

ESG Commission: Recommendation on how the various parties to a transaction should deal with ESG criteria (sponsor, joint shareholders, debt fund, mezzanine fund, banks)

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Debt Commission

- Idinvest Partners, represented by Maxime de Roquette-Buisson
- LGT Private Debt, represented by Olivier Meline
- Tikehau Capital Advisors, represented by Laure Villepelet.

ESG Commission

- Activa Capital, represented by Charles de Lauriston, member of the steering committee of the ESG Commission
 - Ardian, represented by Candice Brenet, Chair of the ESG Commission
 - Azulis Capital, member of the steering committee of the ESG Commission, represented by Yann Collignon
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1. Background

In November 2019, France Invest published an updated recommendation (based on the recommendation of October 2017) intended to facilitate relationships between LPs and GPs, ~~but~~ still aimed at achieving greater transparency, greater cooperation and a joint contribution to greater effective consideration of ESG criteria. The aim was to focus on material priorities and to put forward an operational approach and standardised practices (media, timetable, IT tools).

This approach led to convergence on the principles and the proposal to use alternatively:

- A standard reference framework: a common set of ESG performance monitoring indicators consisting of
 - o 11 indicators relating to the management company and,
 - o 11 indicators relating to the portfolio companies as a whole, i.e. on a consolidated basis for each fund, and not separately for each portfolio company.
- An additional framework for LPs and GPs that together wished to follow a more in-depth approach. To that end, the working group developed two in-depth questionnaires: one for management company indicators and one for portfolio company indicators.

The work of the ESG Commission continues, in particular concerning the specific characteristics of lenders. Two areas of analysis have been chosen:

- What general ESG approach should be put in place for lenders?
- On a given transaction, how should ESG issues be coordinated and harmonised between the management team, the sponsor GP, any co-investors, debt funds, LBO banks and mezzanine lenders?

Lenders are, like the rest of the industry, increasingly concerned by ESG issues and are therefore keen to contribute to the development of these practices. At times, they find that they are ~~leading-driving~~ these ~~questions-discussions when executing on~~ transactions. Their involvement continues during the holding/lending period.

The members of the Private Debt Commission have developed a draft standard ESG clause for loan agreements that they wish to disseminate widely. Going beyond debt funds, promoting a standard ESG clause in loan agreements would help to create a market reference and introduce ESG issues into pre-transaction discussions between financial partners and management.

2. Objective

On any given development capital or LBO transaction, the objective is to articulate and harmonise the management of ESG issues between, depending on the circumstances, the management team, the sponsor GP, any co-investors, debt funds, LBO banks and mezzanine lenders, by integrating those issues into the framework defined by the existing process.

In the background, the approach remains guided by the aim of implementing, with company management, an operational approach to ESG issues, based on the principles of specificity, materiality, priorities and progressiveness.

3. Recommendation

During transactions, it is recommended that the different parties work together to determine the main principles of the ESG approach that will be used with management, led by the equity sponsor. The common objectives must be (i) to harmonise and simplify requests for information and documents to make it easier for management teams to deal with ESG issues, (ii) to thereby avoid multiple reporting formats, which are often time-consuming, and not always suitable, and disliked by management teams.

At the time the transaction is carried out:

- discussions on the company's ESG issues, often managed by the equity sponsor, should be shared upstream with all the other parties;
- if the equity sponsor has arranged for consultants to carry out ESG due diligence (before or after closing), it should send the report to the other partners, as is customary for all other due diligence work carried out on the target company;
- the partners should work together to formalise the operating procedures to be put in place during the holding period/term of the loan based on the target, its size, its business sector and its maturity in relation to ESG issues (complex generalisation given the number of issues and criteria).

Once the transaction has been carried out, the equity sponsor remains, as it does for other matters, the principal point of contact for management, to avoid multiple requests, as is the case for financial issues. In this context, an annual report drawn up based on the work of the equity sponsor and the recommendations of France Invest must be defined by the partners involved in the transaction, together with the associated operating conditions (Q & A, responsibility, costs, etc.). If no specific format is agreed, the "portfolio companies" framework set out in France Invest's recommendation of November 2019 (relationship between LPs and GPs) should be completed by the company and sent by the equity sponsor.

Specific scenarios and further details of the recommendation

1. The sponsor carries out ESG due diligence

If, like other due diligence procedures, ESG due diligence is carried out by an external party before closing, the sponsor agrees to send the due diligence report to the debt providers before closing, for information purposes.

If ESG due diligence is carried out by an external party after closing, the sponsor undertakes to send the report to the debt providers within a reasonable period.

2. The sponsor does not carry out ESG due diligence

In this scenario, the lenders work together and propose a joint approach to the sponsor: joint questionnaire sent to the company before or after the transaction, implementation of a step-by-step approach, reports (...), issues to be defined and documented on a case-by-case basis depending on the size of the transaction, the characteristics of the target, its business sector and its maturity in relation to ESG issues.

3. Transaction without a sponsor

In this scenario, the debt funds use their best efforts to harmonise their approach, always with the aim of putting an operational ESG approach in place with company management, based on the principles of specificity, materiality, priorities and progressiveness.

4. Joint approach by banks and debt funds

In this scenario, just as for other areas on which due diligence is carried out, the parties in a syndicate all benefit from the work carried out by the various parties to the transaction, in accordance with the principles set out above, and do not intervene directly with the company that is the subject of the transaction, unless the other parties have not carried out ESG due diligence and have not agreed on a joint approach.

Documentation

It is recommended that the parties work together to incorporate, by mutual agreement, relevant key ESG issues into the loan agreement, on a case-by-case basis and depending on the context, such as:

- ESG approach and undertakings of shareholders/lenders (signing of PRI, etc.)
- Issuer's ESG approach, material ESG issues
- Issuer's representations and undertakings
- ESG reporting procedures.