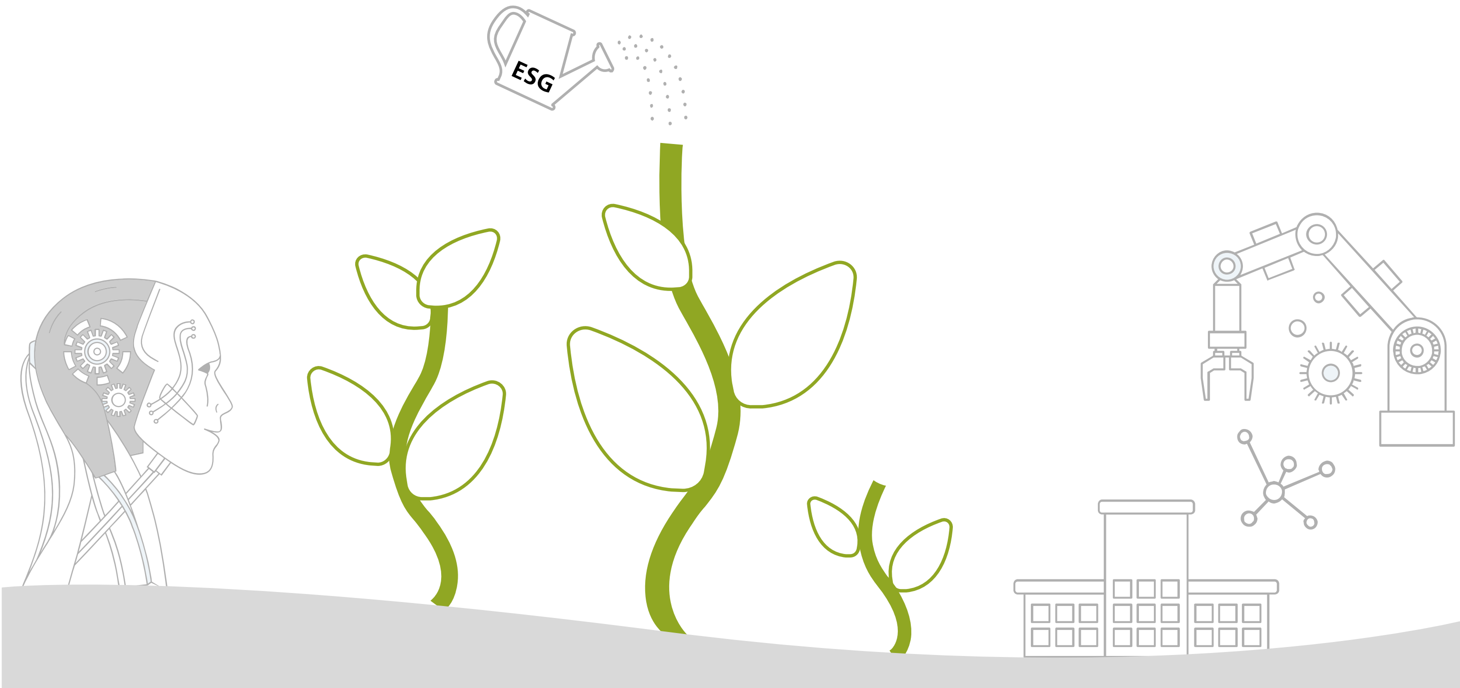
Green News & Views

Real Assets – ESG initiatives

June 2021



ESG isn't just a nice to have, but becoming a critical element in gaining market share, raising capital and engaging stakeholders.

Both private equity investors and stakeholders are now increasingly focused on investing in alignment with ESG principles.

What's the ESG in private equity?

Over the last few years, the private equity industry has radically reassessed the importance and value of ESG to their businesses. ESG has shifted from being considered an area of just compliance, to an overarching framework that informs the strategic thinking of many private equity firms. The private equity industry is now gaining steam in recognizing ESG's capacity to provide a competitive advantage in investment opportunities and value creation.

Private equity investing is about making medium to long-term investments in return for an equity stake in potentially high-growth unquoted companies. Investing indirectly involves purchasing units in a fund, which then invests into private equity on behalf of many investors. Investments typically include high-growth regions and sectors such as IT, manufacturing, services, healthcare etc., amongst various others along the different company development stages (typically referred to as venture, growth, buyout, special situations). Our Multi-Managers Private Equity (MMPE) business has a long history of considering ESG in its investments; since 2012, MMPE has conducted exclusion screening of investments and continuously refined the standards since then. Together with partners, we have also launched dedicated products in that space, e.g. the UBS Oncology Impact Fund which, until today, is the largest dedicated fund in the private markets space dedicated to finding cures for cancer.

We fundamentally believe that integrating ESG in the investment process can help better manage risk and can enhance performance, while aligning the broader interests of investors and managers. The trajectory of ESG concerns will become more important, as private equity firms look to sell today's investments in the future. Therefore, getting ahead of the game starts now.

Integrating ESG

Integrating ESG is about doing both good for society and the environment and recognizing what clients really want, which requires an investment strategy that creates tangible value. Given the broad sectors the private equity industry covers, investors can use their capital to address many of the environmental and social crises we face as a society – benefitting consumers, employees, while adapting to the evolving regulatory environment.

Today, many firms are increasingly starting to recognize that ESG can both contribute to a better world and be good business. As an example, the number of signatories to the United Nations' Principles for Responsible Investment (UN PRI) increased by 28% in 2020, representing USD 103 trillion of AuM from over 3,000 institutional investors and private equity firms[1].

Capturing the true value of ESG requires embedding it along the entire private equity value chain, from due diligence through ownership to exit. While it might not be an investable theme in all deals, it certainly should be a consideration in every diligence – particularly in the investment process.

MMPE has an established investment process of integrating ESG throughout the entire investment lifecycle from sourcing, investment due diligence, to the ongoing monitoring and reporting. ESG factors are considered early on during market screening and sourcing activities. MMPE applies filtering and exclusion of investment opportunities based on ESG merits and risk considerations. Examples of ESG factors considered by MMPE include:

- Environmental exclusion criteria include investments in coal related businesses, large dams, nuclear power, hydraulic fracturing, artic oil, and oil sands, etc.
- Social exclusion criteria include investments involving forced or child labor, businesses, or sectors with poor Health & Safety track records, etc.
- Governance exclusion criteria include investments in jurisdictions with poor governance and regulatory oversight, businesses linked with sanctioned countries or persons, businesses and fund managers not incorporating ESG as part of their processes, etc.

The table below outlines how we've integrated ESG in our investment process.

Initial operational and ESG due diligence	Completed on 100% of invested target funds
Operational and ESG monitoring	Completed on 100% of invested target funds
ESG policy in place	– 71% of invested target funds have a formal ESG policy in place[2] – 100% of invested target funds consider ESG aspects in their due diligence on their underlying investments[2]
Investments in excluded environmental or social risk sectors	0% of invested target funds have investments in excluded environmental or social risk sectors
Negative screening using news and proprietary background screening solutions	Completed on 100% of invested target funds
Investments in sanctioned countries	0% of invested target funds have investments in sanctioned countries

Once an opportunity is deemed appropriate for potential investment it is subject to a rigorous investment process. The detailed analysis covers the opportunity from a commercial but also an ESG perspective.

Initial operation and ESG due diligence
Review ESG scores achieved by a target fund and company levels (e.g., GRESB scores, UN PRI assessment, other ESG accreditations). Such scores may indicate risks and opportunities that could impact current and future investment returns and liquidity. Information is incorporated into the investment decision making process, which includes other commercial and financial analysis too.

Operational and ESG monitoring
After an investment in a target fund has taken place, performance of the manager and its methodology for assessing ESG criteria is continuously monitored and reviewed by the Investment Committee as part of our monitoring process. Fund managers are requested to fill out an ESG due diligence questionnaire on an annual basis which allows us to monitor the General Partners and ensure that they remain ESG compliant consistently over time.

ESG policy in place
Review each fund's ESG policies, how it incorporates these policies into the fund strategy, how it reports its ESG strategy to its investors, what relevant laws and regulations impact the fund, and any sustainability initiatives the fund is already participating in with ongoing and formal annual monitoring.

Investments in excluded environmental or social risk sectors
Prohibiting investment in funds or companies based on exclusion criteria. Target funds that do not meet the criteria are removed from the investment universe and from the portfolios. ESG information is provided by the manager through dedicated reports and covers a number of ESG areas including: ownership; past and current litigations; firms' governance model; firms' ESG policy and principles; past and present investment activity in restricted or sanctioned countries; past or present investment activity in controversial sectors (e.g., palm oil, nuclear, etc.)

Negative screening
Adverse media checks at individual portfolio company level to screen against potential risks by revealing any involvement in illicit activities or sectors listed in exclusion criteria. All findings are analyzed and discussed during the investment decision making process.

Investments in sanctioned countries
No past, present or future investment activity in restricted or sanctioned countries.

We fundamentally believe that ESG will materially impact future results, combined with an overarching fiduciary duty both to manage risk for our clients but also to act responsibly as investors. As an example of this, our flagship private equity growth strategy has been classified as Article 6 under the EU's Sustainable Finance Disclosure Regulation (SFDR). This designation formalizes the strong sustainability positioning of our private equity offering.

In an evolving and dynamic world, private equity firms are important drivers of both liquidity, growth and transformation. Therefore, integrating ESG principles into the investments process, can contribute to a better world while building stronger value-creation and value-preservation – presenting a compelling exit story. This can provide firms with a competitive edge in a market that has never been more competitive.

UBS-AM key commitments:

GRESB ★★★★★ 2020

Signatory of: PRI Principles for Responsible Investment

Source: UBS Asset Management, Real Estate & Private Markets, July 2021.
Notes: **1** UN PRI, July 2021. **2** Figures relate to fourth Global Private Equity Growth strategy's underlying target funds as of 31 March 2021.

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