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FOR THE WORLD'S PRIVATE EQUITY MARKETS

PRIVATE EQUITY INTERNATIONAL

THE RESPONSIBLE INVESTMENT SPECIAL 2015

A PEI supplement

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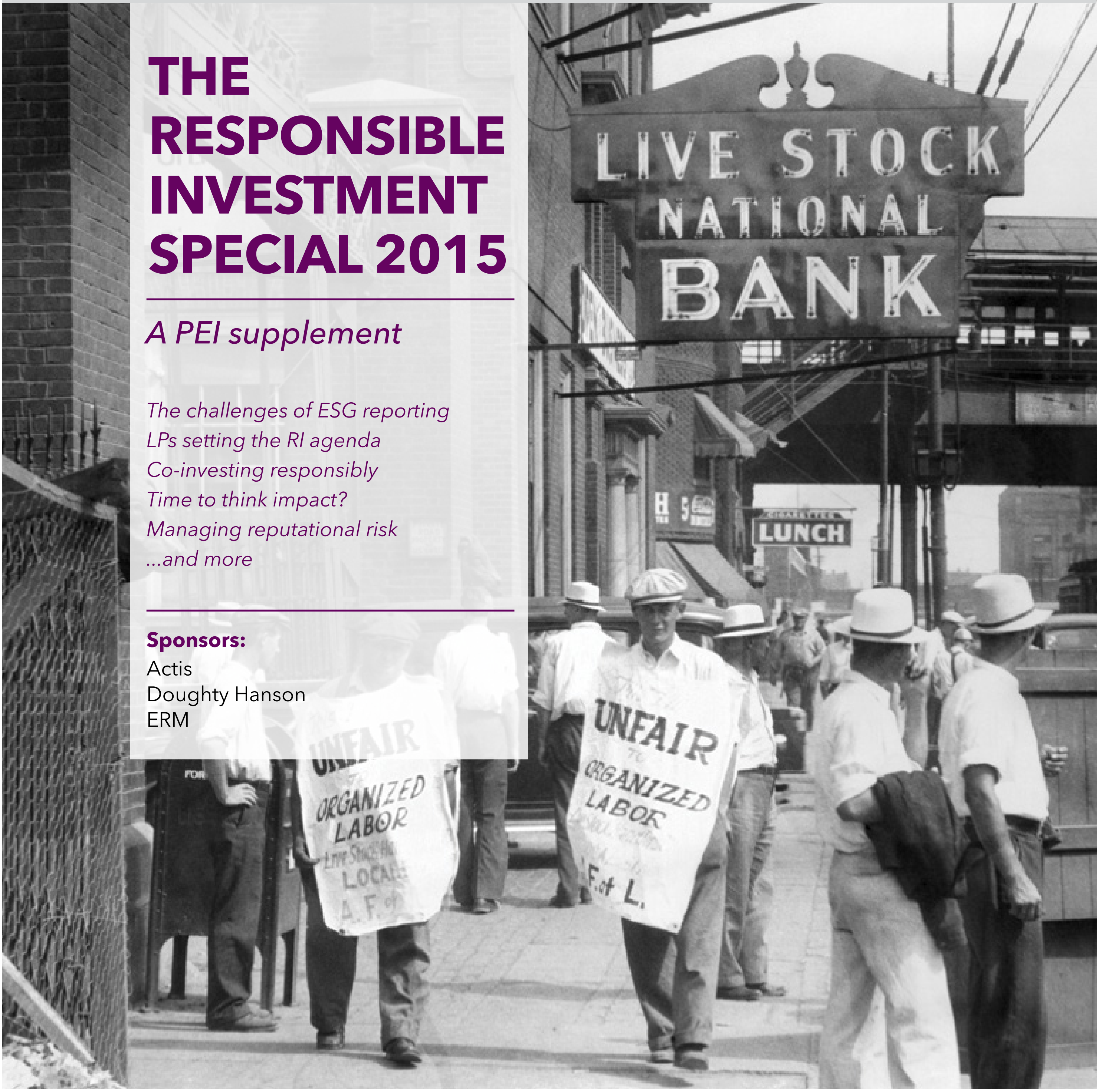


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The ESG imperative

PHILIP BOREL
EDITOR'S LETTER

One interesting fact about private equity is that it hasn't emerged from the financial crisis with a better reputation. It should have.

Financially, the asset class held up well in the post-Lehman years, and proved itself resilient under pressure. There have been losses, but the evidence suggests that many funds invested during '06 and '07 managed to avoid disaster. The case can be made that, relative to other investment classes, private equity's recent record has been rather respectable throughout.

It is worth noting too that private equity is still a largely scandal-free part of the financial world. Corporate misdemeanour and white-collar crime have been rampant elsewhere, perpetrated in particular by banks and rogue operators in the hedge fund world. Private equity firms on the other hand can by and large assert that they've played by the rules, steered clear of defrauding their investors and made sure their portfolio companies kept their noses out of trouble, too.

This isn't just accidental. Private equity is an industry that likes to pat itself on the back for being good at aligning interest and exerting effective governance over the businesses it owns and, again speaking generally, that isn't preposterous: PE really does do these things well. Only it doesn't get much credit for them from the outside world.

The point about this last fact is to try and change it, because hostility from significant others makes it difficult for private equity to operate. The industry's embrace of responsible investment practices, as documented in this latest *PEI* supplement on the subject, reflects a growing recognition that the ESG imperative has real power. Private equity firms have come to understand that committing to ESG excellence, and adopting compatible business processes, can achieve immensely profitable outcomes – morally, reputationally, and above all in terms of higher money multiples and better IRRs.

Last year, in a speech given at *PEI*'s Responsible Investment Forum (see p. 28), TPG co-founder Jim Coulter made the point that private equity, because of its frequent role as the controlling shareholder, is better positioned than any other type of investor to get its investees to do the right things. He is right about that, and a growing number of managers are acting accordingly. On p. 6 and p. 12 respectively, in-house sustainability specialists at Actis and Doughty Hanson explain how ESG practices have become integrated into their firms' investment processes. On p. 16, environmental due diligence specialists ERM share their experience of how and why the industry should invest in RI capabilities. We also looked at how limited partners are influencing the agenda (p. 10) and were reminded that some of them, but not all, are being very influential indeed.

Needless to say there is a lot more the industry must do to fully harness the ESG opportunity. But plenty of groundwork has now been done, the days of mere lip-service are behind us. To finish the project will help the industry safe-guard a long-term profitable future, and who knows – it may even enable it to confound the critics.

Enjoy the supplement,

Philip Borel

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THE RESPONSIBLE INVESTMENT SPECIAL 2015


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SENTIMENT

Strength in numbers

Evidence is accumulating of responsible investment practices and principles continuing to gain mindshare. We found some telling indicators in three recent leading surveys

From the PRI's "Report on Progress", 2014

1,349
number of PRI signatories, including:

286
asset owners

879
investment managers

$45 trillion
AUM of PRI signatories

798
number of PRI signatories required to report during 2013/2014

814
number that did report (indicating some voluntary reporting)

89%
PRI signatories with a responsible investment policy

62%
percentage of 167 signatories reporting on directly managed private equity assets that indicate ESG issues helped to identify risks and/or opportunities for value creation during investment selection

From "Sustainability goes mainstream", PwC Investor Survey, May 2014

73%
investors surveyed that cite risk mitigation as the primary driver behind ESG consideration

61%
investors in the US who are dissatisfied with the current level of corporate disclosure on climate change, resource scarcity, social corporate responsibility, and good citizenship

95%
investors surveyed by PWC who think labour rights and regulatory risk concerning climate change should be periodically assessed by companies for materiality

From "New Business Models: Shared value in the 21st century", published by The Economist, October 2014

number of respondents that see a "strong" causal link between a company's financial performance and its commitments to ESG goals:

16%
short term (1-2 years)

66%
long term (5-10 years)

52%
respondents that think immediate financial goals are more urgent than incorporating sustainability principles

44%
respondents that cite an absence of a compelling business case for sustainability as an obstacle to incorporating sustainability principles

20%
respondents that publish their ESG sustainability goals and progress toward them at least once a year

39%
respondents that do not publish any information about their sustainability practices or goals

57%
respondents who put increasing energy efficiency in their top three ESG priorities to 2018

3%
respondents that put increasing transparency surrounding board members' compensation in their top three ESG priorities to 2018

LP CO-INVESTMENT

Greater concentration

As LPs focus on doing more co-investments, they must be wary of increased exposure to environmental, social and governance risks, writes Clare Burrows

When 20 children were shot dead along with six school employees at US elementary school Sandy Hook in December 2012, private equity firm Cerberus Capital Management came into the spotlight for its investment in Freedom Group, the gun manufacturer that made the killer's weapon of choice, the Bushmaster AR-15.

The backlash that followed was a clear indication of how seriously investors were beginning to take environmental, social and governance issues within their portfolio.

Shortly after the shooting, the investment committee at the California State Teachers' Retirement System (CalSTRS) unanimously voted to divest from manufacturers that produce firearms illegal in California.

The move was soon followed by the California Public Employees' Retirement System (CalPERS), with prominent private equity investors such as the New York State Common Retirement Fund, the Office of the New York City Comptroller and the City of Chicago Comptroller, all saying they would review their investments in firearms manufacturers in the days and weeks following the shooting.

Over two years later, CalSTRS is still indirectly invested in Freedom Group (now rebranded as Remington Outdoors), albeit as a reluctant shareholder.

"CalSTRS has requested and continues to push our partner, Cerberus, to sell holdings of Remington Outdoors from the investment pool in which CalSTRS is a limited partner," a CalSTRS spokesman was quoted as saying in US media late last year.

"However, despite CalSTRS' continued pressure and Cerberus' earnest efforts, Cerberus has not been able to sell the holdings, or to find a way out of Remington Outdoors [for] investors like CalSTRS. You will also notice, CalSTRS has not made additional investments into Cerberus funds since 2012."

Cerberus declined to comment for this article, but CalSTRS has said since that going forward it will include an opt-out provision in its limited partnership agreements for private equity investments in similar firearms manufacturers.

KNOWING WHEN TO WALK AWAY

The bellwether US pension plans are not alone in advancing the responsible investment agenda. In the UK, last year the Church of England ended its indirect backing of controversial UK money lender Wonga after the Archbishop of Canterbury deemed the interest rates charged by such firms unethical and immoral. The church was exposed to the investment through private equity firm Accel Partners.


Rowe: *little room for concessions*

But fund investments are not where limited partners are most vulnerable, industry sources explain.

According to a BlackRock study commissioned last year, 67 percent, 51 percent and 46 percent of LPs from Asia, North America and Europe respectively are intending to increase their level of co-investment activity. Seventy-one percent of GPs said they plan to offer either the same number or more co-investment opportunities to LPs going forward.

As LP co-investment becomes *de rigeur,* LPs are obliged to become as scrupulous about ESG principles in their due diligence on co-investment deals as they are about applying these standards to their fund investments.

"If you're cutting a relatively large co-investment cheque, that company could be 20x the average [fund investment] ticket size and so there is a concentration risk," Doug Coulter, partner at LGT Capital Partners, says. A global fund of funds, LGT is also active on the co-investment front.

"If we felt a GP hadn't done sufficient [ESG] work, then that might be a reason for us to kill a deal on a co-investment basis. On the other hand, we might decide we like the deal so much commercially from a return perspective that we're willing to spend some time and energy on doing our own ESG-related due diligence to give our investment committee comfort."

Pension funds in particular take an uncompromising view on ESG principles, industry sources say.

For example, Jane Rowe, head of Teachers' Private Capital, the private equity arm of Ontario Teachers' Pension Plan, explains that there is very little room for concession when it comes to ESG.

"Conceptually we think if you want to be a good, smart investor, you have to take into consideration ESG issues in your assessment of investment opportunities. As part of making good investment decisions we ask our investment teams, on every investment we look at, to lay out the ESG issues related to that particular investment, just as we might look at financial returns or operational [growth potential]."

Specific questions are no different for GP or a company, we ask the same types of questions of a management team and other partners to make sure our interests are aligned

RAPID RESPONSES REQUIRED

A good way to mitigate the responsible investment risk is to co-invest with existing partners that are already trusted to adhere to ESG standards.

Rowe says: "When you're thinking about backing a GP – and we have about 30 core relationships around the globe today – it shouldn't surprise you that for someone to be a core partner we are going to back folks that assess investment opportunities in the same way we think about it."

So when Teachers' carries out due diligence on potential core partners, it seeks conversation about their track record in, and handling of, ESG , and about how they incorporate it into their decision-making processes. "[For co-investments], specific questions are no different for GP or a portfolio company: we ask the same types of questions of a management team and other partners to make sure our interests are aligned."

However, for LPs to insist on extensive due diligence can be tricky. Given the increasing popularity of co-investment opportunities, competition is rife when it comes to high quality deals, which means the balance of power can shift to the GP.

"There is certainly a lot of competition for co-investments in general [and] most GPs want to have full discretion in terms of who they show co-investments to," Coulter explains.

"In general, talking about commercial or ESG issues, LPs need to be cognizant of the fact that [they] need to quietly and efficiently do our own work, leveraging our own network [without] burdening the GP too much."

Rowe agrees that respecting the GP is important: "We are responsive to GPs, let them know what we like or don't like, and work quickly to let them known if we don't like [a co-investment] so they can move on to finding another partner."

One straightforward test of whether the risk mitigation exercise prior to making a co-investment was sufficiently robust is a retrospective one: if the LP ends up reading about the deal becoming mired in scandal, it evidently hasn't worked. Avoiding this nightmare scenario is the task at hand. ■

RETURNS, NOT TREE HUGGING, DRIVES RENEWABLE INVESTING

Last December, German asset manager Aquila Capital's latest research showed an overwhelming majority of European institutional investors committing to the renewables sector on the back of its returns profile and not because of environmental or ethical reasons. According to the research, 63 percent of respondents said they invest in renewable infrastructure for portfolio returns, with only 6 percent citing environmental and ethical reasons. Twelve percent of those surveyed said they were targeting the sector for diversification and inflation-hedging purposes, and 9 percent said their primary driver was to gain exposure to the sector.

Encouragingly, 52 percent of European institutions polled stated they have exposure to renewable infrastructure, allocating an average of 4 percent to the asset class, with seven in 10 investors intending to increase exposure to the sector over the next three years. The majority (68 percent) of respondents said they were positive about the sector, but cited lack of experience and track record by industry asset managers as their main concern. Solar was identified as the best performing sector by 39 percent of respondents, with wind trailing close behind for 33 percent. Biomass and hydropower were the best performing sectors for the remaining respondents.

Taking advantage of the investor appetite for the sector, Aquila has been active on the deal front. It recently announced a second hydropower deal from its platform with APG for a renewables asset in Scandinavia, and currently manages $610 million of assets in hydro, $810 million in solar and $272 million AUM in wind. The solar portfolio, at 355MW, is Europe's third largest. ■

BEST PRACTICE

Investing with intent

Capital put to work in the emerging markets can make an extraordinary contribution to the social context and economic growth that is needed, at the same time as delivering commercial outcomes for the providers of that capital, says Shami Nissan at Actis

Nissan: *knowing where the red flags are*

Institutional investors have lagged behind the corporate sector in aligning their strategies with sustainability. This is changing. The Principles for Responsible Investment now have the backing of over a thousand financial institutions, with $33 trillion in assets under management and committed to integrating environmental, social and governance into their investment management.

'Lip-service' regarding ESG initiatives is no longer enough in the private equity industry. "Not only do investors want to see Responsible Investment (RI) policies and procedures, they want to see the substance behind the commitment," says Shami Nissan, Director of Responsible Investment at Actis. "We integrate our RI approach into the entire investment process. This is increasingly what LPs are looking for."

CLOSING THE GAP

Actis, which exclusively invests in emerging markets, has been at the forefront of this movement from the time it was set up in 2004. RI is institutionalised at the firm: its methods are rigorous, robust and scrutinised at the highest level. Its in-house senior team, unusual for private equity, has done this since inception.

Emerging markets are fertile ground for ESG. "The risks are more acute in many of the markets we invest in. We apply international standards to our investments irrespective of the local regulatory environments. Our approach is based on five policies- environment, community, health and safety, climate change and business integrity, and underpinned by detailed procedures addressing each stage of the investment decision-making process," says Nissan.

She adds: "When we look at new deals, the question we're asking is: is best practice being followed? If not, can we bring the right knowledge, skills and support to close the gap in time? And once the business becomes part of the portfolio, the detailed pre-acquisition assessment means that we already know where the red flags are."

The Responsible Investing team's mandate is to introduce world class standards to all Actis investee companies and ensure those standards are being met, but the Actis team also takes it further. Nissan cites the example of Commercial International Bank (CIB), an Egyptian bank, which the firm exited in May 2014. During Actis's involvement, the RI team worked with CIB's management to develop a set of subsequently award-winning policies around social lending, in order to realise their goal of becoming Egypt's leading green bank.

Another success story is Vlisco Group, a West African ethnic fabric manufacturer that Actis bought out in 2010. Since then, Vlisco has re-engineered its supply chain to source cotton from African sources. Vlisco has partnered with the Cotton Made-in-Africa Initiative, which ensures that cotton is farmed according to strict social and environmental standards without paying a premium. Not only can the company procure its raw materials more cheaply, quickly and sustainably, as Nissan points out, there has also been a significant wealth creation impact across its African supply chain, from cotton farmers to tailors, distributors and retailers.

32 METRICS

Energy is a burning issue across the emerging markets as it is fundamental to growth. Actis funds own power generation

Vlisco: *wealth creation effect across the supply chain*

It is unequivocally in every partner's mind that the link to financial value is real and direct

and distribution companies in Uganda, Guatemala, Tanzania, Kenya and the Ivory Coast. Despite different countries and cultures Actis draws on common themes to improve these businesses with many of the improvement initiatives rooted in our ESG ethos.

Some of the most compelling investment opportunities come with inherent environmental, social and governance risks. Invest in a wind farm for example, and you will have to think about social license measures. Social and community issues, not addressed early can become a case study in value destruction overnight.

Actis uses a bespoke model of 32 industry-specific metrics to measure impact in its energy portfolio. The Actis Energy Impact Model (AEIM) tracks six areas: finance, people, social/community, infrastructure, environment and government. Management teams use it to identify where action needs to be taken, and to monitor and measure progress. "It allows us to pinpoint genuine value drivers for each business," Nissan explains.

Beyond energy, Nissan sees scope to develop similar structured frameworks for real estate, education and healthcare businesses in Actis's private equity portfolio. "There are many healthcare companies operating in emerging markets, where they are vulnerable to compliance and business integrity risks, which no investor can afford to ignore. In China for instance, regulatory scrutiny is now at a level of intensity that is unprecedented. Bringing world class compliance standards to these businesses can mitigate risk and enhance value."

Another example is real estate: the sub-Saharan Africa real estate market is attracting more attention from investors, so the demographics and demand for quality A-grade space provide an exciting opportunity. Actis, with a long-standing commitment to sustainable real estate, has developed a set of guidelines to create a market for green real estate in Africa. "We are developing a portfolio of internationally rated buildings that incorporate both environmental and social dimensions, creating assets that will endure 30 or 40 years," Nissan says.

All of the firm's real estate developments are at least 25 percent more energy efficient than the market standard. Such an approach resonates with the regulators, tenants and buyers, enhancing returns. "We expect a 5 percent uplift in enterprise value at exit, as a result, says Nissan. One example is Garden City, a $250 million retail-led mixed-use development in Nairobi, which will be the first LEED-rated retail development in sub-Saharan Africa outside of South Africa. The roof space is leased to a solar operator to supply part of the mall's energy requirements, and a three acre public space.

Concludes Nissan: "We've always viewed investing responsibly as the right thing to do. But it is also unequivocally in every partner's mind that the link to financial value is real and direct." There is no better argument for investing responsibly in these markets. ■

65+
years of on-the-ground experience

$6.5bn
funds under management

212
limited partners

100
investment professionals

10
offices

70
portfolio companies

27
countries

114, 444
employees of Actis portfolio companies

ABOUT ACTIS

Actis invests exclusively in emerging markets. With a growing portfolio of investments in Asia, Africa and Latin America; it currently has US$6,5bn funds under management.

Combining the expertise of over 100 investment professionals in nine countries, Actis identifies investment opportunities in three areas: private equity, energy and real estate.

The firm, which was founded in 2004, building on a sixty year heritage, operates under the highest standards of ESG in the industry and helped the UN define the code for responsible investing.

In 2014 Actis was named ‘Private Equity Firm of the Year in Africa’ and ‘Private Equity Firm of the year in MENA’ by *Private Equity International* (*PEI*), ‘Firm of the Year for Africa and the Middle East’ by *PERE* and ‘African Infrastructure Fund Manager of the year’ by *Infrastructure Investor.*

RECENT INVESTMENT HIGHLIGHTS INCLUDE:

Genesis Group (Genesis): Brazil’s largest grain testing and inspection business ($45m, December 2014)

Integrated Diagnostics Holdings (“IDH”): Egypt’s largest private sector healthcare diagnostics service provider ($113m, December 2014)

Université Centrale Group: a leading provider of private tertiary education in Tunisia ($50m, December 2014)

Tekkie Town: South Africa’s leading independent sports and lifestyle shoe retailer (65m, November 2014)

IT’sSEG: Buy and build insurance brokerage platform in Brazil ($100m, November 2014)

Zuma Energía: Mexican energy platform ($250 million, September 2014)

Credit Services Holdings (CSH): A pan-African buy-and-build credit services business ($100m, April 2014)

Jiashili Food Group (“Jiashili”): One of the largest Chinese biscuit brands (April 2014)

Upstream: the leading emerging markets mobile monetisation company (April 2014)

AutoXpress: East Africa’s leading tyre distributor (February 2014)

Paycorp: a leading payments business in South Africa ($95m, August 2013)

Edita Food Industries: a leading snack food business in Egypt ($102 million, July 2013)

Aela Energía: a renewable energy development set to become Chile’s largest wind and solar energy provider ($290m, June 2013)

Garden City: The largest retail mall in East Africa (US$36m, July 2012)

The Exchange: Office, hotel, residential and retail development in Ghana (32$ July 2012)

Visa Jordan Card Services Company (VJCS): Jordan’s largest merchant acquirer and national ATM switch ($87m, August 2011)

Vlisco Group: designer of wax fashion fabrics in West Africa ($151m, September 2010)

Jabi Lake Mall: Nigeria’s first waterfront retail mall ($33m, November 2011)

Heritage Place: The first green building in Nigeria, office space ($108m, September 2011)

One Airport Square: The first green building in Ghana ($62m, December 2010)

You can learn more about Actis at **www.act.is**

SELF-REGULATION

Naming and shaming

Swedish GPs have established a code of conduct that will make it difficult for irresponsible portfolio company owners to hide. Yolanda Bobeldijk reports

It's fair to say the terms 'private equity' and 'transparency' haven't always gone hand-in-hand. But Sweden's GPs are shaking up the status quo.

At the time of going to press, the Swedish Private Equity & Venture Capital Association (SVCA) was set to formally publish a code of conduct that will assess whether its member firms are behaving properly in their capacity as private company owners, says Gabriel Urwitz, SVCA chairman and managing partner at Nordic firm Segulah.

An independent disciplinary board, consisting of "three outstanding people that have no relation to private equity" will evaluate any complaints – which can be made by anyone – against SVCA members, Urwitz explains. "One is a highly reputable law professor, one is an individual with a business background and one is someone who has both a political/governmental and business background."

Urwitz: *holding GPs accountable*

SOFT POWER

Whenever there's a complaint, the board will seek to determine whether a private equity firm's actions were in line with what a good, responsible owner would have been expected to do in that circumstance.

> **We can't put people in jail and we cannot give out fines, but we can 'name and shame' them**

If the firm's actions are found questionable, the disciplinary board will make a public comment about it. "We can't put people in jail and we cannot give out fines, but we can 'name and shame' them," Urwitz says.

The conduct board can also give the firm a warning, or – in extreme cases – recommend that the firm be expelled from the SVCA, which would then ultimately be decided by the Swedish trade body's board.

The code of conduct's specific details hadn't yet been made public at press time, but Urwitz notes there will be a large focus on transparency, including firm's media relations and communications.

"When the media knocks at your door, the code will say that GPs and/or investment advisors have to deal with that. You can't say, 'no comment'. Private equity has become such an important part of the Swedish economy and therefore the general public has the right to know more about us – as company owners, especially when it comes to companies in the welfare sector."

That speaks to the impetus for the code's creation, and also recalls some recent examples of negative press coverage in Sweden around private equity ownership, such as KKR's and Triton's investment in elderly care home group Carema.

In November 2011, the firms came under fire after Carema was accused of neglecting patients and criticised for its tax and remuneration practices – with left-wing Swedish politicians subsequently calling for a ban on private investment in welfare sectors. Despite the fact that, as KKR told *PEI* in 2013, the firms had "never taken 1 cent out of the company" and had reinvested all revenues, the battle of public perception was an uphill one; there's currently an inquiry into whether such investments should be prohibited, creating uncertainty for GPs with care-related portfolio companies until the findings are published in 2016.

With the code – which was initiated voluntarily by Swedish GPs – the SVCA hopes to counter some of the concerns about private ownership. "We have had a lot of contact with politicians, the unions and other organisations and while they haven't seen the details yet, I think they are all backing this code," says Urwitz. Whether it will be enough to improve private equity's image in Sweden remains to be seen, but the efforts must be applauded as a positive step toward greater transparency and accountability. ■

ACTIVE INVESTORS

Trendsetters

Ultimately the commercial and financial benefits are the main incentive for private equity managers to invest responsibly. But LP attitudes are also important. Here's our pick of 10 leading investors that are helping private equity advance its ESG credentials

ALPINVEST PARTNERS AMSTERDAM

In 2012, AlpInvest's then-CEO Volkert Doeksen told the *PEI* Responsible Investment Forum in London that in order for ESG in private equity "to get to the next level", Europe's limited partners needed to do more, because they were the ones

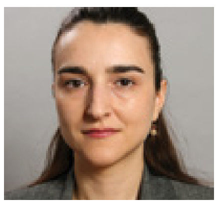
Doeksen: *European LPs to the fore*

with the requisite know-how and conviction. AlpInvest, now owned by The Carlyle Group, has certainly been leading by example. The $50 billion fund investor became an early adopter in 2008, when it formally implemented ESG into its investment processes. The firm's responsible investment strategy is overseen by an operating committee; Maaike van der Schoot serves as corporate social responsibility officer.

AP2 STOCKHOLM

Sweden's SEK265 billion (€28 billion; $32 billion) AP2 has been actively focused on sustainability since 2001. With 16% of its assets pointing at private equity, and a raft of manager relationships including Ares, CVC, EQT and TPG, it is one of Europe's key LPs, and works across its entire portfolio to practice what it preaches. Last October, it said it would no longer invest in 12 coal and eight oil-and-gas production companies and, after attracting criticism in Swedish media, announced that audits of certain holdings in agricultural real estate in Brazil will be conducted by an independent agency in a bid to improve transparency.

APG ASSET MANAGEMENT AMSTERDAM



Jankovic: *vets all GPs*

Until 2012, APG's ESG agenda in private equity was enforced by AlpInvest, which the €400 billion asset manager co-owned together with PGGM. Then AlpInvest was sold, and APG built out its own private markets capabilities, with a strong focus on responsible investment. Not much gets past senior sustainability and governance specialist Marta Jankovic, who joined in 2013 to sign off on the ESG aspects of all investment proposals in private equity, hedge funds and other illiquid asset classes. GPs knocking on APG's doors for fundraising get the full treatment on the group's ESG-related reporting requirements. As an investor, APG has a large footprint in alternative energy, clean technologies and micro loans.

ASIAN DEVELOPMENT BANK MANILA

The Manila-based DFI and anchor investor to countless Asian GPs has ESG principles rooted in its DNA. In particular, ADB has policies and procedures measuring the environmental or social impact of its investments, and is taking a keen interest in expanding access to finance, small-, and medium-sized enterprises, as well as on infrastructure and climate change finance. Through private equity, ADB supports firms like OrbiMed Asia, a fund set up last year to provide affordable healthcare to the region's developing countries. In 2014, ADB established a joint venture to invest in environmentally supportive, low-carbon transactions in Asia – one of its many clean energy-related ventures.

Asian wind farms: *on ADB's radar*

CalPERS SACRAMENTO

Where to start? Through its Sustainable Investment Research Initiative (SIRI), ESG ideas are engrained in the CalPERS investment decision process. The $31 billion LP also has a cross-asset team on sustainable investing to evaluate new allocations alongside existing investments. In 2013, it made waves when it launched an ESG research competition to improve how it uses sustainability factors when making investment decisions. How much does any of this matter? Ask David Rubenstein: "Carlyle launched its efforts to incorporate environmental, social, and governance considerations into its investment decisions in part because of CalPERS' focus on these issues," he's quoted as saying in CalPERS' 2014 ESG report. Sounds like it matters a fair bit.

***Rubenstein:** thank you, CalPERS*

CONSTRUCTION & BUILDING INDUSTRY SUPER, MELBOURNE

According to sources, Cbus is one of Australia's most ESG-focused investors. An LP in funds advised by IFM, Macquarie, Siguler Guff and Lexington amongst others, Cbus manages about A$27 billion ($22 billion; €31 billion), of which 9.5 percent is committed to private equity and alternatives. Louise Davidson is Cbus' dedicated ESG investment manager, who says ignoring responsible investment implications is not an option: "We believe that ESG issues can pose significant levels of risk to our investments in private equity. It is therefore essential that our external private equity managers understand and effectively manage these issues. I work closely with the investment manager, private markets, to ensure that we are comfortable with the approach our external fund managers are taking to ESG."

HARVARD MANAGEMENT COMPANY, CAMBRIDGE

In May of last year, the $36bn HMC (private equity allocation: 18 percent) became the first North American university endowment to join the United Nations-supported Principles for Responsible Investment Initiative, and committed resources to building out an in-house ESG framework for its investments. Jameela Pedicini, who previously worked for CalPERS and also the PRI, joined as vice president of sustainable investing and will oversee the endowment's ESG efforts. HMC also launched a $20 million Climate Change Solutions Fund, which seeks to make investments in companies battling climate change issues. This effort comes alongside the endowment's signing on to the Carbon Disclosure Project, an initiative that works with governments and private sector stakeholders to push for better environmental disclosures from businesses.

PANTHEON LONDON

As the very fund of funds to sign the PRI back in 2007 (source: Pantheon), Pantheon did plenty to start the ESG discussion in the industry. The firm sat on the PRI steering committee, organised workshops for the GPs it invested with, and also worked with other managers on ESG monitoring. "We made it very clear that we would support and guide them rather than batter them with sticks, saying: you must do this" says Dushy Sivanithy, a principal at Pantheon. The firm also spared a thought for its clients and introduced specific ESG reporting to keep them in the know.

ONTARIO TEACHERS' PENSION PLAN, TORONTO

Teachers' has a $15 billion private equity portfolio, about half of which is invested in funds. The Canadians signed up to the PRI in 2011 and have been steadily increasing their focus on ESG principles ever since. Teachers' has adopted all six PRI principals into its investment decisions and built out a team to implement. In January those efforts got a boost when the Ontario Parliament signed the Pension & Benefit Act. The new law takes effect on January 1, 2016 and will require at least consideration of ESG principals from pension plans, alongside enhanced ESG disclosures in their investment reports. In early 2013, Teachers' teamed with ten other institutions including CalPERS to call on world governments to create frameworks for sustainable infrastructure investments that also provide long-term cash flows.

PGGM ZEIST

***Van der Weide:** banging the drum for PGGM*

The fact that many of its clients are historically from the welfare sector has meant that responsible investment has always been high on PGGM's agenda. The Dutch pension giant, which has committed approximately €6.5 billion in private equity and invested with 42 external managers since 2010, requires all of its investments to be ESG- compatible. Since 2000, it has had an ESG team, which currently comprises 13 people and includes a dedicated specialist for private equity and infrastructure. Non-compliant GPs need not apply: when choosing between comparable investments, PGGM tends to select the investment with better ESG practices and performance. ■

PORTFOLIO MANAGEMENT

Dealing with the elephant

Some ESG-related challenges can be too difficult and complex for a portfolio company to fully close out before the equity house wants to exit. That's ok, says Adam Black at Doughty Hanson – as long as the prospective owner gets shown a compelling, and viable, plan of action

Black: *weeding out environmentally sensitive materials*

In 2011, when European mid-market buyout specialist Doughty Hanson was beginning work on an exit for portfolio company Norit, Adam Black called a time-out. Doughty's head of sustainability had discovered a potential spanner in the works in Norit's supply chain that he knew might trip up potential buyers if left unattended.

Norit is a water and air purification technologies producer with manufacturing capabilities in countries around the world. Doughty had invested in the company in 2007, but it was not before Black had joined the firm and looked closely into the production process that he discovered that Norit was using certain raw materials that were environmentally sensitive.

Recalls Black, who has worked as the firm's head of sustainability since 2008: "When I joined and found out what some of the raw materials were, I knew the company was exposed; a well-informed trade buyer would almost certainly have asked about them. This was an issue that was buried deep in the technical details of how they made their products and shows how in-house expertise allows you to ask more focused questions and enhance the external due diligence, providing the GP with some competitive advantage."

Fixing the problem before commencing a formal sales process was out of the question. Reengineering a supply chain is a complex and time-consuming undertaking at the best of times. When LM Wind Power, another multi-jurisdictional manufacturer in the Doughty portfolio, decided to blend a more environmentally benign mix of materials for its rotor blades for wind turbines, it took Black and his colleagues two full years to change the recipe and complete a long-winded and complicated process of certification and approvals. With Norit, Doughty didn't have the time to do anything similar.

What happened next was that Doughty's value enhancement group and Norit worked together to put in place a formal policy for phasing out the problematic ingredients, and to map the suppliers that would need to be replaced in due course. The aim was to provide any future owner of the business with comfort that an appropriate remedial strategy was in place, thus protecting Doughty's ideas of what the valuation for the company should be.

According to Black, it was the kind of intervention that can make all the difference at this critical stage of the investment life cycle: "So you haven't fully closed out the issue, but you demonstrate that you have a plan, and that really will help you with the transaction. If during due diligence you get asked a question you cannot answer, that will be really off-putting to a buyer. It matters enormously to us that we have a viable answer to everything we might get asked, and that we're able to prove that we have a plan."

LEGWORK

Recently Black has had plenty of opportunity to prepare for ESG-related questioning from would-be buyers, as Doughty has been actively realising its investments. When he first arrived seven years ago, the firm's private equity portfolio was composed of 14 businesses. At the moment there are eight. Within the current collection, it is the large manufacturing businesses with international production footprints that have been particularly labour-intensive from a sustainability perspective, as well as some of the services companies.

Alongside LM Wind Power, Black mentions Zobele, which makes electric air fresheners and insecticide products from

LM Wind Power: *new, improved recipe for blade-making*

low-cost manufacturing centres in Brazil, Bulgaria, China, India and Mexico; ASCO, a Scottish logistics business specialising in oil and gas; and Eurofiber, a Dutch telecoms company and owner-operator of a 10,000 kilometre fiber network, and all have received attention from an ESG perspective.

Another revealing investment is Tumi, a premium luggage maker Doughty acquired in 2004 and which listed on the New York Stock Exchange in 2012; Doughty continues to own a minority stake. With Tumi, says Black, the firm was able to "drill right down" into the supply chain and make it fit for purpose. The investment obviously predates him, but with outsourced production in Asia being an important component of Tumi's set-up, other Doughty personnel did the initial legwork to make sure the company was on solid ground.

Factory visits resulted in Doughty-instigated initiatives to improve staff safety and worker welfare, and Tumi joined the Fair Labour Association. Later, with Black now on board, the firm looked at procurement to make sure Tumi was sourcing leather ethically. Managing this kind of reputational risk tightly was deemed essential, and the guiding principle was once again to avoid any late mishaps: "We asked ourselves, if we didn't do this what would happen during an IPO process if it transpired the company was exposed through the supply chain because of child labour concerns, unacceptable safety practices or through the procurement of raw materials from disreputable or unsustainable sources."

GO EARLY, ALWAYS

Speaking generally, Black argues that the point is to identify and address the ESG elephant(s) in the room, and to do so as early on as possible so that there is time to address the issues they represent. The task begins with the pre-acquisition due diligence work the firm scopes out, and continues throughout the holding period of the investment right through to the exit.

With more than two decades of fieldwork in virtually all sectors of the economy behind him, Black says he and colleagues can usually pinpoint the critical aspects quickly. He is both a Chartered Health & Safety Practitioner and a Chartered Environmentalist by background, and has worked in oil and gas, in technical environmental consultancy and at KPMG.

He says colleagues on the acquisition team have come to value highly his ability to support their deal sourcing by pointing them in the direction of the ESG challenges facing a business at the start of their process. And: "No-one in the firm has any doubt that doing this work and getting it right isn't just a nice-to-have; they know it's commercial."

Going in early is a trick that others in private equity still often miss, he finds: "It's still the case that often the environmental due diligence is thought about late on in the process, which isn't smart given that a material issue absolutely can disrupt or delay a transaction. And when people start late, often the due diligence becomes more about box-ticking and remains limited in scope, focusing mainly on compliance. That almost always results in missed opportunities in terms of identifying risks and value creation potential."

Black and his colleagues are determined to not ever fall into that trap.

Incidentally, a few doors down from Doughty Hanson's London head office on Pall Mall in St. James's are the offices of Virgin Galactic, the space travelling venture of Sir Richard Branson. Environmentally speaking, this is a controversial undertaking. Would Black fancy being a part of it? "Rocket fuel isn't a great place to start from an ESG point of view," he concedes. "But then, what they do is so exciting in so many ways, maybe one can forgive them that – so you could count me in!" ■

REPORTING

Crossed wires

Collecting data related to ESG issues is climbing higher and higher up the agenda for GPs and LPs, but both sides are still grappling with how best to convey the findings. Isobel Markham reports

The point bears repeating: paying attention to environmental, social and governance issues is no longer a new concept in the private equity world. GPs know they should be collecting information from their portfolio companies, and LPs know they should be asking for it.

The part of the puzzle yet to be solved is the best way for this information to be transmitted from the portfolio company to the GP and then on to a fund's investors.

"The communication piece, there's still a lot of work to do," Pantheon principal Dushy Sivanithy says. "At the moment it's embryonic".

Two important tools used by the industry as guidance for reporting are the PRI Reporting Framework and the EVCA's ESG Disclosure Framework. These frameworks provide guidance on ESG policies and practices to help both LPs and GPs start a dialogue on ESG. However, what they do not provide are details of how to actually report on ESG issues within the limited partnership itself.

Klein: *integrated reporting reflects integrated approach*

"For each portfolio company, when you address ESG, you have to try and address all three areas, E and S and G

"That's what's currently needed, some more clarification […] from LPs on what they actually need and what this ESG disclosure framework means in practice," PGGM's responsible investment advisor Tim van der Weide says.

Although the frameworks are a step toward standardisation, the approaches that individual LPs and GPs take toward ESG reporting are far from consistent. This presents a challenge for both parties.

"Everybody is doing it in a different way, so there's no way for us to make a consistent report now or to get a portfolio review, on our side, of our complete private equity portfolio," Van der Weide says. The example he offers is that at the moment, it is impossible to tell which company in PGGM's private equity portfolio emits the most CO_2.

One particular frustration for LPs – and what sends them back to fund managers for additional information – is reporting that focuses only on a small aspect of ESG or on particular case studies from the portfolio.

"What we would like to see is annual ESG reporting just to understand annual progress, and not just on certain portfolio companies on anecdotal evidence, but over the whole portfolio, every single portfolio company," Van der Weide says.

This kind of holistic reporting needs to be done both on the GP level, detailing how the manager itself is integrating ESG into its approach and whether it has improved its capabilities and capacities on ESG during the year, and also on the portfolio level.

"For each portfolio company, when you address ESG, you have to try and address all three areas, E and S and G," says Marta Jankovic, head of ESG integration in alternatives at APG. "There's always the temptation to just write positive things, but what we really appreciate is when a manager says 'these are the things that we still find challenging or the company is still working on and needs to improve'. Then you can really see that they are being transparent, because it's all about disclosure at the end of the day."

Jankovic suggests that GPs should always collect more information from their portfolio companies than they ultimately report to LPs.

"There may be ESG items that not every investor is interested in seeing in a report, but you should still collect as much information as possible from the portfolio, so if you get additional requests you're better-placed to respond," Jankovic says.

A CONSISTENT APPROACH

While LPs struggle with inconsistency from GPs, fund managers in turn have to grapple with information requests from investors in many shapes and forms.

Mark Goldsmith, responsible investment director at UK-based Actis, which invests in emerging markets, explains that the firm produces detailed ESG reports quarterly for its LPs, as well as producing a public PRI report and an additional public report, illustrated with case studies, that is available on the firm's website. Despite a thorough approach, Actis still receives requests from LPs for additional information.

"I welcome information being asked, but often the same things are asked slightly differently 10, 20 or 30 times. This is frustrating and I think that's the challenge the industry has," Goldsmith says. "We have 212 LPs, and if they all became as proactive in asking about this as a few of them are, we would be spending the majority of our time reporting."

Fellow emerging markets specialist Abraaj Group, which created its own system – The Abraaj Group's Sustainability Index (ASI) – in 2008 to measure and report the impact of its portfolio companies across a range of indicators, has come up with a way to combat this: it persuades its LPs at the outset to agree to receive ESG reporting in Abraaj's own standardised format.

"As we developed our proprietary measurement system, this has helped us enormously in reporting the impact our partner companies are having and it also means that we tend to report on a lot more impact data than LPs ask us for," says Geetha Tharmaratnam, a director at Abraaj. "When we're going through the fund formation process, we try to bottom out with the LPs what kind of information they're looking for around impact measurement and work to actively incorporate this in the annual ESG reporting we provide to them."

The industry must also contend with the false assumption that all ESG information is the GP's to give, according to Ad van den Ouweland, managing director at Dutch SME-focused fund of funds MKB Multifunds.

"The tension is that LPs are demanding more and more information, whereas the GPs are limited in what they can share with their LPs due to the fact that it's private information. Call it the ESG information paradox," Van den Ouweland said. "It's not reluctance, I would say, on the GP end. Sometimes they are bound by what they have discussed in terms of transparency with the underlying companies they are investing in."

> **There are already international reporting standards for companies that are sector-specific. Private equity doesn't have to reinvent the wheel**

FORGING AHEAD

Speaking to industry insiders, it's clear that some form of standardisation is top of most people's wish lists.

"Our ideal would be that the industry agrees a format, and I think the UN PRI's probably the vehicle for that, and to ask all the difficult questions and what everybody wants, but to ask it once in one set of questions," Goldsmith says.

Standardisation, Pantheon's Sivanithy says, is "a win-win for everyone".

"Not only does it make the GPs' lives easier, it will make our lives easier too because we will have a consistent reporting format from which we can extract information," Sivanithy says. "From the GPs' perspective, I think it will lighten the burden. They can answer questions more thoroughly and more clearly, but they won't have to do it 20 times because they will have a standard set of questions."

Van den Ouweland thinks ESG reporting should be integrated with financial reporting and no longer an addendum to quarterly or annual updates.

Alison Klein, a manager in Dutch development finance institution FMO's private equity department, agrees. She posits that integrated reporting is evidence of a "more integrated approach to managing ESG within the investment process".

"What I would hope is that reporting comes to reflect increased acknowledgment within an investment team that this is not packaging, window dressing, [or] a purely compliance-driven exercise where a bunch of LPs for various political reasons have all kinds of ridiculous requirements with which you have to comply in order to get their money, but that they start to perceive that this is actually fundamentally part of what they do, and it's an integral part of their risk assessment and the value creation opportunity within the investment."

Although there's a challenge ahead for the private equity industry, there is a precedent it can follow, harnessing some of the standards that are currently in use in public markets.

"There are already international reporting standards for companies that are sector-specific," Van der Weide says. "Private equity doesn't have to reinvent the wheel." ■

MONITORING

Portfolio monitoring of ESG performance

Consideration of ESG issues is relevant at all stages of the investment lifecycle. GPs require a framework for effective ESG communication with portfolio companies, investors and other external stakeholders, according to ERM

Private Equity (PE) firms are increasingly recognising the need to not just consider environmental, social and governance (ESG) factors as part of their investment process but also the need to effectively communicate their approach and the ongoing performance of their portfolios to stakeholders.

ERM has identified some strong market trends through the completion of over 250 ESG-related assignments across the globe for PE firms.

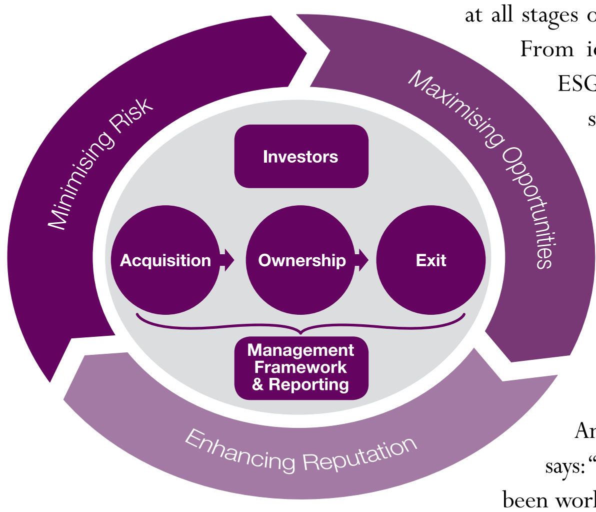
- The evidence that ESG factors impact company value continues to mount, stressing the importance of an integrated ESG approach. For example, environmental considerations revealed $13m of potential value lost from continuity of supply constraints and limits on growth in a recent food business acquisition diligence.
- Given the sustainability megatrends facing companies, such as climate change and water constraints, complex supply chains and human rights concerns, ESG issues have a strong potential to present both material risks and opportunities.
- Some leading companies are maximising value from proactively addressing ESG issues but in our experience more than 70 per cent of PE backed companies are yet to fully realise material ESG opportunities.
- Shaping an effective ESG framework, including processes and reporting, to align interests of stakeholders is critical.
- Applying a holistic ESG mind-set early in the investment process can help maximise business value.
- Focused engagement is needed with portfolio companies including improved visibility and reporting of ESG at board level to enhance performance and realise greater value at exit.

"The impact of PRI has been immense in promoting the ESG agenda within the financial community

Companies that have proactively addressed ESG issues, have not only achieved significant financial gains, but have also achieved better competitive positioning with ESG-sensitive customers, some of whom may have very strict supplier requirements. Matt Klein, Head of ERM's Transaction Services, Asia-Pacific comments: "A good example of a product-focussed initiative is of a lifecycle assessment programme, which enabled a pipe manufacturer to gain significant market share at high double digit margins in Australia by demonstrating their products' better environmental credentials compared to competitor offerings."

Private Equity – the investment perspective

Consideration of ESG issues is relevant at all stages of the investment lifecycle. From identification of material ESG issues during pre-acquisition to active engagement during ownership, the prudent investor looks to ensure risks are mitigated and opportunities identified are realised. Cristina Knapp, ERM's co-lead for M&A Transaction Services in the Latin America & Caribbean Region says: "In Latin America, ERM has been working with a major buy-out



firm to introduce an innovative ESG screen which not only informs the deal team of material ESG aspects early into the process but also, helps to focus the main diligence on the critical issues that can impact value."

When exiting an investment there is an opportunity to demonstrate that ESG issues have been addressed and will not appear as liabilities in the next owner's due diligence. There has been an increasing trend of companies commissioning ESG vendor, or sell-side, due diligence reports as part of the exit preparation, Guy Roberts, ERM Partner, comments: "In the UK, we have seen a 60% increase in the vendor due diligence work commissioned by PE backed companies over the last 18 months." In a recent vendor ESG due diligence programme, a PE backed European manufacturer reduced potential exposure and capital outlay by $2.5million.

While Limited Partners (LPs) are clearly looking for favourable financial returns, their own diligence of the General Partner (GP) is increasingly requesting assurance that a formal management system is in place to ensure that risks associated with ESG issues are understood, mitigated and managed. European LPs have led the way in this regard, however this seems to be changing, Andrew Radcliff, Head of ERM's Transaction Services, The Americas says: "Up until the last year or so, European LPs have been driving the agenda for GPs to address ESG issues in their investments, however, in recent months we have seen more US and Canadian LPs focusing on ESG issues in their investment evaluations."

Julien Famy, Head of ERM's Transaction Services, Western Europe and North Africa adds: "We may also see a trend whereby some of the larger LPs may concentrate their investments in fewer managers. Hence, the ESG factors impacting such investments positively or negatively are likely to get compounded." Some of the larger and leading LPs are working on their internal assurance programmes to get comfort that the GPs and their portfolio companies are addressing such issues appropriately and proactively.

GP ESG Integration Stages

Managing a portfolio provides a challenge for GPs as they look to monitor performance against relevant and material ESG factors with the most potential to impact value of the investment and communicate to LPs how they effectively mitigate risks and realise opportunities to enhance value.

The GP approach will vary depending on where they are themselves in the process of integrating ESG in their investment management. This can be categorised broadly into the following three stages:

- *Stage 1:* **Early stages of ESG integration.** These PE firms will likely have limited internal ESG support and may have a limited experience or knowledge of ESG factors.
- *Stage 2:* **Developing or recently established ESG processes.** These PE firms will likely have some ESG framework in place through policies and process but may have limited internal resource or need technical support as they further develop the roll out of their policy and process, both in embedding ESG within their investment processes, and in their engagement with portfolio companies.
- *Stage 3:* **Fully established investment process that includes engagement on ESG matters across the portfolio.** These firms have implemented strong ESG pre-acquisition diligence processes, collect portfolio wide data on a regular basis, monitor progress and support companies (where this is possible), prepare for exit and report on ESG performance to investors and other external stakeholders.

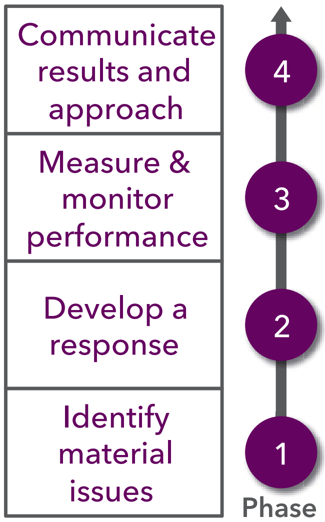
Invested Company ESG Maturity Phases

We have also identified that invested companies themselves go through an evolution in their approach to managing ESG issues (fig. 1). This consists of four phases:

1. Companies need to understand and **identify the material issues.**
2. Having identified the 'material' issues, companies then need to **develop a response.**
3. The next phase is to **measure and monitor performance** so that effectiveness of management controls and progress of performance improvements can be defined.
4. The final phase involves **communication** of approach and results; firstly internally and then externally.

Karen Aitchison, ERM's EMEA Transactions Services Lead comments: "The assessment of material issues requires the identification and engagement of stakeholders, both internal and external – to ensure ESG issues can be identified across the full value chain of the company." These issues then need to be assessed in terms of their importance to the key stakeholders and their potential to impact the business' strategy and goals. Right through these maturity phases, there are ample opportunities for PE backed companies to draw from lessons, both positive and negative, from other corporate sustainability leaders in their respective sectors, who have already been through a similar journey and reporting process. »

FIG 1: INVESTED COMPANY ESG MATURITY PHASES



» DEMONSTRATING ESG MANAGEMENT

Effective management of a diverse portfolio recognises the company phases of maturity as GPs work to engage their portfolio companies to ensure that the *procedural measures* are in place and are robust, i.e., material issues identified and management policies and programmes maintained; and that *performance improvement measures* have been implemented.

Irrespective of the stage PE firms are at, it is important that they look for some level of assurance that their portfolio companies meet basic standards of ESG performance and therefore need to have effective and efficient processes for communicating with their portfolio companies.

ERM has developed an *ESG Reporting Approach* that supports the integration of ESG considerations in the GP investment process in the following ways:

1. Early assessment of ESG awareness and maturity among portfolio companies by collecting:
   - Gathering information to demonstrate adequacy of management of ESG (such as percentage with policies, percentage with ESG committees, with ESG board representative, percentage with ethical products etc.)
2. Identifies the material ESG issues for each company/sector.
3. Monitor and supports exit preparation by
   - collecting data to demonstrate improvements in ESG performance
   - resolving ESG issues during ownership
4. Provides a repository so that the company or GP can review each company's status at a given moment in time.

When a PE firm (GP) is at *Stage 1* or *early Stage 2* the approach can provide a structured mechanism to provide an initial assessment at a portfolio and/or company level and can support ESG policy and practice development at both.

The approach further supports PE firms at *Stage 2* as they work to put ESG polices into practice and engage as owners in an appropriate way to promote the development of relevant ESG metrics at a portfolio and/or company level.

For PE firms at *Stage 3* the approach offers a streamlined process to measure and record progress core metrics and/or improvements in ESG performance over time at a portfolio and/or company level.

In addition to internal monitoring and communication with investors, both LPs and GPs may have additional external reporting expectations or requirements, for example, reporting requirements of the Principles of Responsible Investment (PRI). "The impact of PRI has been significant in promoting the ESG agenda within the financial community," says Jens Wrabel, ERM Partner, Central Europe. Arguably real value from ESG initiatives is generated at portfolio level and hence it will be interesting to see how the PRI further develops its reporting and assurance process to include portfolio company ESG performance indicators.

CONCLUSION

ESG issues have been proven to have the potential to present material risks and opportunities to companies and to their stakeholders. However, there are still a large number of PE-backed companies that are yet to fully appreciate the impact of sustainability mega trends and associated ESG issues on their operations and markets.

Portfolio companies are likely to be at different phases of maturity in terms of their approach and performance on ESG issues, largely driven by their industry sector and customer expectations. An effective GP strategy for engagement takes account of the portfolio company's maturity and adapts to provide a level of support and engagement that is appropriate in terms of the maturity but also commensurate with the extent of risks and opportunities.

The *ESG Reporting Approach* provides a framework for effective communication with portfolio companies, investors and other external stakeholders. Firstly by assessing ESG maturity, for example, have companies identified their material issues, do they have policies and management procedures. Secondly, it assesses ESG performance in terms of efficacy of processes and ongoing management of ESG issues.

Considering the potential ESG can have on investment value GPs are left to assess their stage of ESG integration. Are they able to engage effectively and efficiently with their portfolio companies and assess their ESG maturity? Are they well positioned to take advantage of opportunities to enhance business value? Are they able to proactively communicate with their LPs and to build confidence in their ability to manage the portfolio in accordance with LP's own commitments on ESG and to protect their LPs from adverse media attention and associated erosion of value?

Mark Errington, ERM's Global Head of Transaction Services comments: "Whilst initially LPs may be satisfied to see some minimum ESG standards or commitments from GPs, over time, it will be interesting to see how LPs recognise ESG out-performance or under performance, and establish incentives accordingly." ■

ERM

Adding value across the investment lifecycle

25 years working with Private Equity (PE) firms and Limited Partners (LPs)

Over 250 ESG related projects annually for PE sector

Over 100 financial sector clients supported in the last two years

3 years of working with the EVCA on ESG training

40 years supporting corporate leaders in embedding sustainability

5,000 multi-disciplinary professionals globally

Over 150 offices in 40 countries

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ERM offers the following Environmental, Social and associated Governance (ESG) support across the investment lifecycle.

Raise funds and meet LP expectations

- ESG strategy and policy development
- Bolster ESG management framework
- ESG communication support

Explore opportunities

- Guidance to deal teams to identify ESG opportunities
- ESG capacity development and training

Pre-investment due diligence

- Holistic ESG Due Diligence on material issues that could impact investment thesis

Post-investment planning

- Investment integration support via 100 day planning to drive business value from effective ESG management

Enhance value

- ESG Portfolio review and monitoring
- Reporting process development and implementation
- Enhancement of portfolio company ESG policies, systems & performance

Exit

- Vendor disclosures to provide assurance to bidders on adequate ESG management
- Demonstrate value achieved through enhanced ESG performance

FAMILY OFFICES AND ESG

Raising the bar

As younger heirs of family wealth push for more responsible investment principles, family offices are increasingly readdressing which private equity managers they will trust their money with, Bonny Landers of Bay Street Consultants tells Clare Burrows

Q *PEI:* When it comes to family offices, where is the motivation to be more ESG-aware coming from?

Landers: A lot of family offices start up just to focus on investments, preservation of capital, and how to transfer the wealth to the next generation. What's happening now is the next generation is saying, they would like to have more values connected with their investments, or to solve some social problems with the wealth.

The [young generation] is totally aware of the environmental challenge and there's a lot more focus even in schools to bring awareness up – climate change is all over the place.

Q What was your experience working at family offices, in particular in your dealings with private equity firms?

Because a lot of [GPs] actually have board seats on these companies, they can actually influence practices so that they are more environmentally sound or have best practices in social aspects such as labour. To me, it became quite logical that if you were managing in the long-term with these principles it became better for business.

So when we are working with all managers, but private equity especially, we can push them to say, 'can you look at how your underlying companies are dealing with their employees as one of the key areas to increase productivity'; or they can talk to them about changing their manufacturing processes so they don't pollute, which also obviously will avoid fines in the future, which is a direct hit to the bottom line. They can also help companies see that if you invest in energy efficiency, you avoid another hit to the bottom line, because that is a direct translation into saving money for the company.

Q Which do you find are the more effective managers to work with?

I have been pretty selective on the meetings I'll take now. Sometimes when approached I'll say we only invest in sustainable, responsible and impact investing, and the manager will come back and say they will donate to an orphanage or something. But that's not what we're talking about.

In one case, it was a fund that was going to do mining in developing countries, and when I asked what they were doing when it came to using less water or really respecting the environment when they were extracting, they just had no clue about that, they just said they would donate to the community. We are talking about doing it better, which means in the end, you would get on the list of companies that are mining responsibly.

But we have invested in some groups and in the public forum been accused of, 'How could you possibly invest with them?' And I say: Because they are taking the right steps to improve, and that makes a better investment story. So I'm not saying that [managers] have to be perfect, because if they were perfect I wouldn't have an investment story. If I can get them at the right stage, then we can have an impact.

Q Are family offices in Asia taking a similar approach when it comes to prioritising ESG?

Unfortunately not. I haven't heard about as much interest in Asia, there are a small handful of family offices in each country who are looking at it or at least want to hear about it, but the ones doing it are a very, very small number. They start more comfortably with the ESG part – so maybe managers who have signed the United Nations Principals for Responsible Investment, or have explicit ESG risk analysis in their decision-making on investments. But once the family sees they are not going to have much of a financial hit, they start raising the bar. ■

"We are not talking about GPs making donations in the community

Landers: *ask GPs to make use of their board seats*

__Bonny Landers__ is the founder of Bay Street Consultants, a Hong Kong-based consultancy that advises single- and multi-family offices in Asia, Europe and the US on introducing a total-portfolio approach to sustainable, responsible and impact investments.

ASSET ALLOCATION

Time to think impact?

Investors are increasingly interested in aligning their investments with their values. But can they allocate more capital to impact investing without compromising their fiduciary duty or the balance of their portfolio? By Clara Barby of Bridges Ventures

Most institutional investors now accept that embracing responsible investment principles helps to mitigate environmental, social and governance (ESG) risks. Many also recognise that improving ESG practices can increase the value of their portfolio over time. But what's less clear, particularly to some of the larger institutions, is whether they should go one step further and start allocating more capital to impact investment, which focuses on funding investable solutions to some of our biggest social and environmental challenges.

It's a strategy that has seen rapid growth in the last few years. According to Eurosif (the European Sustainable Investment Forum), sustainable investment – which focuses on creating additional value through best-in-class ESG practices – increased by almost 23 percent between 2011 and 2013, well ahead of the market as a whole. During the same period, impact investing was up by 132 percent (albeit from a low base).

It has also been attracting more interest from policymakers globally. During the UK's presidency of the G8 in 2013, Prime Minister David Cameron established a Taskforce on Social Impact Investment, chaired by Sir Ronald Cohen, to gather input from practitioners around the world. The Asset Allocation Working Group, convened as part of this process, concluded that large institutional investors can and should allocate more capital to impact – though they may need a little help along the way.

> **Since this is still a nascent strategy, some large institutional asset owners are choosing to treat impact investment as a distinct asset class**

THE CASE IN FAVOUR

Despite increases in aggregate global wealth, many countries still face a raft of social and environmental challenges so large and complex – like climate change, ageing populations, inadequate housing, rising obesity and skills shortages to name but a few – that governments and philanthropy will struggle to resolve them. So, in addition to the pioneering investors already allocating for impact, we need impact investment to find a place within institutional portfolios.

At the same time, investors – particularly younger investors – are increasingly seeking to align all their wealth with their values, recognising the limitations of the traditional 'two pocket' paradigm (where asset-owners think about their investments only in terms of financial return, and their philanthropy only in terms of social impact). Meanwhile, even the most traditional foundations are beginning to consider ways that their endowment can further their mission.

There may also be purely financial reasons to allocate to impact.

Some impact investments may be able to deliver both positive social change and market-rate (or even above market-rate) returns. If a business has found a new way to help solve a big societal challenge, it has huge growth potential – which is not easy to find these days.

Examples from our own Sustainable Growth funds include The Gym, a low-cost gym chain. Since its launch in 2007, it has already attracted 300,000 members, including 100,000 first-time gym users (primarily from underserved communities); we were able to partially exit the business in 2013 for a 3.7x return. Further afield, LeapFrog Investments reportedly made an IRR of about 80 percent when it sold its stake in Ghanaian insurer Express Life to UK-listed Prudential; it had been able to almost triple revenues in little more than a year, bringing vital insurance products to 730,000 Ghanaians.

In other cases, some financial trade-off may be required for the sake of impact. Examples might include fund managers that provide equity to microfinance providers in emerging markets; or a social impact bond funding an innovative social intervention (where it's still too early to judge what the returns will be).

However, there's a good argument that these investments may be less correlated to the broader economy – because the issues being addressed are typically non-cyclical. So there may be a diversification benefit to including them as part of a balanced portfolio.

What's more, even if some impact investments do require investors to accept a below-market financial return, there doesn't necessarily have to be a trade-off at the portfolio level. According to an illustrative sample portfolio constructed by the Asset Allocation Working Group, an investor with a carefully-selected impact investment allocation of 8-12%, doing impact deals that on average require a 20% 'haircut' on financial returns (relative to traditional products within the same asset class), should be able to achieve the same portfolio-level financial return as an investor with no impact allocation – without significantly increased volatility. The key is that the investor must be willing to accept a larger share of illiquid investments – which is why such an approach may be ideally suited to pension funds, insurance companies and foundations.

If it turns out that an impact allocation can improve a portfolio's risk-adjusted financial returns while also delivering positive social impact, that's going to be a powerful driver of asset allocation decisions over time.

HELP REQUIRED

There are still some major practical barriers to progress.

For example, in most countries, the current definition of fiduciary duty – the rules by which many large institutions are bound – does not explicitly permit trustees to factor social and environmental impacts into investment decisions.

Equally, there is relatively little track record information on which to base investment decisions; the intermediary market is relatively under-developed; there's a lack of specialist skills; set-up costs can be high; investable opportunities are often in short supply; and there's

Barby: *still more product required*

not universal accord on how to evaluate impact performance.

However, governments can play a useful role in overcoming many of these hurdles. If the rules on fiduciary duty were clarified – to better incorporate non-financial considerations – institutional investors would feel more comfortable factoring impact into their investment decisions. (Of course, governments could even go further and compel regulated financial organisations to account for their social impact.)

Governments can stimulate the market in other ways, too. They can provide tax breaks for investors. They can provide catalytic capital, such as first-loss positions or guarantees. They can help to standardise impact metrics. And, importantly, they can be a large-scale buyer of products and services developed by impact-driven organisations.

MORE PRODUCT NEEDED

So how should investors looking to allocate to impact go about it, in practice?

There's a broad range of possible impact investments, with a range of different risk, return and liquidity profiles. As such, impact investment should be considered a strategy that can be applied across a variety of asset classes (for example, private debt, private equity or real estate), rather than an asset class itself.

That said, since this is still a nascent strategy without much of a track record, some large institutional asset owners – including the likes of AXA and Prudential – are choosing to treat impact investment as a distinct asset class (often within alternatives). The result is a dedicated team with specific skills and a specific budget to invest, which may catalyse more allocation in the short term. Over time, however, the skill of factoring social externalities into investment decisions ought to become commonplace across all asset classes.

But there is one important caveat to all this. While there may be no shortage of societal challenges to address, there definitely is still a shortage of suitable investable products to connect them with investors. And without more suitable product, it will remain very difficult in practice to build up a meaningful impact allocation.

While the intermediary market has a clear role to play here, investors and governments can also do their bit, mainly by telling the market what kind of products – and product features – they need to see. If we can be collectively smarter in the way we do that, we can enable the capital markets to play a powerful role in addressing some of our greatest social and environmental challenges. ■

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RISK MANAGEMENT

Reputational risk in private equity

James Read and Martin Ivanov of Macquarie Group discuss strategies for private equity firms against bad publicity damaging their businesses

Private equity, like the rest of the financial services industry, does not often enjoy a positive reputation within the media and popular opinion. Headlines from newspapers and television illustrate that financial services has not successfully represented its positive contributions to society in the media. The private equity industry has come to appreciate that bad publicity arising from the actions of portfolio companies will have an impact on the GP and the fund. Equally, reputational damage to the owners of private equity funds can impact negatively on their businesses. In this environment, it is crucial to have established means of managing reputational risk.

DEFINING REPUTATIONAL RISK

The financial services sector is the UK's largest source of income (at 11.6 percent of the total UK government tax receipts, December 2012), generating £63 billion[1] and therefore, in part, paying for the social and governmental services shared by UK citizens. However, as newspaper and television headlines often illustrate, media coverage and related public opinion of these positive contributions is not commensurate with their financial value. Reputation, after all, is the product of opinion, not of financial return. Like the rest of the financial services industry, private equity also suffers from a similar negative reputation.

There is a counterbalance, even within the media, to those negative opinions about financial services, at least on an individual basis. The anti-heroes of Wall Street – The Wolf of Wall Street and Rogue Trader – echo a broader sentiment in the public imagination and embody what many look for in financial services. As investors and clients, we want our financial services companies to (sometimes aggressively) pursue profits. A bad reputation can, in some senses, be forgiven if we are allowed to share in the spoils of the bottom line.

The approbation permitted in the stories of those at the centre of financial scandals has, over time, moved away from the enigmatic 'A Fallen Star'[2], about Nick Leeson's role in the demise of one of the world's oldest merchant banks, to a more grotesque 'The Tale of A Whale of a Fail'[3] concerning the spectacular trading losses accumulated by Bruno Iksil who exploited deficiencies in JP Morgan Chase & Co.'s internal risk management and control systems to hide losses of more than $6.2 billion.

The 'London Whale' has hurt the reputation of chairman, president and chief executive officer of JP Morgan Chase, Jamie Dimon, who was named in Time Magazine's list of the world's most influential people in 2006, 2008, 2009 and 2011. When the company was investigated by the Federal Reserve, the Securities and Exchange Commission (SEC) and the FBI, it was found that Mr Dimon himself misled investors and regulators about the extent of the losses. As a result, JP Morgan has paid about US$20 billion in regulatory fines over the last year (2013-2014). Yet neither the scale of the regulatory fines nor the frequency of negative media coverage has been enough to unseat Mr Dimon, who remains in charge of the company. It failed also to rally the shareholders to revolt against the company's management. Furthermore, the company has not been left financially impaired: from September 2011 to September 2014 it has achieved a 93 percent dividends per share growth rate and an 84 percent increase in share price, and from September 2013 to September 2014 the dividends per share growth rate was 20.3 per cent with a 16 percent increase in share price[4].

So then, how should reputational risk in financial services be defined if regular misconduct does not translate into meaningful fines or new management? The answer perhaps lies in the momentum gathered by investors, regulators, governments and the media, which are beginning to school together to lobby for fairer treatment; momentum that is growing in magnitude with each incident.

The key will be how this shapes the direction and future of a finance company. Following the collapse of Lehman brothers in September 2008, huge firms like JP Morgan have been deemed 'too big to fail', or rather too big *to be allowed* to fail, because of the disruption that it would cause to the

> **Amid the public outcry over incidents like mis-sold subprime mortgages, a new relationship is emerging between financial services companies and regulators**

Wall Street: *regulators increasingly unforgiving*

financial ecosystem. They cannot go bankrupt, but they must be restrained via all legislative means necessary, including the creation of new legislation.

Amid the public outcry over incidents like mis-sold subprime mortgages and the willful blindness to a ponzi scheme perpetrated by Bernard Madoff, a new relationship is emerging between financial services companies and regulators. Firms are giving greater priority to reputational risk management in order to reduce the extent to which they are subject to regulatory attention and scrutiny. Furthermore, there is a special role to play in this new world of public appearance in the face of burgeoning legislation and enforcement, from those within financial firms closest to the real consequences of regulatory change – the compliance function.

RECENT FINES AND IMPACTS

The increased complexity of regulation, the pace of regulatory change and the heightened scrutiny by regulators represent significant challenges to financial services firms and have resulted in an unprecedented number of fines and enforcement cases.

Examples of some of the largest fines and settlements during 2013 and 2014 include:

- **BNP Paribas –** $8.9 billion for US sanctions violations.
- **HSBC –** $1.9 billion for lax money laundering controls in the bank's Mexican operations.
- **Credit Suisse –** $2.6 billion for tax evasion.
- **Standard Chartered Bank –** $670 million for US sanctions violations.
- **UBS –** $1.5 billion for Libor manipulation.

In all of the cases listed above, the fines have resulted in both tangible and intangible losses, including a direct financial impact on the firms' bottom line, regulators calling into question their licences to operate in certain markets, and a loss of trust among clients, shareholders and employees. Moreover, each firm has suffered significant reputational damage as a result of these events.

Although the examples above relate to large commercial and trading banks, the ramifications of these cases have a much wider application. This includes hedge funds and private equity funds whose good reputation depends not only on the way in which they themselves conduct their business, but also on the way in which their portfolio companies conduct themselves.

The risk relationship between private equity funds and their underlying portfolio companies is a symbiotic one. Bad behaviour by a portfolio company would directly impact the reputation of the private equity fund or investment bank regardless of the level of control the fund or bank exercises. Equally, a regulatory fine or negative media attention focused on the fund or bank may have a material adverse impact on the reputation of the underlying companies, either directly or by way of market perception.

In terms of the actual impact of the reputational damage, negative impacts could be felt in a number of areas, including:

- **Staff:** a dip in morale and an inability to retain and attract the best staff, resulting in reduced productivity.
- **Customers:** lack of trust, which could result in customers taking their business elsewhere and/or loss of cross-selling opportunities.
- **Regulators:** lack of trust, which could lead to more regulatory scrutiny on the firm or, in extreme cases, a restriction or loss of licence to operate in regulated markets.
- **Shareholders:** erosion of shareholder value caused by a drop in share price.
- **Balance sheet:** financial penalties, the cost of remedial actions, loss of future revenue, reduction in credit rating and market capitalisation could severely damage the balance sheet.

SOURCES OF REPUTATIONAL RISK

The sources of severe reputational damage can be external, internal or a combination of both. In the financial services sector, these sources could include failure to comply with regulatory obligations such as financial crime-related issues like money laundering, bribery and corruption, »

» conflicts of interest and financial misselling, to legal, environmental or social issues or even operational and technical failures.

Financial crime prevention is a key focus area for regulators globally and financial crime risks are increasingly a significant cause of reputational risk for firms given the heightened attention such issues attract in the press. For that reason, maintaining a robust financial crime compliance framework is an essential requirement for regulated firms, including investment banks, hedge funds and private equity funds.

As indicated, the last few years have seen several reputable firms incur significant penalties relating to financial crime compliance failures. In some of these cases, the penalties have been purely compliance framework related (that is, without any evidence of proceeds of crime entering the firm). These fines are based solely on the fact that a firm failed to demonstrate having adequate systems and controls in place to mitigate the risk of proceeds of crime flowing through the firm.

In addition to money laundering, private equity funds are particularly susceptible to financial crime risks like bribery and corruption or sanctions violations. This is partly a result of the typical use of third parties in the asset acquisition process. However, due to the risk relationship between the private equity fund and its portfolio companies, a fund can be put at risk by the differing risk management standards that exist in those companies. The fund could be liable for a bribery and corruption event, which has occurred at the portfolio-company level, resulting in both financial and reputational damage for the fund. These risks are more prevalent in cases where the portfolio companies have operations in emerging markets or jurisdictions, such as China, Brazil, India, Russia and sub-Saharan Africa, which carry a higher risk of bribery and corruption. Financial services companies in the UK are required to develop their own country risk categories based on information available to the public, as part of their overall anti-money laundering framework. Emerging markets often feature as examples of markets deemed to be of higher risk of financial crime by firms that have undertaken this assessment.

Another area that has attracted substantial focus by both regulators and the media is tax fraud and, increasingly, tax avoidance. Tax issues related to both private equity funds and their portfolio companies have the potential to become scrutinised and exposed by the media. Even outside the financial services sector, recent headline examples include the focus on major global companies such as Google, Amazon and Starbucks for low tax payments on the significant revenues in markets such as the UK.

Environmental health and safety issues and failure to meet specific standards set out in regulations can damage the good brand and reputation of the particular portfolio company or asset as well as the private equity fund investing in these assets.

Private equity funds can mitigate these reputational risks by implementing a targeted pre- and post-transactional due diligence process capable of uncovering and mitigating these risks. The importance of this is now well recognised by private equity firms and increasingly part of established practice. Risk management and mitigation strategies are explored more fully in the next section.

"How should reputational risk in financial services be defined if regular misconduct does not translate into meaningful fines or new management?

MECHANISMS FOR CONTROLLING REPUTATIONAL RISK

Reputational risk management has become a discipline in and of itself. The power of the media is well documented and one should not be naïve about the extent to which large and powerful firms seek to control the messages that reach the public about their conduct. This is true within the finance sector just as in any other business sector.

As spin doctors can win or lose elections for governments, adverse publicity can move investment into or out of geographical regions, industrial sectors and certainly out of banks whose internal controls are under public scrutiny. Dedicated publicists have appeared within the sector of reputational risk management to help 'protect' the reputations of clients by managing the outflow of scandalous stories in tabloid newspapers.

There is usually a corporate communications or investor relations department in any sizeable financial services business. At a very minimum, there will be a marketing function. The core purpose of these areas is to promote the company through attractive messaging to investors. In times of reputational hardship, these departments will be at the centre of external communications to investors and the media. It is not uncommon for the heads of prominent financial services institutions to have close connections to figures in the media or even the government. One could speculate that these connections could prove useful when putting out the perspective of a company into the public domain.

Above and beyond the ability of financial services firms to get their message out, there are internal operations that seek to limit the risk of damaging information leaking to the outside world. IT security, data protection, fraud prevention and operational risk management are all examples of areas where financial services firms employ specialists to protect their most valuable asset – their information.

It is recognised that having a proper whistleblowing policy can reduce the risk of employees going first to the media or regulator therefore giving the company time to self-report and/or investigate. It can nevertheless be 'rewarding' for individuals to report directly to the regulator. Bradley Birkenfeld experienced the benefits of going to the authorities in September 2012; afterwards he received $104 million from the US Internal Revenue Service (IRS) for exposing large-scale tax evasion practices whereby his company encouraged US clients to hide money in Swiss bank accounts under the protection of Swiss Banking Secrecy.

INCLUDE A REPUTATIONAL RISK REVIEW IN THE COMPLIANCE MANDATE

Since the primary driver of reputational risk in financial services firms is regulatory misconduct, compliance officers have become guardians of reputational risk. It has not been a deliberate strategy by firms or regulators to put compliance at the helm, but as those who act as a first point of contact for regulators, track regulatory change and sentiment, oversee mandatory internal controls and have independent reporting lines to the most senior management, compliance officers are often best placed to assess the reputational implications of commercial decisions.

The requirement for compliance officers to consider reputational risk is not new, but it is not (yet) a formal aspect of the compliance mandate in many firms. Reputational risk management is an aspect of a compliance review that has grown over time concurrently with the growth of the compliance function itself. The scope of responsibility for the compliance function within financial services companies in Europe has grown significantly since the late 1980's largely due to the increase in quantity and subject matter of financial services regulation and from more stringent expectations of market conduct set by regulators. In the UK, the financial services regulators themselves have evolved from self-regulating organisations such as the Investment Management Regulatory Organisation (in the 1980's) to more powerful agencies backed by statutory powers, such as the Financial Services Authority (1990's) and more recently the Prudential Regulation Authority (PRU) and the Financial Conduct Authority (formed in 2013).

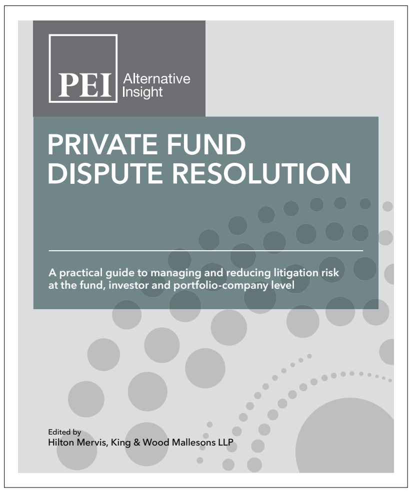
As financial markets have grown in sophistication, many regulators have realised that firms will find ways to work round and avoid being caught by prescriptive rules and that regulations based on 'principles' is a more effective approach. Compliance officers are required to interpret regulatory principles in the context of specific business activities and regulatory expectations and it is a small step from deciding on the interpretation of principles to managing reputation.

CONCLUSION

We believe that the momentum gathered from successful investor and regulatory action against firms in the financial sector will lead to more frequent and more meaningful fines in the future. To defend against the reputational as well as direct monetary costs of such fines, a new approach will be required from business leaders that will focus on compliance as a tool for reputational risk management. It will become established practice for the compliance function to take the lead on reputational risk review and assessment. Accordingly, reputational risk management will develop into an integrated part of a private equity firm's operations. The value of reputation has never been greater. To lag behind in this approach will cause financial as well as reputational loss. ■

1 The Total Tax Contribution of UK Financial Services Report, prepared for the City of London Corporation, by PwC, published December 2012.
2 The Economist, (March 4, 1995), pp 19-21.
3 Dealbreaker, May 11 2012.
4 GuruFocus.com.

This is an abbreviated version of an article that first appeared as a chapter in "Private Fund Dispute Resolution", a new book published by PEI and edited by Hilton Nervis of King & Wood Mallesons LLP.
https://www.privateequityinternational.com/dispute



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GOVERNANCE

Think GES, not ESG

At PEI's Responsible Investment Forum last year, TPG co-founder Jim Coulter urged private equity to use its governance expertise to push responsible investment throughout the industry ecosystem

Private equity's ability to improve governance at portfolio companies is crucial to driving value-enhancing environmental and social changes. This is the view of TPG managing partner Jim Coulter, who delivered a key note speech on the topic during a *Private Equity International* event in June last year.

Speaking at The Responsible Investment Forum in London, Coulter said that rather than ESG, the acronym typically used in this area (environmental, social, governance), he preferred to think in terms of GES, to emphasise the importance of governance in changing the culture of portfolio companies.

Since governance is a core strength of private equity, he added, this was also the best way for the industry to differentiate itself and fend off negative media coverage.

"We're doing pretty well, but we could do a lot better," Coulter said. "The way private equity works, with the governance structure, we can push things down into our supply chains – so not just our investments but the entire ecosystem within which we operate. If we do so, the noise we're making today, which is beginning to permeate the industry, will transform into truly deep impact for years to come – and differentiate the industry as one that cares."

Coulter also talked about how he had attempted to inculcate a culture of making the right choices throughout TPG's wide-ranging business, which spans 18 offices and over 150 investee companies.

Part of the answer, he suggested, was making it about personal rather than corporate responsibility. For instance, the firm changed its philanthropic giving policy to embrace individual rather than firm-wide causes, encouraging its staff to become personally involved with the charities concerned.

Equally, he said, the portfolio companies that had made the most progress on ESG issues tended to be the ones where the leaders of the business had taken a personal interest.

Coulter also emphasised the importance of continuing to do the right thing even in the face of external pressure. He cited the example of TXU, the biggest private equity bankruptcy in history. Despite all the 'noise' around the restructuring, TPG had continued to honour all its commitments to the business, he said, including spending $400 million on energy efficiency measures.

These external pressures on private equity had intensified since Mitt Romney's run for US president, he added. He talked about how Facebook had been invited to the White House to talk about job creation, while private equity was vilified despite creating jobs at double or triple the rate of Facebook.

This was in no small part due to the industry's failure to communicate better with the outside world, he said. "We're doing the right thing, but we need to talk about it a bit more." ■

Coulter: *take personal rather than corporate responsibility*


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