EXPERT Q&A

From rigour in due diligence to a more hands-on approach to governance, debt managers can play a crucial part in responsible investing, says Jean-Marc Fiamma, partner at CAPZA

Lenders have key role in driving ESG

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Q What requests and expectations are you currently seeing from LPs on the subject of ESG?

We have noticed that LPs are more and more concerned about environmental, social and governance issues. This can be observed during the fundraising process when a growing number of ESG questions are now routinely included in the due diligence questionnaires. The most sophisticated LPs even have dedicated questionnaires on ESG.

We feel that ESG is becoming a global concern, but we still see variations between investors in different jurisdictions. Perhaps unsurprisingly, investors in the Nordics are generally the most concerned, but French investors are also very keen on ESG.

LPs are enquiring about ESG both at the portfolio and the management company level, with increasingly sophisticated questions such as the integration of climate impact. There are also more requests from investors to have specific ESG requirements reflected in side letters or by-laws, whether these are enhanced exclusion rules or increased reporting requirements.

Q What role can private debt managers play in driving ESG commitments across a portfolio, given the role is only that of lender?

Debt managers can't drive their portfolio's ESG impact in the same way as private equity sponsors, but we still believe we have an important role to play and so do LPs. We have no formal right to impose our views or requirements, but there are two crucial ways we can influence ESG.

First, before the investment process, we perform increasingly in-depth ESG due diligence. We can decline an investment if we don't consider it to be fully ESG-compliant. Second, during the life of the investment, we perform an annual ESG review with detailed criteria and we work hard to share our views with both the management and the private equity sponsor.

When we are working with a sponsor on a transaction, we try to assess its maturity on ESG topics and, if we deem it is not enough, we try to drive change. As we often have observer seats on the boards of directors of the companies that we lend to, we try as much as we can to raise ESG matters to the agenda of the board throughout the life of our involvement. In the context of sponsored transactions, more and more PE sponsors are now performing ESG annual reviews that we integrate into our own monitoring tools. If we think the report is incomplete, we will request that additional performance indicators are monitored.

We also do sponsorless transactions and there, of course, we can be more influential because we are in a one-to-one relationship with the management team. Again, while we don't have any formal right to direct because we are not a shareholder, in most cases we do get the opportunity for input.

Q How do you measure and track ESG progress across the portfolio?

We perform an annual review of all our portfolios whether private debt or private equity. Our detailed ESG review seeks to monitor 15 criteria around environmental, social and governance factors. It comprises more than 110 questions.

Our objective is to have the same quality of information whether we are in private equity or private debt. We know that, in most cases, in sponsored transactions we have to work alongside the PE sponsor in order to get ESG information.

Then, we aggregate those criteria for all CAPZA's portfolios in order to build a synthetic view. This enables us to better identify what areas to place emphasis on. In 2020, for instance, we have set objectives on three criteria: increase the number of independent members on the boards of directors, formalise codes of ethics and establish formal commitment for diversity.

Q How important is ESG to CAPZA at the management company level, and what kind of initiatives are you focused on in that context?

If we want to make an impact with our portfolio companies and challenge them on ESG topics, it is pretty obvious that we have to apply the same principles to CAPZA. Until 2019, we had a number of different initiatives going on but they were not really coordinated at the company level.

We decided last year to gather all those activities into an overall approach, which we called CAPZA for Good. The first thing we did was to perform the same type of ESG analysis on our own company as we do on our investments, and identify the areas that we need to focus on. We wrote our own corporate social responsibility charter and we have already identified several areas that we intend to prioritise, including happiness at work, diversity, carbon footprint and waste management.

In all of these areas we now have a number of initiatives up and running – we are planning to compensate our carbon footprint by offsetting all our travel by plane, for example, and we are looking at moving from an ad hoc approach to taxi use in favour of a commitment to using green cabs. On diversity, we are now monitoring the number of women in the investment team and monitoring our progress on several different metrics in that area to make sure we continue to take diversity seriously across our business. ■

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Q Have you ever declined an investment opportunity because of ESG concerns? If so, can you give examples?

Of course, it happened several times in the past. We recently declined an investment in a company engaged in medical tests on live animals. Another example is a company specialised in the sale of dry fruits, where we found out that some of the fruits were originated from water-stressed areas, and then transported to India for processing. We walked away from that opportunity.

Jean-Marc Fiamma is a partner at CAPZA with responsibility for ESG issues for private debt. He is a member of the firm's CSR committee, CAPZA for Good