GPs through the process of implementing the TCFD recommendations themselves. The guide offers a set of practical steps and deliverables to address the core pillars of the TCFD recommendations through training, collaboration, integration with investment processes, scenario analysis, and exit planning.

Within the Strategy pillar, SASB Standards and the SASB **Materiality Map**® can help GPs identify the industry-specific impacts of "macro-level risks and opportunities" associated with climate change. Within the Risk Management pillar, SASB-reported climate data can support "the process used to identify, assess, and manage climate related risks." Within the Metrics & Targets pillar, SASB-aligned data can enable and inform portfolio-level, TCFD-aligned climate reporting.

EXAMPLE: AGRICULTURAL PRODUCTS

Let's use PRI guidance and SASB Standards to put the TCFD recommendations into practice, using the example of AgriCo. (See sidebar.)

Given the nature of its business, AgriCo faces a range of climate-related risks over the short, medium, and long term, including transition and regulatory risks related to the company's direct emissions and physical risks related to its sourcing of key ingredients.

For example, AgriCo's operations generate Scope 1 emissions from its processing facilities and transportation of goods. Processing facilities account for the majority of total Scope 1 emissions. Transportation infrastructure, including a fleet of marine, road, and rail vehicles, roughly account for the remaining balance of total Scope 1 emissions.

AgriCo

Throughout this paper, we use a hypothetical company, AgriCo, to illustrate how private equity investors and their portfolio companies can put key concepts into practice.

AgriCo is a family owned and run, diversified, global agricultural products company primarily engaged in processing, trading, and distributing peanuts and cocoa. AgriCo sells its products directly to consumers and to businesses for use in consumer and industrial products. The company typically purchases agricultural products, including commodities, from third-party entities around the world that grow such products (either directly or indirectly). The company is also involved in wholesale and distribution.

Through an extensive, market-informed, and evidence-based process, SASB has identified the primary channels of financial impact for GHG emissions-related risks in the Agricultural Products industry. (See Table 3.) For example, emissions regulations may increase the cost of capital, operational costs, and affect the operational efficiency of companies that do not have strategies in place to manage GHG emissions. Employing innovative technologies that use alternative fuels and energy inputs—including biomass waste generated from internal processes—and improving fuel efficiency are ways agricultural products companies can limit exposure to volatile fuel pricing, supply disruptions, future potential regulatory costs, and other consequences related to GHG emissions.

Table 3. SASB's Financial Impact Channels for GHG Emissions in Agricultural Products

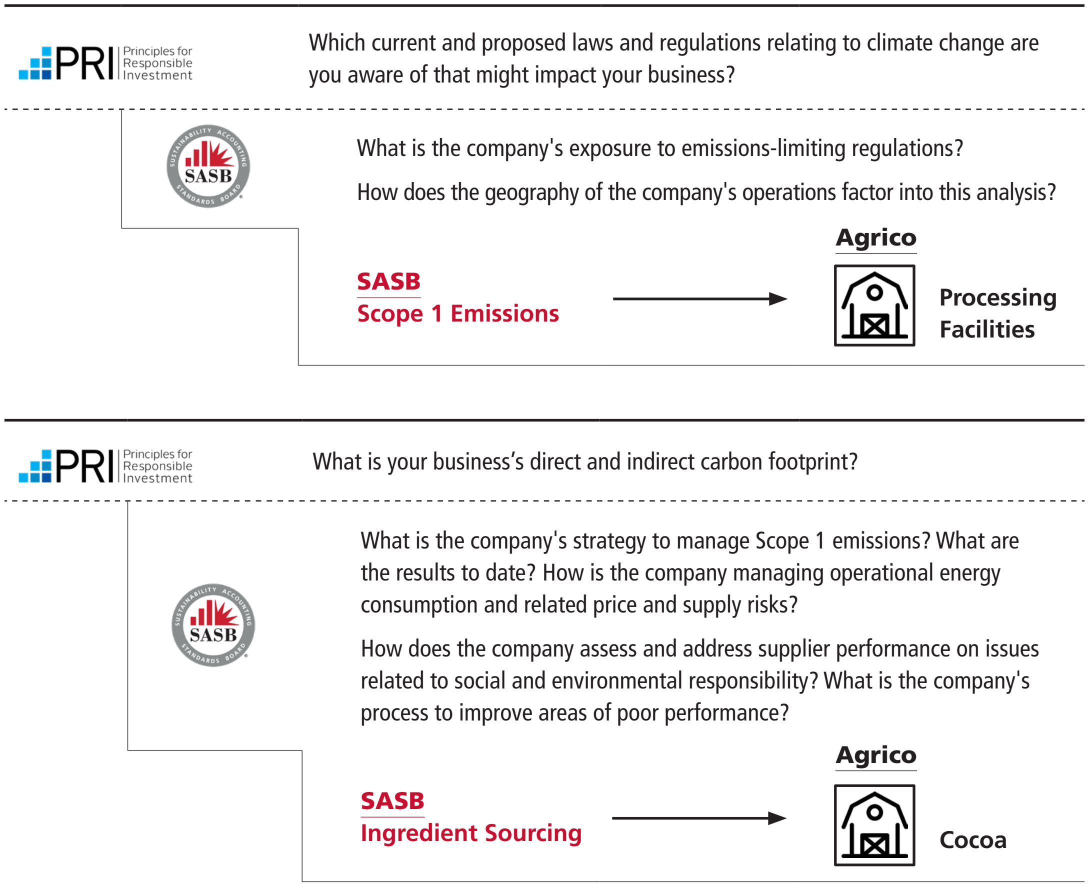
Greenhouse Gas Emissions - Financial Drivers

Revenue			Operating Expenses		Non-Operating Expenses		Assets		Liabilities		Risk Profile	
Market Share	New Markets	Pricing Power	Cost of Revenue	R&D	CapEx	Extraordinary Expenses	Tangible Assets	Intangible Assets	Contingent Liabilities & Provisions	Pension & Other Liabilities	Cost of Capital	Industry Divestment Risk
			■		■						■	

■ High Impact ■ Medium Impact

To better understand AgriCo's risk exposure and response strategy, a GP may employ the PRI's guidance during pre-transaction due diligence and post-transaction risk assessment. For example, the **Technical Guide** recommends GPs develop their regulatory awareness by asking portfolio and potential investee companies, "Which current and proposed laws and regulations relating to climate change are you aware of that might impact your business?" Putting a finer point on it, SASB's **Engagement Guide** recommends an industry-specific take, "What is the company's exposure to emissions-limiting regulations?" These and other follow-up questions (see Figure 3) are designed to initiate a dialogue in which investment managers can garner insights to facilitate a more complete and robust assessment of risks to enterprise value. These insights, along with the GP's recommendations, can also inform AgriCo's strategy to manage those emissions, including reduction targets tied to SASB metrics.

Figure 3. Connected Questions: PRI Technical Guide and SASB Engagement Guide



By connecting the PRI Technical Guide and SASB Engagement Guide, along with the SASB Standards, GPs can develop a better understanding of AgriCo's exposure to the risks identified by the TCFD, as well as the effectiveness of the company's strategic responses and governance oversight. Such an assessment should bear in mind that every company's circumstances are unique, and thus should balance bottom-up insights with sector and industry-driven standards and guidance.

OUTCOMES AND IMPACTS

Signatory commitments from coalitions such as PRI and frameworks such as the recommendations of the TCFD can support ESG integration with an eye toward understanding and communicating financial risks and opportunities. Meanwhile, the norms agreed through the Impact Management Project (IMP) and the UN Sustainable Development Goals (SDGs) uniquely support all stakeholder groups—including investors—in understanding how a company's social and environmental impacts significantly affect broader society. Because SASB Standards address sustainability issues that straddle this line, they can serve as a bridge to help both companies and investors allocate financial capital and other resources to areas where the potential to impact environmental and social outcomes aligns with the potential to influence financial returns.

The Impact Management Project (IMP)

KEY INTERCONNECTIONS:

- SASB Standards can help GPs more effectively classify investments according to the "impact classes" agreed through IMP
- Portfolio companies can use the IMP's "five dimensions of impact" to better evaluate their contributions to broader sustainability issues, such as the SDGs

It has been said that "all investing is impact investing." To understand why, consider IMP's definition of "impact":

> *Impact is a change in an outcome caused by an organization. An impact can be positive or negative, intended or unintended.*

The IMP, through its market-informed and consensus-driven process, has facilitated agreement on "impact management" norms that provide a common logic to help enterprises and investors assess, manage and communicate their impacts on people and the planet.

IMPACT MANAGEMENT PROJECT

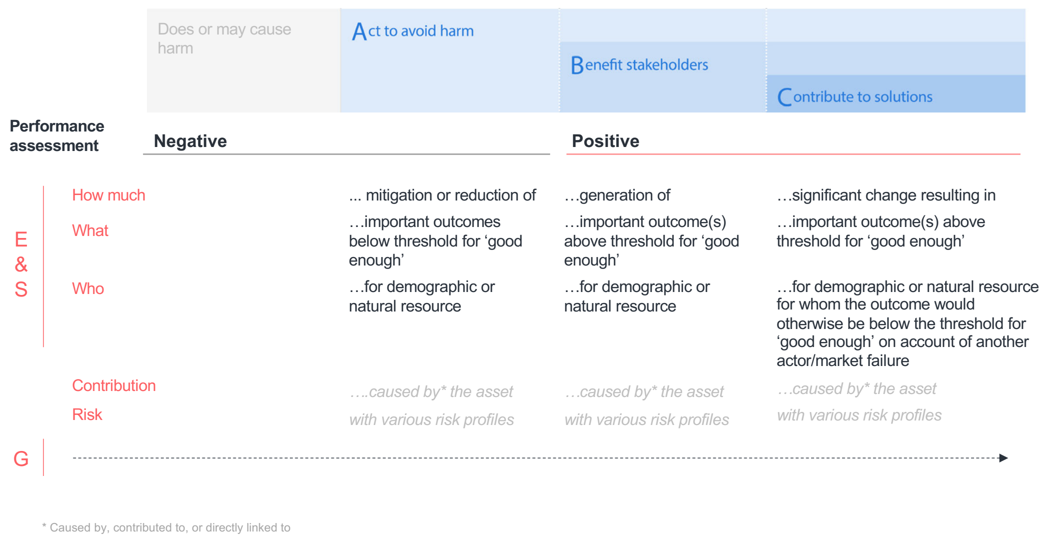
Getting Started with IMP

In addition to exploring the tools and resources available on **IMP's website**, private markets participants can also **join the IMP's Practitioner Community** to engage with other organizations and share best practices around measuring, reporting, comparing, and improving impact. They can also share their expertise and insights in an **online discussion forum** hosted by Harvard Business Review's Idea Lab. Private equity investors and their portfolio companies can **freely** incorporate the IMP into their work without any formal commitments, official certifications, membership dues or other requirements.

The norms facilitated by the IMP enable enterprises and investors to contextualize their performance on social and environmental metrics, such as those metrics provided by the SASB Standards, to assess whether economic activities are causing harm, reducing or avoiding harm, benefitting stakeholders, or contributing to solutions to pressing social or environmental challenges.

To support consistent communication, the norms agreed through the IMP include "impact classes" which—much like asset classes—group investment products with similar impact characteristics. IMP's ***A Guide to Classifying the Impact of an Investment*** makes it easier for GPs to determine the impact class of their overall portfolios based on the performance of underlying assets across five dimensions: how much, what, who, contribution and risk. (See Figure 4). SASB Standards help GPs identify key, industry-specific areas of impact at portfolio companies and evaluate relevant data, where available, to classify their portfolio companies and funds according to the IMP's impact classes. In doing so, GPs can ensure their investments are well aligned with their policies and the interests of their LPs.

Figure 4. Classifying the Impact of an Enterprise (IMP)



These IMP classifications are not intended to pass judgment on an investor or investment product, but rather to help investors identify opportunities aligned with their intentions and to avoid inappropriate apples-to-oranges comparison of the contribution to sustainability made by different investment opportunities. Many "returns-first" GPs will invest in enterprises whose combination of impacts falls into either the "does/may cause harm" or "acts to avoid harm" classification. Others may specifically look to align with long-term sustainable growth drivers by investing in enterprises that also "benefit" one or more of their stakeholders (e.g. companies providing services that generate positive health or educational outcomes). Those latter investors, traditionally dubbed "impact investors," often actively seek to "contribute to solutions" by investing in enterprises that also benefit stakeholders that may otherwise be 'left behind' by another actor or market failure.

An investment can also employ a range of "investor contribution" strategies to contribute to the impact of underlying enterprises in the portfolio, as detailed in Figure 5. Any "returns-first" GP can act to avoid harm not only by signaling impacts that matter to them using performance on SASB Standards to make investments, but also through conventional means of influence and control afforded to them through the structure of their investment. Each investment affords different types of opportunities for contribution, and impact classification can be made at both the fund and enterprise level.

Figure 5. IMP Impact Classes

INVESTOR'S CONTRIBUTION		ACT TO AVOID HARM	BENEFIT STAKEHOLDERS	CONTRIBUTE TO SOLUTIONS
Signal that impact matters + Engage actively + Grow new/undersupplied capital markets + Provide flexibility on risk-adjusted return	1	E.g. Ethical bond fund	E.g. Positively-screened / best-in-class ESG fund	E.g. Sovereign-backed bonds (secondary market) funding vaccine delivery to underserved people or renewable energy projects
Signal that impact matters **+ Engage actively** + Grow new/undersupplied capital markets + Provide flexibility on risk-adjusted return	2	E.g. Shareholder activist fund	E.g. Positively-screened / best-in-class ESG fund using deep shareholder engagement to improve performance	E.g. Public or private equity fund selecting and engaging with businesses that have a significant effect on education and health for underserved people
Signal that impact matters + Engage actively **+ Grow new/undersupplied capital markets** + Provide flexibility on risk-adjusted return	3	E.g. Anchor investment in a negatively-screened real estate fund in a frontier market	E.g. Positively-screened infrastructure fund in a frontier market	E.g. Bond fund anchoring primary issuances by businesses that have a significant effect on environmental sustainability, access to clean water and sanitation
Signal that impact matters **+ Engage actively** **+ Grow new/undersupplied capital markets** + Provide flexibility on risk-adjusted return	4	*Investment archetype not widely observed*	E.g. Positively-screened private equity fund making anchor investments in frontier markets	E.g. Private equity fund making anchor investments in businesses that have a significant effect on income and employment for underserved people
Signal that impact matters + Engage actively **+ Grow new/undersupplied capital markets** **+ Provide flexibility on risk-adjusted return**	5	*Investment archetype not widely observed*	*Investment archetype not widely observed*	E.g. Below-market charity bonds, or an unsecured debt fund focused on businesses that have a significant effect on employment for underserved people
Signal that impact matters **+ Engage actively** **+ Grow new/undersupplied capital markets** **+ Provide flexibility on risk-adjusted return**	6	*Investment archetype not widely observed*	*Investment archetype not widely observed*	E.g. Patient VC fund providing anchor investment and active engagement to businesses that have a significant effect on energy access for underserved people

For example, consider a private equity fund making anchor investments in businesses that have a significant effect on income and employment for underserved people. The underlying enterprises in the fund contribute to solutions (Column C in Figure 5) while the GP's strategy employs several mutually supportive contribution strategies: signaling that impact matters, engaging actively, and growing new or undersupplied capital markets (Row 4 in Figure 5). Along both axes, relevant and reliable ESG data can facilitate the GP's efforts—for example, by measuring the contributions of portfolio companies and informing the engagement strategy to drive performance gains.

As a participant in IMP's Structured Network, SASB believes its Standards can bring the IMP's impact management norms and impact classes to life through industry-specific applications and quantitative performance data that can then be contextualized and assessed to understand a company's contribution to outcomes and impacts.

The Sustainable Development Goals (SDGs)

KEY INTERCONNECTIONS:

- SASB Standards can help companies and investors identify the SDG targets most relevant to financial performance in a given industry, enabling them to allocate financial and other resources toward activities that can influence both global goals and financial returns.

- IMP's Impact Dimensions can help GPs and portfolio companies identify and assess the outcomes to which they are contributing—or to which they might contribute.

Today, 65 percent of global asset owners and managers say they have aligned their investment framework with the SDGs.[6] Meanwhile, 72 percent of companies mention the SDGs in their annual corporate or sustainability report.[7] These figures demonstrate clear recognition that the Goals represent important considerations for the users and providers of financial capital.

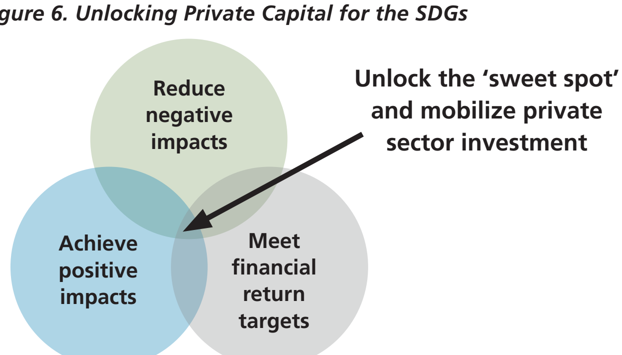
However, some investors have expressed concern that investment vehicles are being marketed as having positive impact on the SDGs without a credible underlying investment thesis or robust integration into decision making.[8] Although in some cases skepticism may be warranted, this "credibility gap" is also to some extent a function of inherent characteristics of the Goals, including the fact that SDGs were not designed to provide investors with a detailed understanding of the linkage between the Goals and the risk and return characteristics of their investments.

As detailed in the ***SASB Industry Guide to the Sustainable Development Goals***, SASB Standards can be a key tool to connect financing with sustainable development-related opportunity by identifying the "business incentive" to invest in SDG action.

Getting Started with the SDGs

Private equity investors and their portfolio companies can **freely** incorporate the SDGs into their work without any formal commitments, official certifications, membership dues or other requirements. For GPs, both PRI and SASB have developed guidance and other tools that may prove useful. For example, PRI's ***The SDG Investment Case*** helps investors answer key questions, such as, "Why should I consider the SDGs relevant to my investment strategy, policy, asset allocation, investment decisions and active ownership?" Meanwhile, the ***SASB Industry Guide to the SDGs*** provides an overview for investors and companies to build their understanding of the important and actionable interconnections between SASB standards and the SDGs.

Figure 6. Unlocking Private Capital for the SDGs



Using the 169 targets associated with the 17 SDGs is key to the credibility and accountability of company and investor claims when mapping firm activities to the Goals. In linking measur-

6 BNP Paribas, *The ESG Global Survey 2019* (April 10, 2019).

7 PwC, *SDG Challenge 2019: Creating a Strategy for a Better World* (2019).

8 MSCI and OECD, Institutional Investing for the SDGs (December 2018).

able SASB Standards with the SDG targets, investors and corporations can identify opportunities to contribute to and benefit from the market opportunities unlocked by sustainable development.

However, the specific opportunities available to investee companies will vary across an investor's portfolio. Many of the SDGs are highly relevant to value-creation in the context of certain business models, but largely irrelevant to others. For example, global progress on improving health and well-being (SDG 3) may present a range of opportunities to businesses in the Health Care and Food & Beverage sectors, while having relatively little effect on firms in the Extractives & Minerals Processing sector. The unlocking of private capital in the context of the SDGs relies on investors' ability to find the "sweet spot," where harms are reduced, positive impacts are achieved, and financial risk-and-return targets are met.

Figure 7. Links Between SASB Standards and the SDGs

EXAMPLE: AGRICULTURAL PRODUCTS

Returning to our AgriCo example, we previously outlined how to use SASB, PRI, and TCFD guidance to inform a GP's pre-transaction due diligence or post-transaction risk assessment on key climate risks facing the business. SASB Standards can also serve as a bridge, from viewing these factors as drivers of financial risk and return to considering how they may also contribute to environmental and societal outcomes.

Recall that IMP measures impact across five dimensions: "What," "Who," "How Much," "Contribution," and "Risk." The "What" dimension highlights the outcomes the enterprise is contributing to. Classifying outcomes into one or more of the 17 SDGs (and their accompanying 169 targets) provides enterprises and investors with macro-level insights into how their micro-level actions are contributing to, or detracting from, the global Goals. To better understand impact using this SDG overlay on the IMP's impact dimensions, companies and investors can also leverage SASB's mapping to the SDG targets to provide data-driven assessments. For example, in the case of AgriCo, we can quickly identify two SASB disclosure topics—GHG Emissions and Ingredient Sourcing—that if effectively managed during the hold period may influence the following SDG targets:

- SDG Target 2.4: By 2030, ensure sustainable food production systems and implement resilient agricultural practices that increase productivity and production, that help maintain ecosystems, that strengthen capacity for adaptation to climate change, extreme weather, drought, flooding and other disasters and that progressively improve land and soil quality.

- SDG Target 8.4: Improve progressively, through 2030, global resource efficiency in consumption and production and endeavor to decouple economic growth from environmental degradation, in accordance with the 10 Year Framework of Programmes on Sustainable Consumption and Production, with developed countries taking the lead.
- SDG Target 12.2: By 2030, achieve the sustainable management and efficient use of natural resources.

Whether a GP is intentionally focused on driving impact or not, they can use the linkages SASB has identified between financially material ESG issues and impact outcomes to engage with portfolio companies on opportunities to create value that delivers multifaceted returns: financial, environmental, and social. Demonstrating this activity through GP communication via widely accepted and supported SDGs creates a win-win scenario for investor and other stakeholders, unlocking the power of markets to effect change at scale.

ONEX

Practitioner Application: ONEX Corporation

Onex' ESG Committee, which provides strategic direction to their ESG program, chose the SASB Standards as the foundation for integrating ESG analysis into its private equity, private credit and wealth management platforms. Onex selected SASB given its identification of industry-specific, financially material issues, which help steer investment-specific value creation and risk mitigation strategies in both due diligence and the investment period. SASB's broad market acceptability and congruence with other ESG industry initiatives was also an important consideration for determining to integrate SASB.

Within each platform, senior-level ESG champions steward the platform strategy while the investment teams drive implementation of ESG diligence and monitoring. To illustrate, the investment teams at Onex's flagship private equity fund, Onex Partners, integrate SASB Standards, consider physical and transitional climate change risks as defined by TCFD, and identify alignment to the UN SDGs in their portfolio company investment analysis. Onex believes that adding TCFD and UN SDG elements helps to consistently address factors important for monitoring and reporting purposes.

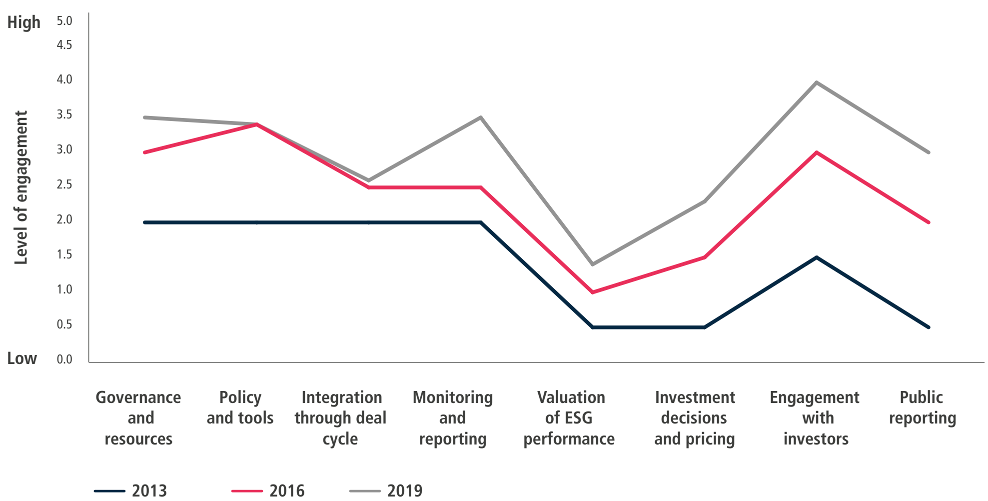
ESG IN THE INVESTMENT PROCESS

Key contributors to the ecosystem and their interconnections offer flexible and scalable pathways to effective integration. In a vacuum these insights can feel daunting to apply and disconnected from the day to day exercise of investing. In this section, we will overlay these interconnections and insights from the ecosystem onto the various phases of the investment process. Additionally, guidance from notable actors within the private equity industry and their views on ESG integration are included to further highlight overlapping insights and areas of potential integration within the various phases of the fund lifecycle.

DEMYSTIFYING THE ECOSYSTEM

The previous section illustrates how SASB Standards can help GPs identify, measure, manage, and communicate business-relevant sustainability factors in alignment with other key initiatives in the ESG ecosystem. Taking advantage of SASB's unique focus on financial materiality, investors can implement guidance from leading ESG initiatives on due diligence, active ownership, and reporting. Due in large part to the efforts of these initiatives and others in the ESG ecosystem, GPs have already begun to adopt various forms of ESG integration across all phases of the fund lifecycle.

Figure 8. Increasing Sophistication of ESG Integration in Private Equity



Source: PwC PE Responsible Investment Survey 2019

That said, the degree of ESG integration varies considerably from phase to phase. For example, relatively few private equity investors report robust integration of ESG into core investment activities—such as valuation and investment decisions—compared to policy-setting, communications, and engagement.[9] (See Figure 8). In fact, among 431 private equity firms that directly

9 PwC, *Older and wiser: Is responsible investment coming of age? (2019).*

invest and commit to PRI's principles, just one in eight (less than 13 percent) publicly disclose that they receive ESG reports from their portfolio companies. Only 16 (less than 4 percent) share whether ESG issues impact financial performance.[10] Even in the relatively engaged phases, firms integrating ESG factors represent a small minority of the nearly 9,000 GPs and $3.4 trillion in assets under management represented by private equity firms.[11]

There are several reasons for this modest level of integration. For instance, GPs making direct investments with control positions have far more opportunities to engage in each of these phases versus those making minority or debt investments where access to information and degrees of influence are less available. Additionally, a key enabling factor to increase integration is demystifying the ESG ecosystem, making it easier for private equity investors to understand where ESG can add value within different phases of the fund lifecycle.

The previous section introduced key initiatives within that ecosystem and emphasized the role of SASB Standards as a common thread:

- With **PRI** guidance and tools, investors can enhance due diligence, improve GP-LP dialogue, and more effectively monitor and report business-relevant ESG factors.
- **TCFD** recommendations more specifically support consideration of climate-related risks and opportunities during due diligence, the integration of related metrics into monitoring and reporting, and communications among portfolio companies, GPs, and LPs about the actual or potential effects of climate change on risk and return.

10 PRI, *PRI Reporting Framework 2018: Snapshot Report – RI Practices in Private Equity (February 2019).*

11 EY, *A New Equilibrium* (October 2019).

Additional Guidance from Within the Industry

The ESG ecosystem has been shaped in part by contributions from key organizations within the private equity investment industry.

For example, in response to changing and diverse expectations around the disclosure of ESG information from GPs and on their portfolio companies, the **BVCA** developed a Responsible Investment Toolkit and, with contributions from **Invest Europe,** over 20 Private Equity Associations, 10 private equity firms and 40 investors in private equity from 11 countries, developed an **ESG Disclosure Framework for Private Equity**. The framework addresses disclosure by GPs during fundraising and throughout the life of the fund, and served as key foundational work for current UN PRI guidance for Private Equity investors.

Meanwhile, since 2006, **CDC** has provided an **ESG Toolkit** aimed at private equity fund managers in emerging markets. The Toolkit is an easy-to-use reference guide for assessing and managing ESG risks, impacts and opportunities.

ILPA produces industry best practices aimed at improving the private equity industry for the long-term benefit of all industry participants and beneficiaries, and has detailed its views on ESG integration in its set of principles with its **third edition** released in 2019. Additionally, ILPA has developed a **Due Diligence Questionnaire** (ILPA DDQ) which aims to standardize the most frequent and important diligence questions posed by investors and includes a dedicated section focused on ESG. In its most recent version, the ILPA DDQ includes question 10.5: "Does the Firm make formal commitments relating to ESG integration in fund formation contracts, Limited Partnership Agreements, or inside letters when requested by investors?" This question's relevance, and GP commitments identified in an answer to the question, cut across all phases of the fund lifecycle.

These resources inform the discussion below about how private equity investors can use SASB Standards as a foundation upon which to base their ESG integration commitments and practices across the fund lifecycle.

- As frameworks and coalitions focused on broader social and environmental outcomes, **IMP** and the **SDGs** can inform strategy around broader impact goals, facilitate asset-level engagement, and portfolio-level reporting.

In the sections below, we'll highlight how the guidance developed by these initiatives and other key players in the private equity space (see "Additional Guidance from Within the Industry") may be applied in each phase of the fund lifecycle. As this discussion will demonstrate, private equity investors can use SASB Standards to flexibly apply widely-accepted approaches to ESG integration.

INTEGRATION THROUGH THE DEAL CYCLE

Sourcing & Due Diligence

CDC's guidance notes that certain ESG factors can play an important role in "informing investment decisions by understanding the potential related liabilities, costs and influence on financial performance, and potential opportunities for value creation." During the due diligence phase, GPs can identify potential ESG metrics to inform post-investment action plans, use in monitoring the company's progress and reporting for LPs, and to effectively convey the company's strategic value on exit.

The BVCA Responsible Investment Toolkit recommends that GPs evaluate inherent sector ESG risks for investment teams. GPs apply a pre-defined materiality threshold informed by these sector risks to focus due diligence and assess findings related to ESG issues (e.g., financial implications above a defined limit, potential for business interruption, or legal compliance issues). BVCA additionally suggests that GPs identify and assess risks (e.g., potential liabilities, current/future capital or operational expenditure costs, need for additional human resources, or management time inputs), and factor in opportunities (e.g., new markets, income streams, or efficiencies) during due diligence where they are able to obtain this information from the target company.

As standards developed to identify ESG issues that materially impact financial fundamentals such as revenue impacts, operating costs, asset value, impact on liabilities, and financing costs, SASB Standards can provide the data inputs needed to operationalize the CDC Guidance, and BVCA Responsible Investment Toolkit and thus provide investors with a clearer understanding of ESG-related risks and opportunities that can impact valuation and a firm's sustainable growth potential.

EXAMPLE: AGRICULTURAL PRODUCTS

Let's return to the AgriCo example. We previously discussed the company's direct Scope 1 emissions in the context of implementing TCFD guidance during due diligence. However, agricultural products companies also face ESG risks and opportunities not directly tied to climate change that merit consideration ahead of an investment decision. (See Table 4).

Table 4. Non-Environmental Dimension SASB Material Issues in the Agricultural Products Industry

Sustainability Dimension	Material Issues
Social Capital	Food Safety
Human Capital	Workforce Health & Safety
Business Model & Innovation	GMO Management
Business Model & Innovation	Environmental & Social Impacts of the Ingredient Supply Chain
Business Model & Innovation	Ingredient Sourcing

For example, issues such as food safety and the management of increasingly complex, global ingredient supply chains are critical to AgriCo's business model. Data from the Centers for Disease Control and Prevention suggest that each year in the US there are 48 million episodes of foodborne illnesses resulting in 128,000 hospitalizations and 3,000 deaths.[12] Agricultural products companies must meet high food quality and safety standards to maintain consumer confidence.

Table 5. SASB's Financial Impact Channels for Food Safety in Agricultural Products Industry

Revenue			Operating Expenses		Non-Operating Expenses		Assets		Liabilities		Risk Profile	
Market Share	New Markets	Pricing Power	Cost of Revenue	R&D	CapEx	Extraordinary Expenses	Tangible Assets	Intangible Assets	Contingent Liabilities & Provisions	Pension & Other Liabilities	Cost of Capital	Industry Divestment Risk
■ High Impact	■ Medium Impact	■ Medium Impact				■ High Impact		■ High Impact	■ Medium Impact		■ High Impact	

■ High Impact ■ Medium Impact

When companies in the supply chain mismanage this issue, product recalls can adversely impact sales and reputation. This may lead to trade restrictions and import bans due to concerns about food safety.

Focusing on ingredient supply chains, GPs can again develop a more comprehensive understanding of embedded risks and opportunities through targeted questioning. The **SASB Engagement Guide** recommends pursuing the following lines of discussion:

- How does the company assess and address supplier performance on issues related to social and environmental responsibility? What is the company's process to improve areas of poor performance?
- What is the company's exposure to environmental and social risks arising from contract growing and commodity sourcing, and what strategies does it use to manage these risks?

A target company's answers -or lack thereof- to the questions highlighted in the AgriCo example from the SASB Engagement Guide can inform potential plans for post-investment actions or offer useful insights on key medium-term impacts to financial drivers such as capital expenditures, cost of revenue, and cost of capital considerations.

These factors will be of keen interest to a financial sponsor or strategic buyer during their own due diligence and hold period as the initial GP exits the investment.

12 Centers for Disease Control and Prevention, Estimates of Foodborne Illness in the United States (2011).

The Hold Period

A growing body of research on the financial materiality of ESG issues and the varying timelines in which these issues unfold provides important context for the post-investment hold period. The median hold period for a PE-owned portfolio company is 4.5 years.[13] If there are preconceived notions that ESG issues only play out in the long term, GP's may deprioritize sustainability initiatives and miss opportunities. In reality, these issues can play out during the typical hold period and may influence the success of the company in its next period of ownership.

GPs who equip a company to succeed both during their investment period and in its next period of ownership could influence the exit price paid and/or the ease of sale. When examining potential candidates in the next ownership period, strategic corporate buyers who are subject to increasing ESG disclosure requirements from regulators and exchanges may focus on these factors. Similarly, continued demand from LPs for ESG information can bring these factors into view for potential sale to other GPs.

The BVCA Responsible Investment Toolkit suggests that ESG considerations should be integrated with other traditional initiatives wherever practical, such as financial assessment and monitoring portfolio companies' adherence to best practices. Beyond the metrics and thresholds assessed during due diligence, GPs should establish a set of key performance indicators (KPIs) for financially material ESG impacts, collect baseline data, and set targets for improvement at both the portfolio and asset level. Company-level ESG performance improvements (and related return improvements) can be contextualized as part of their management process and reported to investors and the public.

SASB Standards provide key performance metrics using verifiable data applicable to most companies in an industry. Just as SASB data supports BVCA operationalization in sourcing and due diligence, so can it enable benchmarking, monitoring, and target-setting using quantitative KPIs. In addition, SASB Standards are designed to yield qualitative data to provide vital context and improve the decision-usefulness of SASB disclosures, directly enhancing traditional hold period engagements with ESG information.

EXAMPLE: AGRICULTURAL PRODUCTS

Let's explore how the BVCA Responsible Investment Toolkit pertains to AgriCo's time horizon. Recalling this is a family owned and run business, the GP or family may insist on a continued ownership stake for the family. This would help to align incentives for a successful transition and continued operational improvements to ultimately enhance and protect enterprise value. It also may create ongoing alignment of interests in managing ESG issues that play out over near-, medium-, and long-term time horizons, including a subsequent change of ownership via GP and/or family exit. By focusing on climate and its impact on AgriCo's operations, a GP can support AgriCo in setting targets for improvement to best position the company's future operations.

Based on AgriCo's business model and risk exposure, there are opportunities to address its Scope 1 emissions through improvements to its processing facilities and transportation fleet, as well as through its ingredient sourcing practices for its current product mix without extending into newer products, which may be inconsistent with the GP's hold period, as detailed in Figure 9.

13 Ken Pucker and Sakis Kotsantonis, "Private Equity Makes ESG Promises, But Their Impact Is Often Superficial," *Institutional Investor* (June 29, 2020).

Figure 9: Timeliness of Materiality

Agricultural Products Industry - Material Issues Effecting Climate

	Scope 1 Emissions	Scope 1 Emissions	Ingredient Sourcing	Ingredient Sourcing	Ingredient Sourcing
	AgriCo Business Relevance				
Time Horizon	Processing Facilities	Transportation	Peanut Oil	Cocoa	Product Mix
Short Term - Potential Financial Impact			Cost Of Revenue		
Medium Term - Potential Financial Impact	Cost Of Revenue CAPEX Cost Of Capital	Cost Of Revenue CAPEX Tangible Assets	Market Share Cost Of Revenue CAPEX Cost Of Capital	Market Share Cost Of Revenue CAPEX Cost Of Capital	
Long Term - Potential Financial Impact					Market Share Cost Of Revenue CAPEX Tangible Assets Cost Of Capital

The GP can leverage SASB to enact PRI's TCFD guidance in part by engaging with AgriCo's management team, either in due diligence or as part of an active post-investment strategy. This engagement may explore receptivity to opportunities to sign long-term leases with coffee producers to shift cocoa cultivation based on changing weather and precipitation patterns associated with climate change. These actions have the potential to secure the supply chain, avoid significant disruption and improve crop yields leading to preservation or enhancement of enterprise value. A result of action around this type of GP to portfolio company-level engagement can lead to meaningful outcomes around food security for a growing population (SDG #2 Zero Hunger) and optimal use of land for local communities (SDG #15 Life on Land).

AgriCo may also consider strategic partnerships with key suppliers to reinforce or redesign harvesting facilities to increase their resiliency and reduce the likelihood of significant disruptions resulting from severe weather. Actions to achieve this can include an initial climate risk assessment of supplier facilities and operations, with the goal of completing assessments on 100% of facilities within 12 months of the GPs investment. Additionally, the GP can work with AgriCo to prioritize engagement with suppliers that present the greatest risk based on this initial assessment. For AgriCo's processing facilities, completing a structural integrity review for 100% of owned and operated plants, and developing a 3-year plan to address critical findings to ensure facilities are resilient to potential heightened storm frequency and intensity addresses financially material ESG impacts, provides baseline data, and identifies opportunities to set targets for improvement. Information produced by this process can be presented by GPs to LPs (as well as other subsequent potential buyers) to instill confidence regarding the resiliency of AgriCo's business.

Additionally, potential regulations designed to limit Scope 1 emissions may emerge over the medium- to long-term. Fuel efficiency standards in some markets may mandate early retirement or replacement of portions of AgriCo's transportation fleet with more fuel efficient vehicles. Such developments may result in significant increases in direct expenses associated with generated emissions and require additional capital expenditures to replace existing transportation fleet infrastructure. As such, the GP and AgriCo can explore several strategies to mitigate these risks, such as setting targets to reduce its overall energy consumption with a shift to renewables. To accomplish this, AgriCo can perform an assessment of its transportation fleet and establish an early retirement and replacement plan to achieve fuel consumption reduction targets.

When used together, SASB helps identify financially material ESG issues, PRI's TCFD Guidance puts these issues in context of an overall implementation plan, the SDGs highlight meaningful opportunities where outcomes and impacts can be linked and contributed to, and SASB adds actionable data to empower GPs and their companies to make decisions surrounding these issues. As a result, hold period engagements are enhanced and a company may be better positioned.

Reporting

SASB's Standards are linked to fundamental financial impacts and thus support the development of reasonable, collaboratively-identified thresholds. SASB disclosure also encourages entities to use metrics to assess and manage KPIs related to risks and opportunities in investor-focused communication.

In their ESG toolkit, CDC highlights the importance of consulting with the company and agreeing upon the KPIs that will be used to monitor key ESG factors early in the investment phase. These metrics can help to focus management and employees on material business issues, and help to build commitment as well as track and chart improved performance.

The ILPA Roadmap advises that GPs need to adopt "a framework to measure, audit and report on the impacts achieved by the fund." To facilitate the measurement, assessment, and tracking of KPIs, ILPA developed the **Portfolio Company Metrics Template (PortCo),** which includes an ESG section. Historically, LPs have requested this information from their general partner managers (GPs), often in bespoke formats. The PortCo Template standardizes this request so that LPs can receive more timely and consistent data, while GPs can report more efficiently without the burden of completing multiple, customized forms from each of their LPs. Released in 2019, the PortCo Template gives the option to measure multiple ESG issues, establish targets, and monitor progress associated with each one. The PortCo Template includes SASB as an ESG standard-industry classification to describe material ESG issues. Notably, the Template also aligns key columns with PRI Reporting framework guidance.

EXAMPLE: AGRICULTURAL PRODUCTS

Based on AgriCo's business model and GP-informed identification of operational improvements and communication, a SASB Standard is used to convey its progress toward achieving collaboratively determined goals.

Greenhouse Gas Emissions

	Year Ended December 31,		
Metric	2016	2017	2018
Gross global Scope 1 emissions, in thousands of metric tons $CO_{2\text{-}e}$	9,625	9,125	8,800
Fleet fuel consumed in GJ	807	772	740
Percentage renewable	5%	8.5%	16%

As mentioned previously, AgriCo's emissions primarily consist of direct emissions from its processing facilities as well as its transportation fleet. A successful implementation and shift to renewables can reduce emissions. SASB Standards can be used to report progress towards its goals for emissions reductions as seen above.

Ingredient Sourcing

	Year Ended December 31,		
Metric	2016	2017	2018
Percentage of agricultural products sourced from regions with High or Extremely High Baseline Water Stress	20%	12%	10%

AgriCo faces product-specific risks associated with both acute and chronic physical climate risk. As part of its risk assessment process, AgriCo has identified long-term shifts in precipitation patterns that may impact its peanut oil & cocoa supply chain and has begun engaging suppliers to develop long-term plans to develop irrigation strategies and/or re-optimize cultivation areas. SASB Standards can be used to report progress towards its goals to securing the supply chain from changing precipitation patterns as seen above.

With SASB Standards, GPs can better meet CDCs recommendations and populate the PortCo Template with financially material ESG information to improve ease and timeliness of communication. Notably, effectively deployed strategies paired with KPIs can showcase GPs and their portfolio companies contributions to outcomes and impacts key to the goals of the TCFD, IMP and the SDGs.

CASE STUDIES

We'll now move beyond the hypothetical example of AgriCo and onto the real experience of two GPs. In the following case studies, Generation Investment Management and Partners Group describe where they derive value from the ESG ecosystem and apply some of the above tools and resources to their investment processes.

(These case studies solely reflect the work and experience of Generation Investment Management and Partners Group. SASB was not involved in the firms' work with portfolio companies in any way)

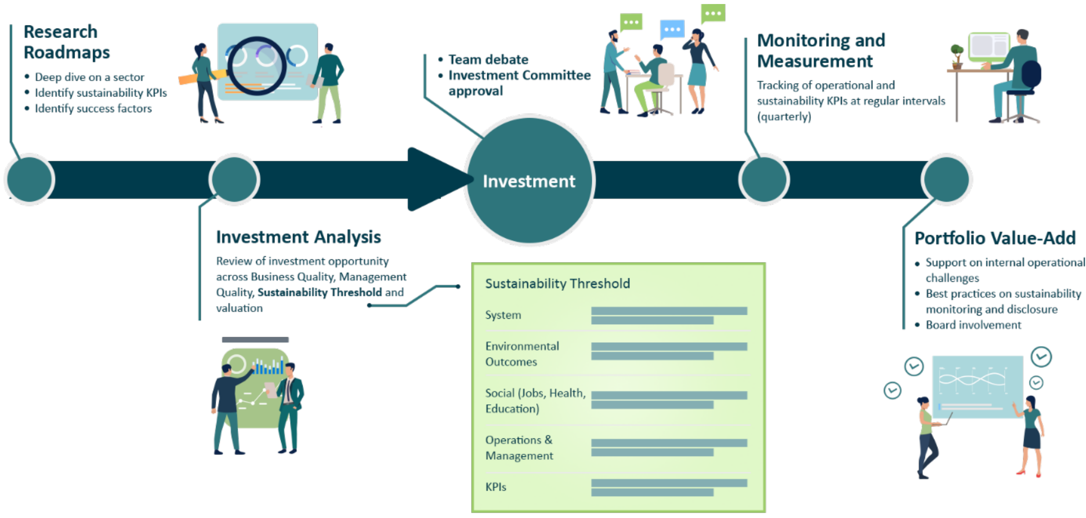
GENERATION INVESTMENT MANAGEMENT

Since its founding in 2004, Generation is dedicated to furthering Sustainable Capitalism, by delivering long-term returns through investing in sustainable companies. Sustainability research has been a core part of our mission and our process for 16 years. Over this time, we have supported and taken part in a number of initiatives aimed at improving and standardizing sustainability management, measurement and reporting. As such, over time, we have incorporated content and guidance from the ESG ecosystem at various phases of the investment process, refining our assessments and with the desire to contribute to alignment and sharing of best practices within the industry.

At Generation, we see our process as a distinctive characteristic of our strategy and a key differentiating factor, which drives both our financial returns and the outcomes we can foster. A team-based approach is central to our process, and key to the integration of sustainability in our investing strategy. There is no separate ESG or impact team at Generation. We are all responsible for the alignment of our investments with a sustainable world view. Our process starts with Research Roadmaps, which are deep dives on a specific sector aimed at identifying sustainability KPIs, success factors and promising opportunities in each space.

CASE STUDY

Figure 11: Generation's Investment Process



Sustainability frameworks and standards are utilized at different points across our investment process. The table below aims to summarize the most important ones:

Figure 12: ESG Ecosystem Players Applied to Generation's Process

RESEARCH ROADMAPS	INVESTMENT ANALYSIS	MONITORING & MEASUREMENT	PORTFOLIO VALUE-ADD
SDGs TCFD	TCFD	SASB IMP	SASB TCFD

Our areas of interest fall within three Impact Areas: Planetary Health, People Health and Financial Inclusion. While not a driver of our research focus, we track how each Roadmap, and each company in our portfolio, addresses the Sustainable Development Goals at the target level.

CONVOY Application: Our Research Roadmap on the Digital Freight Marketplace in 2018 highlighted the potential for disruption that tech could have in the traditional freight broker model, leading to significant operational cost savings in the $800 billion trucking industry. In turn, improved efficiency was highly needed in an industry which generates 72 million metric tons of wasted CO_2 emissions annually from empty trucks driven in the full truckload (FTL) segment alone, in the USA. This highlighted the potential impact of this space on SDG 13, Climate Action.

Moreover, SASB Standards identify GHG emissions as a financially material sustainability issue to several transportation industries.

After opportunities are uncovered through the Research Roadmaps, the investment team members deepen conversations with companies of most interest, seeking to unlock investable opportunities. When one is deemed attractive, the deal team presents its Investment Analysis to the broader team. In this stage, the team debates the Business Quality, Management Quality and the Sustainability Threshold of the company.

In particular, our Business Quality framework highlights the potential for a business to achieve profitable growth and return on investment, underscoring areas such as network effects, unit economics, customer ROI, pricing power and its ecosystem's characteristics.

CASE STUDY

The Management Quality framework focuses on the management team's track record and fitness for their roles, and governance issues such as Board structure, alignment, and diversity.

Finally, the Sustainability Threshold enables us to outline the main positive outcomes for a proposed investment, as well as ensure other key areas do not present negative unintended consequences. It is delineated across five areas. The first three areas are related to "WHAT" a company does, broken down across System, Environmental and Social outcomes. One further area is related to "HOW" a company operates, i.e. Operations and Management. Finally, we consider KPIs (or metrics) that the team proposes to track the outcomes above, keeping in mind the IMP five dimensions. Here our process focuses on highlighting climate-related risks and opportunities in line with the Risk Management process recommended by the Task Force for Climate-Related Financial Disclosure.

CONVOY Application: Among the various companies under considerations, we identified Convoy as one of significant interest. Convoy is a digital freight marketplace that connects shippers to carriers to move hundreds of thousands of truckloads, leveraging technology, advanced analytics and an automated centralized decision-making platform, saving money for shippers, increasing earnings for carriers, and reducing carbon waste for the planet.

In line with the TCFD analysis, in the case of Convoy we identified a significant opportunity in the transition to a low-carbon economy, which the company directly enabled. In particular, Convoy's solution reduces empty-freight miles by 45%, from ca. 35% in the industry to 19% with Convoy. In terms of physical risks, we deemed that Convoy may have limited exposed on the transportation infrastructure it relies upon.

As active investors and owners, we support our portfolio companies through engagement, helping them as needed in different parts of their value proposition, and helping them incorporate best practices to optimise their impact. In particular, we kick off Board level conversations with all of our companies within the first 100 days of ownership to help them enact best practices of integrated measurement and Board reporting over time. This, in turn, forms the basis for our sustainability reporting to our investors.

We view our work with portfolio companies as a key activity that amplifies our outcomes, both directly as we support our companies to develop their own internal impact practices, and indirectly as the growth of these companies has a direct relationship with positive system-level outcomes across our impact areas. We firmly believe this is instrumental in creating economic value for our investors as well.

We align our impact measurement using two main tools: the SASB Standards and the Impact Management Project (IMP). We chose SASB Standards for disclosure to assess HOW our companies operate. Its industry-based approach focuses on materiality and financial impact is particularly aligned with our worldview, and its broad mandate and wide uptake amongst public companies make it an aspirational standard for our private companies. In addition, we align our investors' reporting to the IMP framework for what concerns the main outcome(s) within one of the three Impact Areas, because we value its precision and comprehensiveness. For this, we used extensive customer surveys based on the Lean Data approach to corroborate our findings.

CONVOY Application: In our SASB-aligned investors' reporting on HOW Convoy operates, we picked the relevant industry Standards of Software and IT Services (Primary) within Technology & Communication, and Road Transportation (Secondary), within Transportation.

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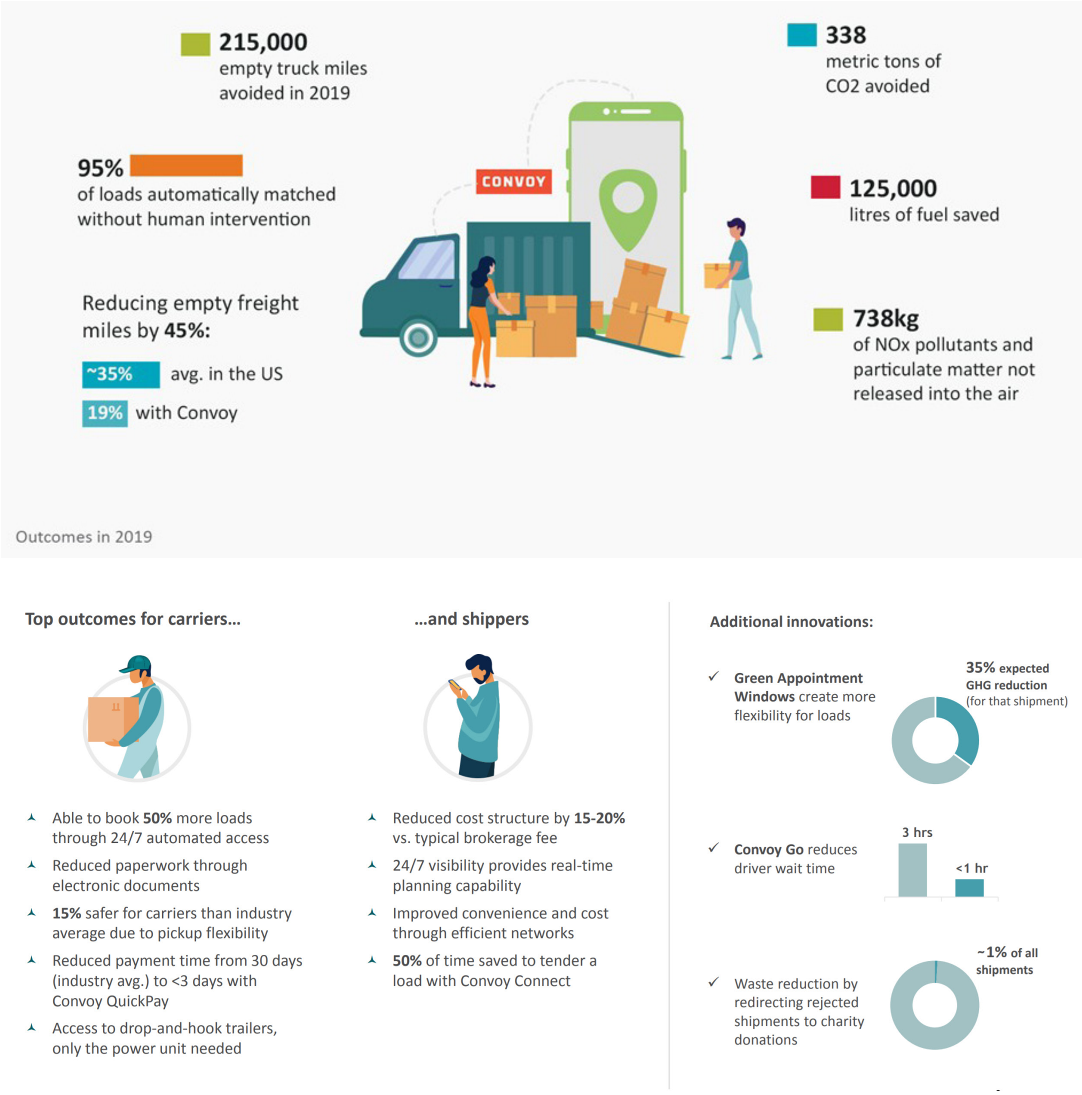
GHG Emissions Scope 1 and 2 are a component of SASB's Standards for the transportation sector, however we note that, due to the early stage of our companies, we found that none report these metrics at this stage, an area which we have identified as an opportunity for value creation which we can bring. Moreover, we note that for most of our companies, as is the case of Convoy, the bulk of the impact happens in the Scope 3 through emissions avoided in their sector. We account for this through a Life-Cycle Assessment. In addition, we particularly value Human-Capital related indicators, as we find that employee retention, diversity and engagement are insightful data-points that can be predictive of a company's performance over the long run.

In terms of the WHAT, we reported using the IMP framework, focusing on the tons of CO_2 avoided, litres of fuel saved and kg of pollutants not emitted in the air to determine "How Much" impact is occurring. Moreover, we assessed that the "Contribution" was high, given that in the absence of Convoy's data-driven platform, load matching would have happened manually at much lower efficiency. Finally, we found that the "Impact Risk" was limited and centered on the company's ability to survive and operate.

Figure 13: 2019 Impact Outcomes for Convoy



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Core to our ability to link sustainability research to value creation is the integration of ESG analysis at every step of the process – from research and pipeline development through to diligence, ownership and ultimately exit.

As the ecosystem continues to evolve, we remain very active participants and supporters of a number of initiatives with the hope that increased collaboration across the industry brings improved transparency and comprehensibility to results.

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PARTNERS GROUP

Partners Group is a global private markets investment manager committed to integrating ESG into investment due diligence and active ownership on behalf of its clients. We believe that ESG strengthens our investment approach by identifying material risks and value creation opportunities that could otherwise be overlooked without an ESG lens. Partners Group has developed an industry-leading approach to responsible investment, which takes into account industry ESG standards and principles, such as those outlined by SASB, and the UN Principles for Responsible Investment (PRI). When we seek to achieve positive impact through a company's product or services, we align our unique strategy with principles from the Impact Management Project (IMP) and the United Nations Sustainable Development Goals (SDGs) to achieve meaningful outcomes. Our consistent achievement of A+ ratings from UN PRI over the last six years speaks to the rigor of our responsible investment approach. We support our peers in adopting these standards and frameworks by sharing how we apply them in our investment process. In this way, we hope to promote greater transparency and comparability in ESG and impact integration across the industry.

This case study outlines how Partners Group navigates the ESG ecosystem, and how our approach has been shaped by key principles, frameworks, and industry standards shaping responsible investment, ESG, and impact integration. To demonstrate the practical application of these concepts, the case study examines our direct equity investment in EyeCare Partners, the largest vertically integrated medical vision services provider in the US, which we acquired in December 2019 on behalf of our clients. While this case study will focus specifically on SASB, UN PRI, IMP, and the UN SDGs, the Task Force on Climate-related Financial Disclosures (TCFD) framework is also an important tool in our ESG toolbox. As an eyecare services platform, climate change is not a high-materiality consideration for EyeCare Partners, however, the TCFD framework has helped to shape our broader climate change strategy, which is especially relevant for our industrial and infrastructure investments.

Due Diligence

PRI's Principle 1 calls for investors to "incorporate ESG issues into investment analysis and decision-making processes." This principle is demonstrated by the ESG integration in Partners Group's due diligence processes across our four asset classes. This case study focuses primarily on ESG integration in our direct equity investments; however, we also use PRI resources when we adapt our ESG due diligence approach to the nuances of each asset class. For example, for primary and secondaries investments, our Due Diligence Questionnaire for investment managers is compliant with UN PRI's Principles. We also engage with UN PRI to maximize our ESG integration in debt investments.

To put PRI's Principle 1 into action, SASB Standards are useful when identifying material ESG considerations. Specifically, Partners Group has developed a proprietary ESG assessment tool employed by investment teams across our private equity, infrastructure, real estate and debt investment teams. Using SASB Standards, the tool identifies the most material ESG topics for a target investment by automatically flagging the most relevant SASB disclosure topics and metrics based on the target's industry and sector. Investment teams use these SASB disclosure topics and metrics as a roadmap for ESG due diligence.

The due diligence process for Partners Group's investment in EyeCare Partners demonstrates how this tool works in practice for direct equity investments. EyeCare Partners is the largest vertically integrated medical vision services provider in the United States. Under SASB's classification, the company falls within the healthcare sector and healthcare delivery industry. Based on SASB Standards for this industry, our ESG assessment tool flagged the most material SASB

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disclosure topics for the company, such as patient privacy, employee retention, and pricing transparency.

Guided by these disclosure topics, our investment team worked with an external ESG due diligence provider to evaluate EyeCare Partners' performance by collecting data on specific SASB metrics tied to each disclosure topic. This data helped the investment team to form a view on ESG risks and value creation opportunities, which they outlined in the investment memo for consideration by Partners Group's Global Investment Committee. Specific examples of the key SASB disclosure topics and associated metrics reviewed during due diligence are outlined in the table below.

Figure 14: Examples ESG Due Diligence Considerations for EyeCare Partners based on SASB Standards

Issue Category	SASB Disclosure Topic	SASB Accounting Metric
Data Security	Patient Privacy & Electronic Health Records	Number of data breaches, percentage involving personally identifiable information, and number of customers affected in each category
Employee Engagement, Diversity & Inclusion	Employee Recruitment, Development & Retention	Voluntary and involuntary turnover rate for employees
Selling Practices & Product Labeling	Pricing & Billing Transparency	Description of policies or initiatives to ensure that patients are adequately informed about price before undergoing a procedure

*To view SASB's Health Care Delivery Standards and see a quick snapshot of SASB's other industry standards, the **Materiality Map** is a useful starting place.*

Active Ownership

Post-acquisition, Partners Group's approach to ESG integration is aligned with UN PRI Principle 2, to be "active owners and incorporate ESG issues in…ownership policies and practices." For Partners Group, this means systematically identifying and executing strategic, KPI-linked ESG value creation and protection opportunities for all direct lead investments. As in due diligence, we use SASB's Standards to operationalize UN PRI's Principle 2 during ownership.

For example, during due diligence, we identified two high-priority ESG topics for EyeCare Partners: (1) employee recruitment, development and retention and (2) data security. During ownership, Partners Group's ESG & Sustainability team will work closely with our investment and Industry Value Creation teams, and in partnership with company management, to strengthen performance on these topics. We have already begun the process of onboarding management to our ESG approach, identifying opportunities for action, and executing quick wins. For example, we have implemented an upgraded HR Information System and are working closely with management on a broader effort to enhance employee benefits to increase retention.

To make the case to management teams for prioritizing ESG, we leverage SASB's Financial Drivers' tool, combined with model projects from similar portfolio companies, to demonstrate how these ESG issues can create or protect value for the company. Specifically, SASB's basis for financial materiality of its Standards includes direct ties to income statement, cash flow and balance sheet factors for companies. This evidence-based determination helps reveal specific value creation and protection levers available through management of ESG issues likely to affect operating performance. This content is a factor in helping Partners Group to

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identify and explain to management teams exactly how specific ESG issues can impact financial performance.

As discussed, employee recruitment, development, and retention is an ESG priority for EyeCare Partners. SASB's financial drivers evidence indicates that, for healthcare delivery companies, performance on this topic can directly impact four financial drivers: (1) cost of revenue; (2) market share; (3) pricing power; and (4) intangible assets.

Employee Recruitment, Development & Retention - Financial Drivers

Revenue			Operating Expenses		Non-Operating Expenses		Assets		Liabilities		Risk Profile	
Market Share	New Markets	Pricing Power	Cost of Revenue	R&D	CapEx	Extraordinary Expenses	Tangible Assets	Intangible Assets	Contingent Liabilities & Provisions	Pension & Other Liabilities	Cost of Capital	Industry Divestment Risk
Medium Impact		Medium Impact	High Impact					Medium Impact				

High Impact   Medium Impact

To support these insights from SASB, Partners Group can draw on case studies from our existing portfolio to demonstrate why this ESG topic matters to the company. For example, we have a majority investment in a UK-based healthcare delivery company called Voyage Care, which has been working on employee recruitment, development, and retention since 2018. Projects and metrics related to this topic have been incorporated into the objectives for Voyage's Executive Committee and Senior Team. These include improving employee rewards and benefits, enhancing initiatives around employee health and wellbeing, reviewing and updating Voyage's learning and development curriculum, and conducting the company's first employee engagement survey. To measure Voyage's progress, Partners Group tracks employee turnover, one of SASB's key metrics for this topic. From 2018 to 2019, Voyage decreased its employee turnover rate by 2 percentage points, which directly impacts recruitment and training costs and productivity levels.

Using Voyage as a model, we will work with EyeCare Partners to implement similar projects that will drive progress on this topic. The primary goal of this work will be to achieve material improvement during our ownership period. SASB's Standards will help us to measure this improvement and articulate how EyeCare Partners has become a more valuable asset by managing key ESG issues.

SDG Alignment

Partners Group also uses key principles and frameworks in its strategy that aims to achieve impact beyond ESG integration. PG LIFE, our "impact-at-scale" investment strategy, has a dual mission of achieving attractive financial returns along with positive impact. The IMP principles contribute to our impact assessment methodology. We also incorporated the UN SDGs to shape our impact goals and believe SASB tools can support firms with their ongoing impact measurement and management.

The goal of PG LIFE is to invest in companies whose core products and services contribute to the achievement of the SDGs. This strategy relies on our proprietary impact assessment methodology, which assembles data and evidence to demonstrate how a particular investment's core business model drives impact on a specific SDG target. To determine the strength of this impact, our methodology employs the IMP's five dimensions to outline the "What", "Who", and "How Much" of the potential impact, as well as define PG's contribution to impact and identify any risks to achieving it.

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EyeCare Partners is a recent PG LIFE investment and an example of how Partners Group assesses SDG-alignment for PG LIFE candidates during due diligence. EyeCare Partners provides essential ophthalmology services, primarily to elderly patients who access services through Medicare. Our PG LIFE impact assessment for EyeCare Partners focused on determining the extent to which these core healthcare services contribute to SDG target 3.8, to "achieve universal health coverage, including financial risk protection, access to quality essential health-care services and access to safe, effective, quality and affordable essential medicines and vaccines for all."

Our impact assessment focused on two key considerations to determine EyeCare Partners' alignment with SDG 3.8: (1) service quality and safety and (2) access and affordability. To understand the company's performance on these topics, we examined data on access to care for low-income (Medicaid/Medicare) patients and patient satisfaction scores. This data provided evidence of EyeCare Partners' likely contribution to SDG 3.8, given the proportion of Medicare and Medicaid patients accessing critical ophthalmology services (representing more than half of patient visits), along with EyeCare Partners' strong patient satisfaction scores (including a Net Promoter Score well above industry average, as of the end of 2019).

In addition to assessing impact potential during due diligence, Partners Group seeks to actively measure and manage the impact of PG LIFE investments during ownership. The SASB Standards are useful for monitoring this impact on an ongoing basis. For example, SASB has aligned their Standards to the SDGs to identify how companies' operating activities link to the goals. Specifically, SASB has developed an SDG mapping tool that identifies connections between financially material ESG disclosure topics and SDG targets. For target 3.8, two important SASB disclosure topics are service quality and safety and access and affordability. Partners Group will continue to monitor these topics for EyeCare Partners, in order to assess the company's ongoing SDG contribution, disclose impact performance to PG LIFE investors and identify levers to scale impact during ownership.

Conclusion

This case study demonstrates how ESG standards and frameworks can be used during the investment process, from defining a firm's commitment to responsible investment to shaping the ESG due diligence process to measuring performance and impact during ownership. Our approach is one example of how private equity investors can adapt these standards, frameworks, and principles to complement their specific responsible investment strategies. Whatever approach investors take, the first step in using these tools is to understand what each offer before incorporating them into the relevant investment activities.

CONTINUED COMMITMENT TO SUPPORT INVESTORS

The above curated overlay of the ESG ecosystem onto the phases of the private equity investment process can be used by investors no matter where they are on their ESG journey. There is no prescriptive application of the principles, tools, and resources provided by ecosystem actors identified in this report, although we encourage investors to leverage points of integration among these resources to their benefit. By applying relevant interconnections among the ecosystem actors, GPs can commit to a curated set of resources to scale their efforts and move toward holistic ESG integration without significant financial outlay or straining of internal resources.

Should other components of the ESG ecosystem better fit GP or LP needs for their integration and evaluation of ESG considerations, we would be pleased to both learn about it and to share and/or explore how it may connect with SASB Standards in application.

SASB plans to continue educating and empowering GPs and LPs through future workshops, distributing integration resources, and demonstrating application from supporters incorporating the Standards. To provide feedback on this report or learn more about SASB's private markets work, please contact **Jeff.Cohen@SASB.org**.

If you would like to use the SASB Standards in your ESG integration efforts, please visit **SASB Licensing** or email **licensing@sasb.org**.