

GREAT FUND INSIGHTS

In conversation with PRI – navigating the ESG landscape in 2021 from a manager and investor perspective

Paul Sampson

Hi, everyone, and welcome to this podcast. My name is Paul Sampson and I am a partner in the Funds & Asset Management practice at Allen & Overy in London. Joining me today is Eleanor Wells, an associate in the Funds & Asset Management practice. Hi, Eleanor.

Eleanor Wells

Hi Paul.

Paul Sampson

Now the topic for today's discussion is one which I know is close to the hearts of many of our clients and that is ESG. One of the key organisations that have been driving the ESG agenda is the UN-supported Principles for Responsible Investment and I am delighted today to be joined by Peter Dunbar, who leads the UN PRI's work on private equity. Pete joined the PRI last March, prior to which he worked at Capital Group in its emerging market PE business for over 10 years and he has experience in a range of key business areas, including ESG, investor relations, fundraising and operations. Welcome, Pete and thank you for joining us today.

Peter Dunbar

Hi, Paul.

Paul Sampson

I suppose to start with it would be really interesting to hear from you in terms of what exactly the PRI's role is within the ESG debate.



Peter Dunbar

Sure. Well, I am of the opinion that ESG is such a wide ranging discipline, it's quite difficult for anyone to actually be an expert in ESG as it covers so much ground. But thanks for having me. The main thrust of what we do is we help the investment industry understand the investment implications of ESG factors and then go on to support our signatories to actually incorporate those factors into their investment decision making processes and stewardship of the assets under their management. The roots are traced back to 2005 when Kofi Annan actually put together a group of institutional investors, assets owners and managers to define and come up with the principles for responsible investments, which is our six core principles. Since then we've grown enormously. We are now at I think, it's 3,100 signatories with again, I think, it's around USD110 trillion of assets under management of those signatories. At last count we had six of the top 10 largest GPs globally as signatories but also I think, possibly more importantly 40 of the top 100 [LLP]s in the world.

Eleanor Wells

Thanks, Pete. Would you mind talking us through why, aside from regulation in governmental policy, managers and investors should engage now in the discussion on ESG?

Peter Dunbar

The incorporation of ESG factors and considerations into whether you are managing a portfolio company or doing due diligence on a portfolio company or whatever it might be, it's simply making sure that your investment decisions incorporate all of the relevant information that's held there in determining the risk return profile of that investment. We have kind of moved past that 'why do you do it?' stage because it's more or less a no brainer. Why would a company not think about climate-change related risks to their business, especially if it's material to it?

Paul Sampson

That brings us quite neatly to our next topic and the key question I suppose I have for you is how effective are those policies in navigating the commercial, regulatory and market pressures that participants are facing?

Peter Dunbar

Policies are obviously the foundation or element of a GP's or LP's output approach to ESG. There is definitely no one-size-fits-all approach. We see good practice to be good disclosure. So how do you go about disclosing to your investors what the risks to your portfolio from climate change are? Probably the best way of doing that, we feel at the moment, is through the TCFD Framework. Within climate, again there's just such a wide range of sophistication and the degree to which private equity GPs are tackling this. At one end of the spectrum you have the most sophisticated where they are beginning to do things like owning and operating proprietary forestry projects to offset those emissions. The LP side of the equation making net zero commitments is still kind of nascent, I guess, but you might have seen one of the Canadian pension plans, OTPP, made a net zero commitment commensurate about 2050. Those pressures from LPs: it's not going to change overnight, the dynamic, I don't think. I think GPs are going to have to respond more and more to that as the years go by.

Eleanor Wells

Thanks, Pete. I think on that note it would be useful to talk now through some tools that are available to investors specifically and we understand that the UN PRI has developed a technical guide for limited partners to help integrate ESG into investment processes. Could you give us a brief overview of who the guide is aimed at?

Peter Dunbar

I would say it's predominantly aimed at any LPs, those really just starting their journey in responsible investments. Basically it walks people through the rationale for doing responsible investment in ESG in private equity and we helped LPs engage a little bit more effectively with their GPs on the topics, so equips them with good questions to ask their GPs, the right tools, and points them where to find all sorts of things to help them. It's important guidance because again, going back to the beginning of the recording, I really do think it's the LPs, it's the asset owners that drive developments in ESG in this marketplace. On the GP side of the coin, it is, generally speaking, the more reactive side of the equation.

Eleanor Wells

We understand that the UN PRI has also developed a responsible investment due diligence questionnaire as a first step to use by LPs on investing in a fund. Could you also tell us a bit more about the importance of this?

Peter Dunbar

We did do that. And I think aside from just the kind of achievement of getting industry buy-in and around DDQ on ESG I think the smart move at the time there was to not just have it as a PRI standalone DDQ, but it was actually adopted by ILPA into their overall private equity DDQ. So it has become I suppose somewhat of an industry standard by bringing in some form of standardisation at least where a core set of DDQ questions can cover off, let's say, 75% of what an LP needs to know from a GP then that's a good thing. The market practice is always evolving as is the PRI's reporting framework. We have all these signatories but one of the things that they must do each year is report to us on how they incorporate ESG and then they are actually assessed on that. So that they get a grade which they can make public but if you're an LP for example looking to invest or start off a new relationship with a GP, you could look at PRI's reporting and understand how that GP incorporates ESG. But anyway that framework is changing this year, in this reporting cycle. We are going to look to update our ESG DDQ and produce a newer version later in the year which will hopefully get adopted by ILPA also.

Paul Sampson

Thanks, Pete. I suppose with the advent of the SFDR managers now are going to have to have much more explanation about how they approach ESG, how they classify their different products, and that's all thanks to the host of new regulation that is coming down the track, including the new taxonomy, so I think it must be a good thing generally and I think it's important to say there are no sides to this debate. My perspective is that managers and investors actually want the same thing here. They want to make a positive contribution from an ESG perspective. Historically the question has been how much do managers want to contractually agree to do that and that is something that is going to change going forward.

Peter Dunbar

I agree. I think just the concept of ESG has always been quite nebulous. It can mean so many different things to different people, it's kind of... I suppose it's difficult to enshrine exactly what an investor wants its GP to do on an ESG front in documentation. I guess if you have... one of the big North American buyout firms last week was committing to ...I think it was reduce portfolio company carbon emissions by, I think, 20% during their ownership period. Now that's a very specific target so, for me, things like that perhaps could actually be included in documentation. There are KPIs you can use to monitor it etc. It's much easier to include something specific like that as opposed to a much broader brush of everything that ESG covers.

Paul Sampson

One final question, maybe an impossible one to answer, but where do you see the future ESG debate going? Which players in the asset management industry do you think are lagging behind and what can they do to, I suppose, mobilise and reach the ambitious targets that have been set by our various regulators?

Peter Dunbar

I think for me I think it's got to be all about moving away from focus on integration in investment processes and more towards actual real world outcomes. It's great to have an ESG policy. It's great to think about those things during an investment process but if you're not taking the extra step and making sure many ESG issues you identified during your due diligence process aren't properly followed up on, they don't make their way through to a creation plan for example, or a 100-day plan; it's kind of pointless. There are certain sub-sectors within the private markets which are probably still yet to even get to the integration phase though. For example, the venture capital world. Every VC can latch on to the ESG trend and I think it's important because those are the guys that are putting the first institutional capital into companies which go on to potentially huge companies that have all sorts of impact on other investors.

Paul Sampson

Thank you, Peter. I just would like to say that we've really enjoyed having you on today's Great Fund Insights podcast. It's been a really interesting discussion and I'm sure our listeners will take lots of practical tips away from today's session.

Peter Dunbar

Thank you for having me.

Eleanor Wells

Thank you.

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