Private Equity

Annual Responsible Investment Report

2018

About PGGM Investments

PGGM Investment Management provides fiduciary management and asset management services to Dutch pension funds. As the administrator for investment funds and the asset manager for pension funds, PGGM supports its clients in their duty of providing a stable and high-quality pension for their participants, now and in the future.

Introduction

PGGM Investments is committed to investing responsibly. We manage our clients' private equity investments in order to contribute towards a stable pension for their participants while also taking into consideration the impact we are having on the world around us. We recognize that environmental, social, and governance (ESG) factors have a material impact on the financial performance of the private equity portfolio both through the identification of value creation opportunities and the mitigation of identified risks.

In 2018, the PGGM Private Equity (PE) team has continued to demonstrate its commitment to responsible investment by further integrating ESG in the investment process. The focus has been on improving monitoring and engagement as part of the ownership step in the investment process. As a prominent and sizeable investor in private equity, we are well positioned to make a difference and follow this through with active engagement across the industry.

We are pleased to present PGGM's first Private Equity Responsible Investment Report, which coincides with the launch of a €500 million Investing in Solutions sleeve within Private Equity, created to help invest in ESG-related positive impact projects over the next 5 years. In this report, we focus on outlining how we have integrated ESG considerations into each step of our investment process to highlight our ongoing commitment to responsible investment.

"We believe we can affect meaningful change by encouraging our GPs to make incremental improvements over time in how they approach ESG within their firms and portfolio companies."

Eric-Jan Vink
Head of Private Equity department

Highlights and KPIs for PE in 2018

15% average net return over the past 10 years

65% of capital invested with GPs that score either "High" or "Very High" on our ESG Integration Assessment

68% of GPs report on ESG on either an annual or quarterly basis

11% of GPs report on ESG through our template

97% of GPs report on ESG incidents

13 GPs engaged on ESG, resulting in 4 of them significantly improving their approach to ESG

Set-up of a **€500 million** programme for Investing in Solutions within private equity over the coming 5 years

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1. Responsible Investment at PGGM and in PE

In 2015, PGGM Investments began the transition of responsibility for ESG integration from the dedicated Responsible Investment team to the individual investment management teams. In a two-year project, PGGM's investment and advisory teams were given full ownership of responsible investment. The ultimate aim is for responsible investment to be fully integrated into all teams and internalised as part of their daily activities.

Since the transition process ended in 2017, PGGM's PE team has the full responsibility to analyse and integrate ESG considerations in their investment process. The Risk department has taken up the role of "challenger" in deal teams and the RI team serves as a knowledge center for both.

In the PE team, all investment professionals are actively involved with ESG. ESG analysis is included in the preliminary and the final investment proposal for the consideration of the relevant investment committees. Every year, the RI and the PE team set mutual goals for next steps regarding ESG. ESG targets are included in the compensation targets of the private equity team.

Private Equity Team

Eric-Jan Vink
Head of Private Equity department

Christine Winslow
Director

Harrie van Rijbroek
Director

Pieter Willemse
Senior Investment Manager

Berend Schiphorst
Senior Investment Manager

Wouter van der Geest
Senior Investment Manager

Carlos Garcia Rivas
Investment Manager

Elisabeth Villas
Investment Manager

Martijn van Gils
Investment Manager

Diederick Plasmans
Investment Manager

Megha Jain
Investment Manager

Daniel Zwier
Associate

Adesh Bridjmohan
Analyst

Julian Segeth
Analyst

Gust van der Meeren
Analyst

Niek van Wijngaarden
Analyst

Alex McKinney
Analyst

Coen Keijzer
Analyst

Joris van der Zee
Analyst

Investing in Solutions PE Team

Willem Jan Brinkman
Director

Maurice Klaver
Senior Investment Manager

Niels Las
Analyst

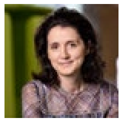
Direct Support

Bas Lasseur
FOS

Chantal Reijerse
FOS

Bo Furman
Secretary

Responsible Investment

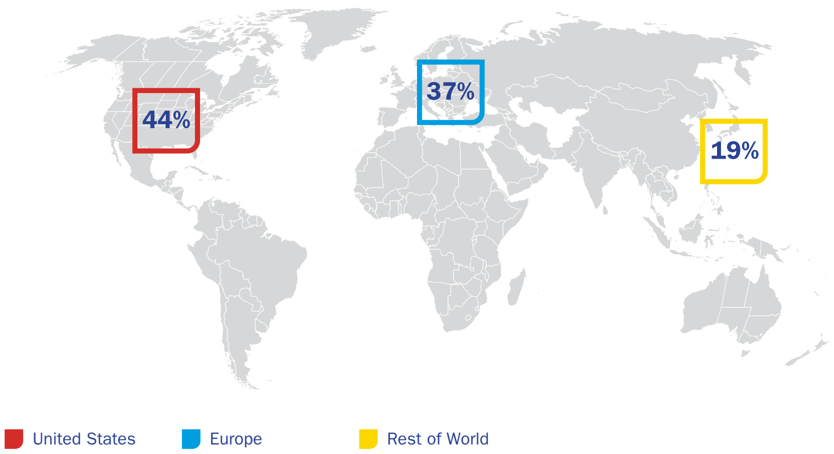


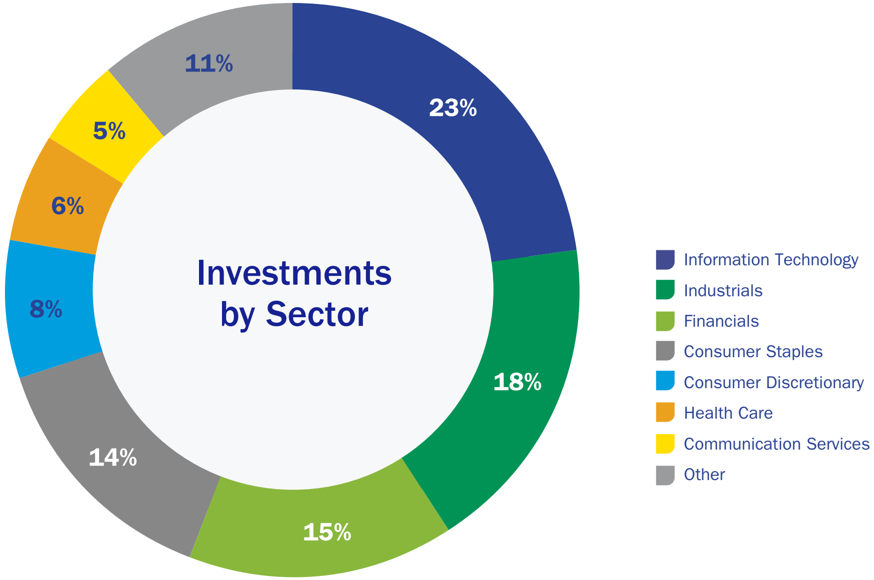
Jelena Stamenkova van Rumpt
Senior Advisor

2. Our portfolio at a glance

PGGM PE has a total of €12.5 billion in assets under management. Our objective is to outperform the public markets by 2.5% which we have exceeded historically. We have achieved a 10-year average return of 14.9%.

The PE portfolio is well diversified. While it is global, the majority (80%) of investments are with GPs in developed countries, primarily the US and Western Europe, with a focus on buyout investors.





The underlying investments in the portfolio are broadly diversified across sectors with significant exposure to **IT**, **Consumer Discretionary**, **Industrials** and **Health Care**. Note that we are in principle sector agnostic.

PGGM was an early investor in private equity, starting in 1983. From 2000 until 2011, it outsourced its private equity investing to AlpInvest. Since then it built up its in-house PE team again. The rest of this report focuses on the portfolio that the PGGM PE team has built since 2012, representing 56% of the total PE portfolio.

PGGM PE has invested with 71 individual GPs in 114 primary fund investments, 11 secondary fund investments, and 48 co-investments.

3. Our approach to ESG

PGGM PE has integrated ESG considerations into the investment and portfolio management process and strategy. The ESG integration process is organized around the different investment stages: selection, commitment and ownership.

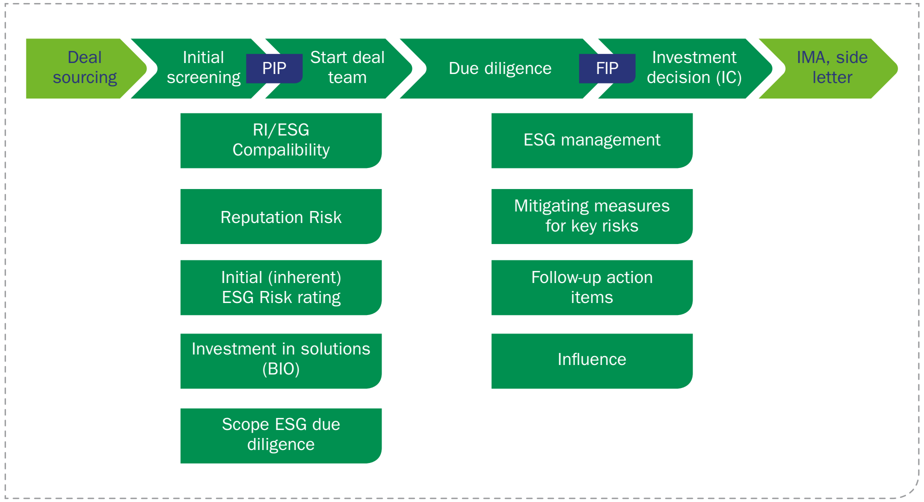
Our activities are guided by our clients' policies and PGGM's Guidelines for Responsible Investment in PE. We strive to incorporate these into the legal documentation with our GPs where possible and made considerable progress towards this end in 2018. We are effecting a shift from a focus on compliance to an increasingly active approach in which investments continue to support the present and future financial security and well-being of pension beneficiaries, but just as importantly help sustain a good and liveable world for the future.

We also encourage our GPs to better understand which ESG factors are material for the investments. We consider a factor material when it significantly impacts the financial performance of the portfolio companies. We consider other potential negative impacts to society and the environment which may also have a negative impact on reputation and the business' license to operate. In the following chapters, we will go in to greater detail on what we do in the different investment stages (as set out in the Figure).

Selection (Ch. 4)	Commitment (Ch. 5)	Ownership (Ch. 6)
- GP ESG Integration Assessment based on the UN PRI DDQ - DD fund and co-investment assessment based on sector/ country risk	- Include adherence to PE Guidelines and Exclusion implementation Guidelines in the side letter - Include ESG action plan and reporting according to PGGM's reporting template in side letter - Incident reporting	- Monitoring GPs on adherence to agreed upon ESG approach - Identification and prioritization of GPs for engagement based on e.g. the GP ESG Integration Assessment and exposure to ESG country and sector risks.

4. The selection stage: screening and due diligence

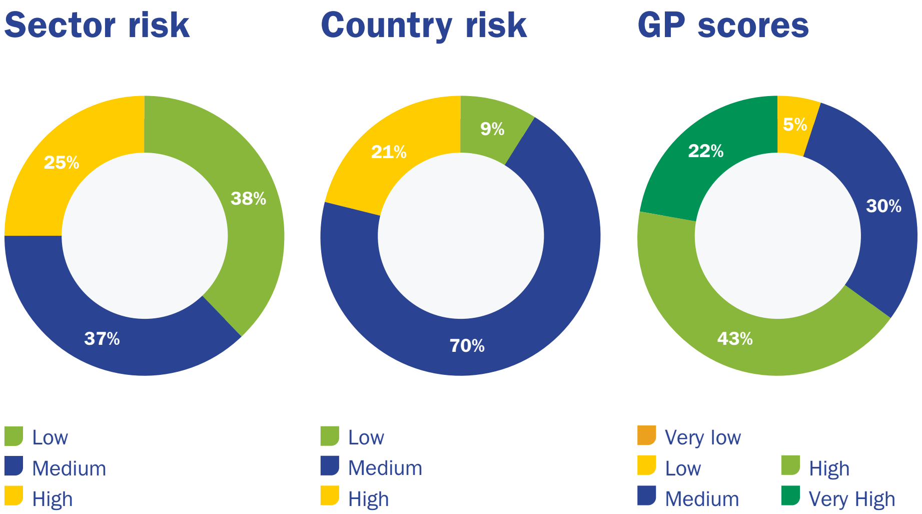
In the selection stage, as part of our broader selection process, we assess whether our investment partners will treat ESG risks and opportunities appropriately and in line with our responsible investment strategies and beliefs. The PGGM PE team wants to achieve strong returns with partners who are focused on investing responsibly and willing to keep improving with respect to how they approach ESG.



4.1. ESG sector and country risk score

The PGGM PE team uses data from external data providers, such as MSCI and Sustainalytics to determine the sector and country risks to determine the country and sector risks within the underlying portfolio companies in a fund's portfolios. This gives us primary insights into the ESG risks based on the sectors and countries in which the underlying companies are located.

The combined data on assets' ESG risks and its managers' ability to manage them as defined by our GP ESG Integration Assessment framework, enables the PE team to assess the ESG risks in the portfolio and, hence, prioritize which GPs to engage with. We are comfortable investing in high risk countries and sectors as long as we believe the GPs can effectively manage these risks.



"For PGGM, it is important to understand how our GPs are integrating ESG into their investment processes and to report this back to our pension fund clients. We want to beat market rate returns and also help build more sustainable businesses with less negative and more positive impacts on the world. This is our goal and we rely on our GPs to get there. They are great partners, we can learn a lot from them and we think it's an exciting challenge for all to achieve."

Jelena Stamenkova van Rumpt
Senior Advisor Responsible Investment

4.2 GP assessment

During the due diligence phase the private equity deal team will use the ESG questionnaire to assess the ESG management of the GP. This questionnaire, our ESG Integration Assessment, has seven questions drawing from the PRI's Due Diligence Questionnaire. It includes questions relating to RI policy and responsibility in the fund, involvement in industry initiatives (i.e. UNPRI signatory), ESG integration in day-to-day activities, ESG monitoring, and ESG reporting, resulting in a score of 1 (worst) to 5 (best). The PGGM PE team uses the framework to score the GPs in the due diligence period before investment and then also for monitoring.

The scoring of GPs is summarized within the final investment proposal (FIP), the document upon which the relevant Investment Committee(s) take a decision on whether or not to make a commitment. During the deal team process, PE investment professionals, challenged by the Risk Analysis team and supported by the RI team when necessary, consider the ESG risks and opportunities of each investment. The PE Investment Committee is committed to showing an improvement in ESG implementation within the portfolio over time.

Sometimes we decide not to invest due to ESG considerations. We have included examples of both a fund and a co-investment where we decided not to pursue an investment at least in part due to a lack of commitment to improving ESG on the part of the GP or ESG concerns around the investment.

Fund decline

We considered investing with a North American GP which had demonstrated relatively attractive performance. While there were additional reasons for the decline, one of the most significant was their lack of commitment to improving the ESG integration in their investment process. Although we are willing to invest with GPs with lower scores on their GP ESG Integration Assessment, they should make a commitment to improve.

Co-investment decline

We were invited to co-invest alongside a European GP in a manufacturing company. The main concern which prompted declining the opportunity was the potential for reputational issues stemming from the company's involvement in Iran and Russia and the potential political fallout from this.

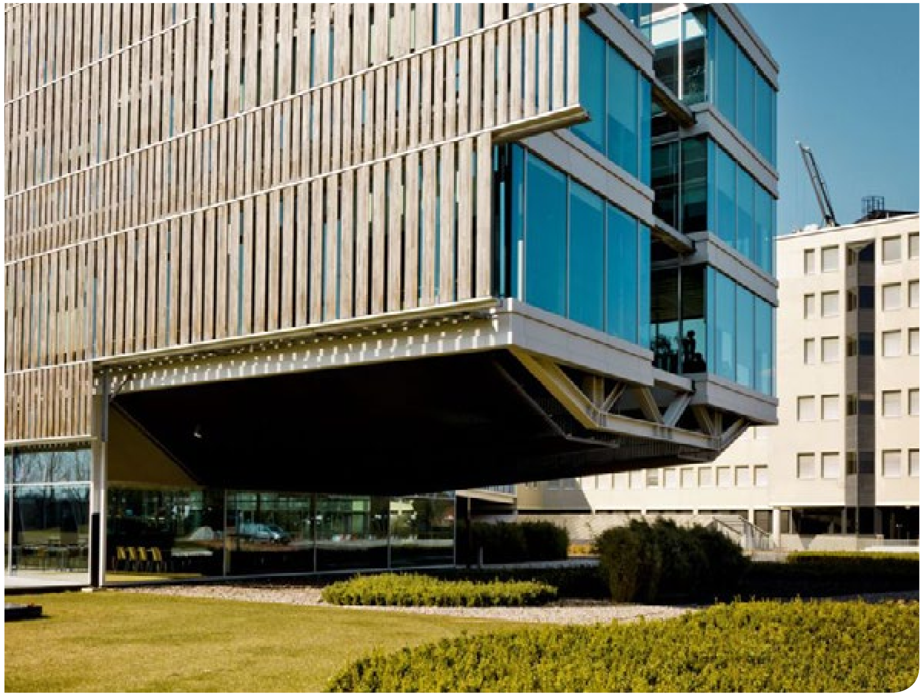
5. The commitment stage

PGGM PE generally looks for GPs who demonstrate a willingness and commitment to improve on their approach towards ESG over time. Language is included in the legal documentation with the GP which ensures that PGGM PE will not be invested in companies engaged in the production or sale of specific types of weapons, tobacco manufacturing or companies which violate the UN Global Compact Principles. We look to include additional language stating that the GP agrees to incorporate ESG criteria in their investment process in line with the UN-backed Principles for Responsible Investment and that the GP will annually disclose to investors progress on and reporting of ESG."

We also ask our GP's to report on incidents, such as accidents with severe physical injury, major environmental pollution or legally established misappropriation of funds in order to ensure that GPs will follow up on these.

In 2015, together with AlpInvest Partners, APG and MN, we developed a template to promote standardised ESG reporting for private equity investments. The intention of this template is to help PGGM PE understand and monitor the ESG implementation process at the fund and portfolio company level. For example, it will help compare CO2 equivalent emissions across the relevant part of the PGGM PE portfolio once implemented. The template can also be used for co-investments.

Requirements regarding reporting have been incorporated into the legal documentation with GPs since 2015. There continues to be a divergence in the extent to which our template is embraced by GPs, with only 11% currently agreeing to our template however an additional 18% have developed a similar or own ESG reporting template which we are comfortable with. We hope continued focus from investors such as ourselves on the value of a sound ESG process and reporting will continue to drive improvements across the industry.



6. The ownership stage: monitoring, engagement and reporting

During the investment period of the fund, PGGM PE actively engages with GPs to encourage improvement regarding ESG integration.

6.1 Monitoring

The PE team monitors improvements in the ESG integration at our GPs and incidents present in the portfolio in weekly team meetings or as and when necessary. Formal fund monitoring meetings, where GP engagement as well as other topics regarding the fund investments are discussed, are held twice a year. Formal co-investment monitoring meetings are held more frequently at four times per year. Following each meeting, a handful of funds and co-investments in the portfolio are added to an ESG engagement list based on the outcome of our previously described GP Assessment framework and the country/sector risks identified in the portfolio. Specific focus is placed on driving improvements, primarily through discussion with the respective GPs.

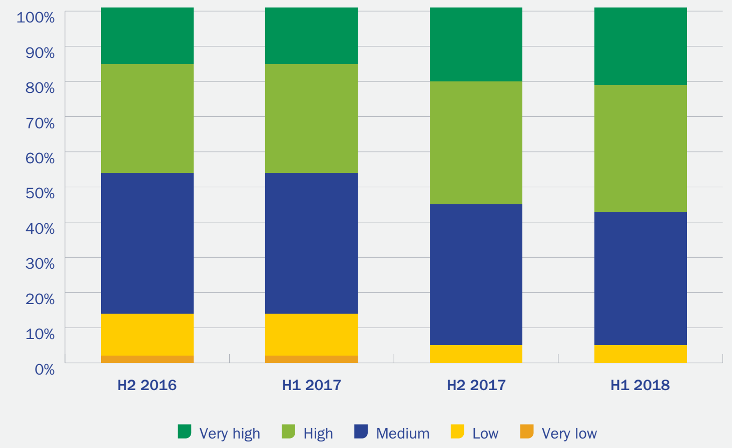
6.2 Engagement

The GP ESG Integration Assessment framework and the country/sector risks identified can be helpful when approaching new and engaging with existing GPs. The analysis provides us with a proper context to engage our partners in dialogue about how they integrate ESG in their investment process. In addition, it is an instrument to gain insight into which partners are lagging and it enables us to identify whether the portfolios of our GPs contain high ESG risks.

PGGM PE uses the GP's ESG risk score and ESG assessment score as a tool in the discussions with GPs. The ultimate aim of this communication is to drive improved performance on the approach that GPs and their portfolio companies take to sustainability and reporting to LPs. In 2018, pursuant to this analysis, we engaged in a dialogue with 13 GPs and 4 of them have since improved their monitoring and reporting systems for their portfolio companies.

During the ownership stage, we often help GPs that are interested by sharing best practices on ESG and encouraging collaboration and knowledge sharing between them.

ESG scores of GP



Over time, the GP Assessment scores in PGGM PE's portfolio have improved, due both to more active selection with ESG as an investment consideration and active engagement with GPs to lobby for a stronger focus on sustainability in portfolio companies. All GPs scoring "Very low" are either no longer in the portfolio or have improved their performance, and the best performers, those ranking "Very high" or "High" have grown from 47% of the portfolio to 58% in the last 18 months.

While not all GPs in the PE portfolio are UNPRI signatories, their share has been steadily increasing over the past years. As of 2018, 42% of GPs are signatories. We continuously encourage GPs to join the PRI and other relevant industry initiatives.

6.3 Reporting

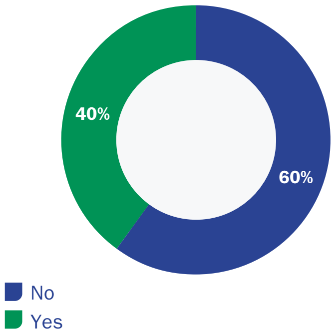
PGGM also engages with the market in order to improve ESG performance. We enter into a dialogue about sustainability with partners and stakeholders to elevate the private equity industry to a higher level. Among other things, we devote attention to ESG reporting standards.

One of the questions from the GP Assessment focuses on reporting. As mentioned earlier, PGGM has developed a reporting template that we encourage our GPs to use. We also contributed to the development of PRI's guidance on ESG monitoring, reporting and dialogue in private equity. In general, Monitoring and Reporting is becoming increasingly important for us.

At the moment, 68% of our GPs report on ESG, although at different frequencies and level of detail. 43% of our GPs report in an annual ESG report, 32% in their general quarterly reports and 14% report specifically on company-level KPIs (with some GPs reporting in a combination of these). Another 26% of our GPs have already agreed to start reporting company-level KPIs in the future.

These figures indicate the market is moving towards improved reporting including reporting on company level KPIs. As ESG awareness becomes increasingly widespread in the market, we expect that the trend will continue with even more GPs providing more detailed ESG reports in the coming years.

KPI's reported
(currently or agreed for the future)



"Two years ago, PGGM PE committed to a US private equity fund focused on control investments in leading North American mid-market companies. From our first due diligence meeting onwards, we have engaged with the GP to improve on ESG. As a result, the GP agreed to comply with our reporting template and we received their first report in 2018. Additionally, we have seen the GP improving significantly on formalizing ESG practices through the engagement of an external consultant for assistance with the ESG strategy, due diligence reviews, monitoring, reporting and ongoing ESG support. Based on these positive developments, we have adjusted the GP's ESG score from 2 to 3 (5 being the highest) and we have decided to commit to the GP's new, 2019 vintage fund. Going forward, we will continue to engage with the GP, with particular focus on the GP taking in-house ownership of its ESG practices and developing specific KPIs that can be measured and communicated."

Niek van Wijngaarden
Analyst

Memberships

PGGM actively promotes ESG integration, both in PE and other investment classes, through initiatives such as presenting at conferences, participating in panel discussions on ESG and stewardship, and explaining the importance of ESG integration to clients.

Signatory of:

As one of the organizations which helped found the UNPRI, PGGM has been a signatory since 2006 and participates actively. Most recently, PGGM became a member of the UNPRI working group which focuses on developing ESG monitoring, reporting, and dialogue in private equity guidance. PGGM PE has also been a formal member of the Institutional Limited Partners Association (ILPA) since 2010, and has since then, with the help of other likeminded organizations, been successful in lobbying for the inclusion of ESG in the revised ILPA guidelines. Lastly, PGGM is also a part of the affiliated network of Invest Europe.

6.4 Material ESG Incidents

While PGGM tries to protect its investments and clients from ESG related risks, incidents nevertheless occur occasionally. The focus following an incident is on how the GP manages the situation and resolves problems for all stakeholders. In 2018, there were eight material incidents logged. Out of these eight cases, three (37.5%) were in emerging markets, three in North America (37.5%) and two in Europe (25.0%). Currently, we are still monitoring investigations into 2 of these incidents.

"Last year, one of our relationship GPs in the emerging market reported that an employee at a construction site had been fatally wounded, due primarily to a lack of proper safety measures taken as a sub-contractor was rushing to catch up after delays. Following the incident, the portfolio company halted work, as well as any other business with the sub-contractor, until a full investigation was completed and safety trainings and procedures were implemented. In addition, the company went above and beyond the bare minimum by providing support for the family of the deceased following the incident. While the process is still ongoing, we have maintained contact with the GP to ensure that relevant information is reported and improvements are made."

Alex McKinney
Analyst

7. ESG in our co-investments

In addition to the GPs in the PE portfolio, PGGM has to date completed 44 co-investments (including add-ons). Of these, only one investment has thus far been in an emerging market, with the remainder headquartered in Europe or the US. A breakdown of investment by sector can be seen below, with the most significant being Financial Services.

As co-investors in a portfolio company, PGGM PE is closer to the company and so may exert more influence with regards to ESG than might be the case regarding a portfolio company in a fund investment through regular update calls with the GP and by requesting reporting on specific ESG KPIs.

Co-investments which contribute towards reducing food waste, water scarcity, or the development of life-saving medications are designated as Investing in Solutions investments. For the request that the GP track, report and improve specific ESG metrics over the life of these investments.

PGGM tends to co-invest alongside GPs with higher than average ESG scores. GPs with which PGGM has done co-investments have an average ESG score of 3.33 (out of 5), as compared to 3.16 in the full PE portfolio.

Breakdown of investment by sector	
Financial Services	28,3%
Industrials	25,0%
Consumer Discretionary	23,4%
Information Technology	11,4%
Healthcare	7,8%
Media	2,3%
Consumer Staples	1,9%

Breakdown of investments by region	
Europe	53,3%
US	37,8%
Rest of World	8,9%

Our largest client PFZW has set an ambitious target to invest €20 billion in solutions that contribute to solving problems related to climate change, water scarcity, food security and healthcare across all asset categories by 2020. €14.5 billion has been invested up to now. The PE team is expected to contribute towards achieving this goal.

8.1 Our impact investments: 'Investing in Solutions'

"Investing in solutions" are clearly defined investments that not only contribute to the portfolio's financial return, but are also intended to generate societal added value. We invest in solutions for climate change, water scarcity, healthcare and food security.[1] These problems not only constitute threats to society, they also translate into financial risks for companies and investors. At the same time, contributing to solutions to these issues represents a financial opportunity for investors.

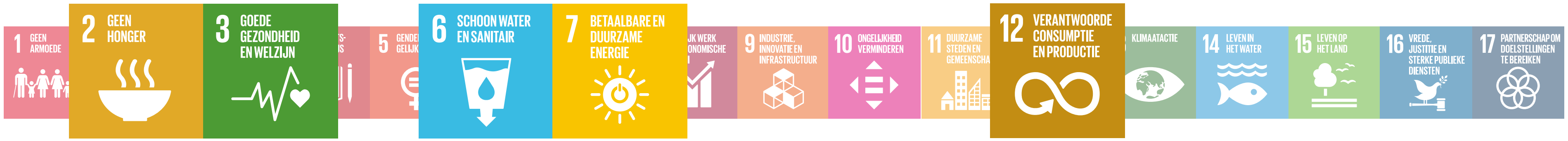
Each year we calculate the impact of these investments over the previous year: in addition to the financial return, we indicate how these investments contributed to the selected themes. We use impact data reported by companies and impact data based on impact models for this purpose.[2] In this calculation, we only allocate the share of the total impact to us that matches our share in the company or the fund. For a more detailed explanation of how the impact is calculated, you can visit our website.[3] During 2018, there were no new Investing in Solutions investments in the Private Equity portfolio.

8.2 Our contribution to the SDG's

By investing in solutions for these social challenges, we contribute to the UN Sustainable Development Goals (SDGs).

In 2018, we analysed for the first time which of the investments on behalf of our clients contribute to the 17 UN SDGs. We estimated that by the end of 2017, PE had invested €1.55 billion in 316 companies that contribute to at least one of the SDGs. This is 13% of the total invested capital within the fund. We call these investments SDI: Sustainable Development Investments.

You can read about the taxonomies we used to determine whether an investment contributes to an SDG. We developed this together with APG in order to have more comparable results. We don't think that we have fully achieved this as the taxonomy still leaves room for a different interpretations.



1 To comply with the Investing in Solutions criteria, an investment must have an actual positive social impact on at least one of the four areas of focus eligible for investment. The investment's contribution to a solution must be substantial and the social impact must also be tangible: for the company or the project we require that the real impact of the solution is measured, managed and reported on. See our website for the criteria.
2 The increase in the impact reported by us in comparison to last year cannot be linked one-on-one to the improved performance of the companies in the portfolio. Part of this increase is due to the increased availability of impact data: the data coverage has increased.
3 Our clients do not have a target for the impact to be achieved.

One of the biggest challenges is of course the lack of data. Most of the companies still don't report on how they contribute to sustainability and when they do they have different definitions. Another challenge is taking into account the potential and actual negative impact when counting something as having a positive impact.

You can read more about the SDIs and the challenges in the PGGM Responsible Investment Annual Report 2018.

8.3 New initiative for Investing in Solutions in private equity

To contribute towards the investing in solutions goal, Private Equity is starting a new initiative in 2019 with dedicated resources to source additional private equity opportunities that contribute to solving problems related to climate change, water scarcity, food security and healthcare. A central part of this initiative is to measure the impact. PGGM is cooperating with other large investors and investee companies to improve the quality of the data and the ability to measure the impact.

PGGM has formed a dedicated team within the private equity department. This team will work full time on sourcing and executing investments in private equity funds that invest in companies that have a positive contribution to one or more of the mentioned sustainability themes. Next to fund investments, the team has a target to invest a significant amount of the allocated capital through co-investments. With this approach the additional costs of the strategy will be mitigated and it provides the opportunity to specifically build up exposure to individual companies that fit the sustainability themes. PGGM has allocated €500 million to this new strategy, to be deployed in the next 3-5 years.

The new sustainability strategy will focus on thematic funds in addition to buyout funds. Most of the investments will be smaller and can be a mix of venture, growth and buy out strategies. This will mean more effort per invested euro, indicating a strong commitment to increase the investments in the sustainability focus areas.

The investment will be part of the Private Equity mandate and will need to stack up against the wider private equity portfolio in terms of risk / return profile. The mandate is global, but the focus will initially be on developed country managers. We are looking for GPs with a proven track record and have a preference for GPs with whom we can co-invest. First time funds are possible if the team members have convincing attributable PE track records.

The minimum investment PGGM would like to commit to a fund is €25 million, which implies a minimum fund size of €100 million. In the US the minimum target fund size should be at least (the USD equivalent of) €200 million. For co-investments, we can commit a minimum of €5 million. Note that these minimum investment sizes apply only to Investing in Solutions investments and are significantly smaller than for other Private Equity investments.

Going forward, we will calculate and report the impact of these investments over the previous year: in addition to the financial return, we indicate how these investments contributed to the selected themes. We use impact data reported by companies and impact data based on impact models for this purpose.

9. Outlook

Although PGGM is recognized as an industry leader with regards to ESG, there will always be opportunities to further improve ESG integration in investing, monitoring and reporting. We are therefore committed to continuously improving and refining this process to ensure that PGGM remains a best-in-class responsible investor, providing a model for other stakeholders in the industry. In regards to management of GPs and portfolio companies in the portfolio, PGGM PE is devoted to effecting a shift from a focus on compliance to an increasingly active approach. This involves investments that continue to support the present and future financial security and well-being of pension beneficiaries, but just as importantly contribute to ensuring that tomorrow's world and society is one in which these beneficiaries will want to live. To achieve this, we will be focusing in 2019 on asking for improved ESG reporting and improved management of the ESG risks and opportunities by our GPs and the underlying portfolio companies.