Private Equity

Annual Responsible Investment Report

2019

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.

PGGM

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 2019, 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 2019 Private Equity Responsible Investment Report which highlights our ongoing commitment to responsible investment. In this report, we focus on (i) updating you on the ESG characteristics of our portfolio including the first year of investing our private equity impact sleeve and (ii) outlining improvements we have made to how ESG considerations are integrated into our investment process.

"In this time of crisis when things are changing rapidly, there is an opportunity for our GPs to make meaningful advancements in how they approach ESG within their firms and portfolio companies."

Christine Winslow
Director

Highlights and KPIs for PE in 2019

16% average net return over the past 10 years

73% of capital invested with GPs that score either "High" or "Very High" on our ESG Integration Assessment

70% of our GPs report on ESG on either an annual or quarterly basis

24% of our GPs report on company level KPIs

30% of our GPs have launched a formal diversity & inclusion initiative or committee

10% of our GPs report on their carbon footprint

Engaged with 32 of 55 active GPs in our portfolio and saw improvements in the ESG integration scores of 23 of them

Improved the GP engagement process such that engagement will take place at least once per year with every manager where we have committed to the most recent fund

Invested €94 million for Investing in Solutions in its first year since launch through 1 fund commitment and 3 co-investments

Helped drive a significant increase in the number of GPs reporting on company level ESG KPIs from 9 in 2018 to 17 in 2019

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This report addresses 2019 however it is being published in a time of crisis from a health and economic perspective due to COVID-19. We have been pleased by the response of our GPs during this crisis which has universally been to focus in the first instance on the health and safety of its employees and those of its portfolio companies. Further, 19% have announced significant charitable programs to help alleviate the effects of the pandemic locally and/or nationally.

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 per 30 April 2020

Head of PE & Directors

Eric-Jan Vink
Head of Private Equity

Christine Winslow
Director

Harrie van Rijbroek
Director

Senior Investment Managers

Wouter van der Geest
Senior Investment Manager

Maurice Klaver
Senior Investment Manager (Investing in Solutions)

Berend Schiphorst
Senior Investment Manager

Elisabeth Villas
Senior Investment Manager

Investment Managers

Megha Jain
Investment Manager

Tanvi Karambelkar
Investment Manager

Diederick Plasmans
Investment Manager

Associates

Tamara Ertner
Associate

Niels Las
Associate (Investing in Solutions)

Alex McKinney
Associate

Gust van der Meeren
Associate

Niek van Wijngaarden
Associate

Daniel Zwier
Associate

Associates Direct Support

Chantal Reijerse
Front Office Support

Bas Lasseur
Front Office Support

Bo Furman
Executive Assistant

Analysts

Mark Al
Analyst

Lilit Aslanyan
Analyst

Coen Keijzer
Analyst

Stepan Naumov
Analyst

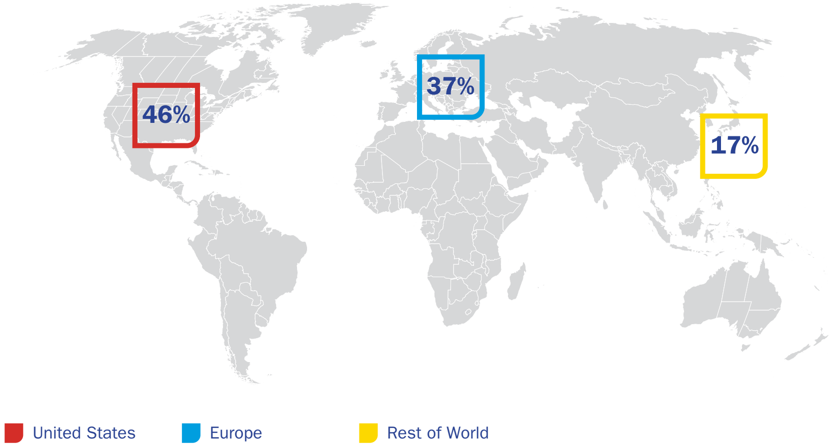
Rita Nguyen
Analyst

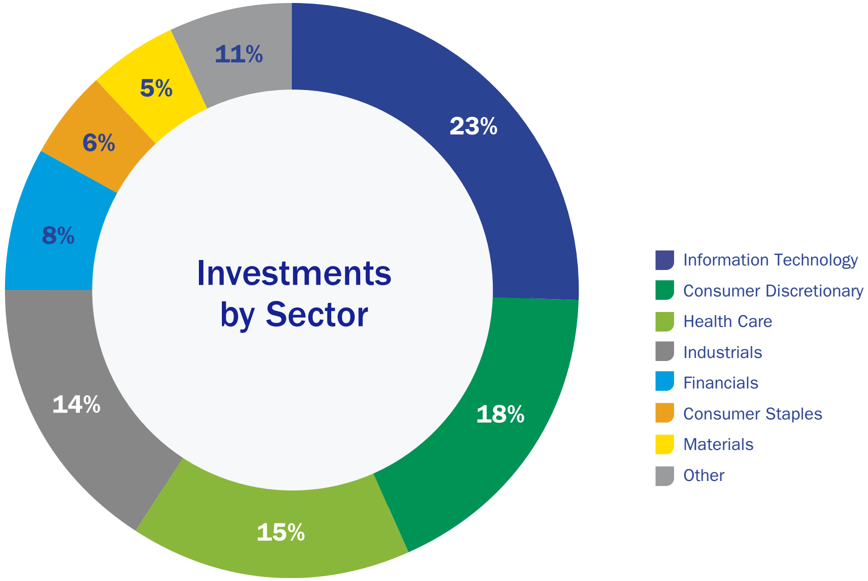
Joris van der Zee
Analyst

2. Our portfolio at a glance

PGGM PE has a total of €13.7 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 15.5%.

The PE portfolio is well diversified. While it is global, the majority (83%) 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, Health Care** and **Industrials**. 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 61% of the total PE portfolio. PGGM PE has invested with 70 individual GPs in 132 primary fund investments, 11 secondary fund investments, and 54 co-investments.

In 2019, PGGM PE made 16 fund commitments and invested in 10 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 continued to make progress on this in 2019. We are effecting a shift from a focus on compliance to an increasingly active approach. We look for investments which 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 (i) significantly impacts the financial performance of the portfolio companies or (ii) has other potential negative impacts to society and the environment which may jeopardize the business' reputation and 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).

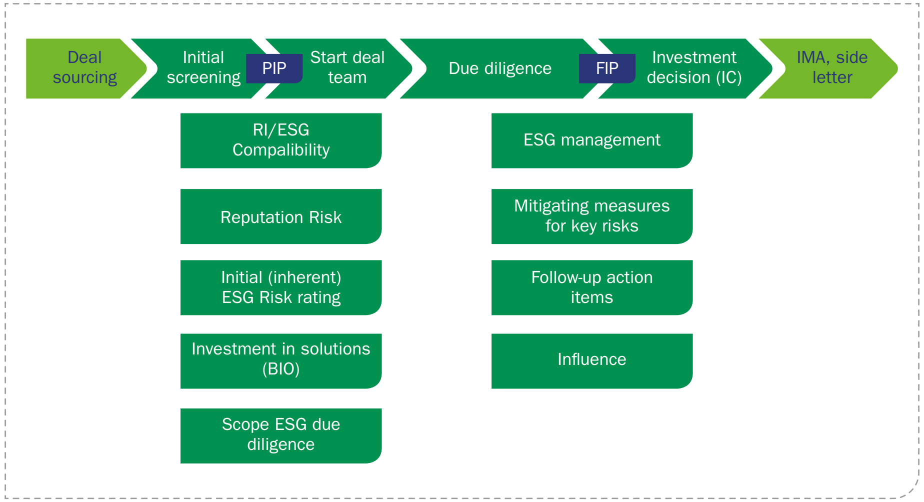
Selection (Ch. 4)	Commitment (Ch. 5)	Ownership (Ch. 6)
- GP ESG Integration Assessment based on the UN PRI DDQ - DD fund and co-investment assessment based on sector/ country risk	- Include adherence to PE ESG and Exclusion Guidelines in the side letter - Include ESG action plan and reporting according to PGGM's reporting template in side letter - Incident reporting	- Monitoring GPs on adherence to agreed upon ESG approach - New in 2019: we created a new process by which we will engage on ESG with each of our active GPs in every given year.

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.

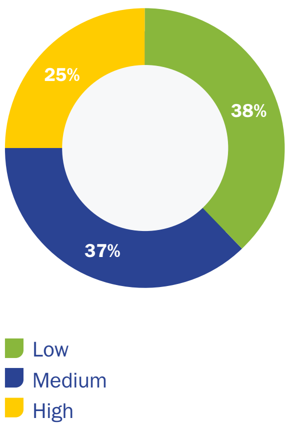
4.1. ESG sector and country risk

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

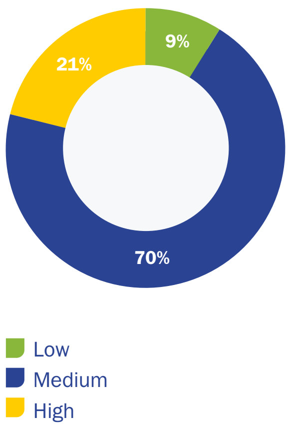
The combined data on assets' ESG risks and its managers' ability to manage them as defined by our GP ESG Integration Assessment framework, enables the PE team to assess the ESG risks in the portfolio. We are comfortable investing in high risk countries and sectors as long as we believe the GPs can effectively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



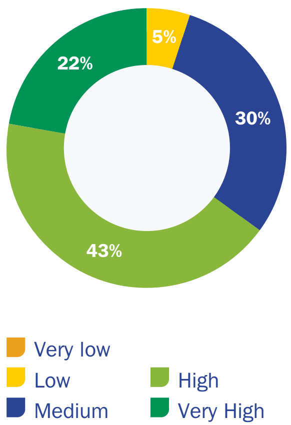
Sector risk



Country risk



GP scores



"PGGM is strongly committed to sustainability. Together with our GPs, we aim to demonstrate leadership in our investment approach and mitigate ESG risks. Responsible investment in private equity is moving fast. Jointly we rise to the challenge and contribute to a more sustainable world."

Rui Chang
Junior Advisor Responsible Investment

4.2 GP assessment

During the due diligence phase the private equity deal team will use the ESG questionnaire to assess management of ESG at 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 (e.g. 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.

We are willing to invest with GPs with lower scores on their GP ESG Integration Assessment if they are willing to make a commitment to improve over time. However, sometimes we decide not to invest due to ESG considerations. We have included examples of both a fund and a co-investment decline related to ESG concerns.

Fund decline

We considered investing with an Asian GP which had a solid track record and good reputation in its key market. However, the GP was unwilling to grant us our usual exclusion rights from investments in companies generating revenue from the sale of controversial weapons, production of tobacco products or companies which violate human rights as defined by the UN Global Compact. As a result, we declined to pursue a commitment to the fund.

Co-investment decline

We were invited to co-invest alongside a GP in a waste management company. The main concern which prompted declining the opportunity was the potential for reputational issues stemming from the environmental impact of the company's involvement in landfill activities.

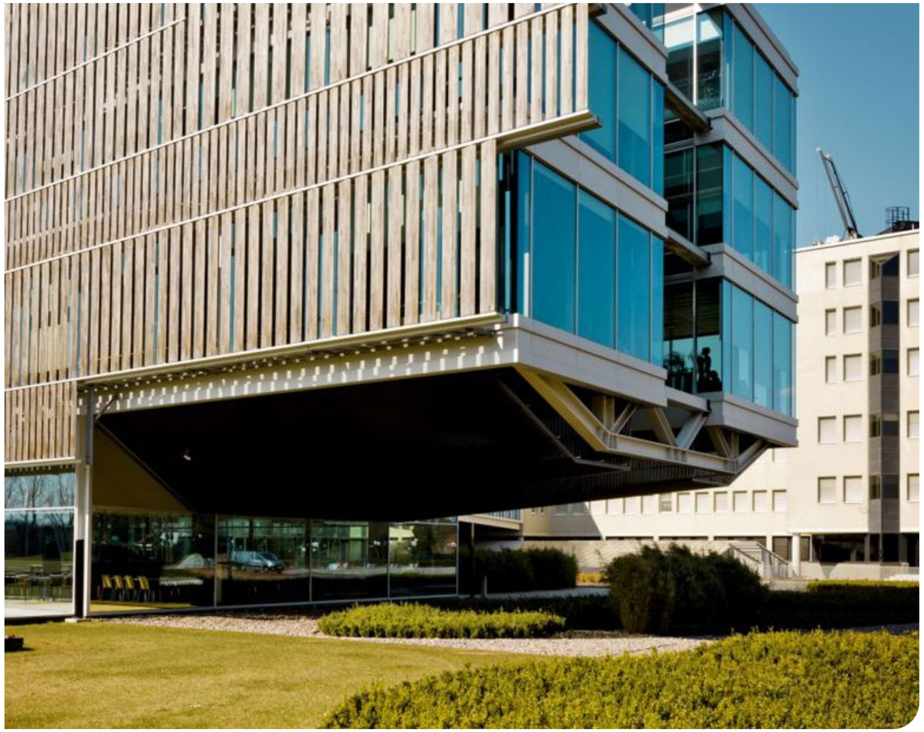
5. The commitment stage

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 ESG.

We also ask our GPs 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

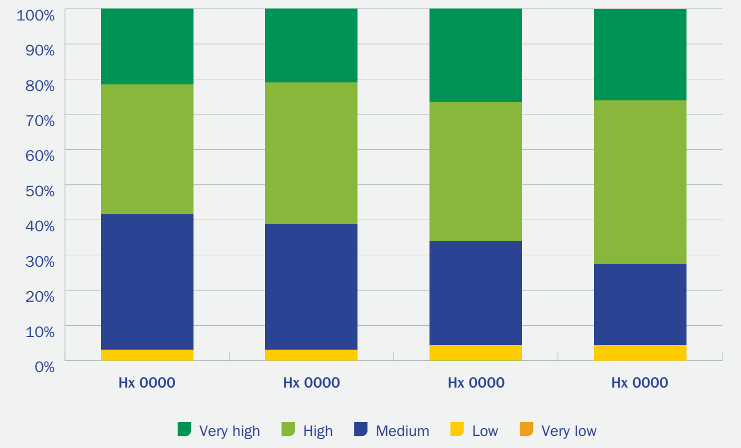
The PE team monitors improvements in the ESG integration at our GPs and incidents in the portfolio in weekly team meetings or as and when necessary. Formal fund monitoring meetings, where GP engagement as well as other topics regarding the fund investments are discussed, are held twice a year. Formal co-investment monitoring meetings are held more frequently at four times per year. 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 with our partners on 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.

In 2019, we intensified the GP engagement process such that engagement will take place at least once per year with every active manager. This will mean having a dialogue with the GP to share best practices, discuss updates and discuss ways to continue improving on the approach that they and their portfolio companies take to sustainability and reporting to LPs. In the past, we would identify specific GPs to engage with each quarter based on our risk assessment whereas going forward we will engage with all active GPs annually. In 2019, we pro-actively engaged in a dialogue with 32 GPs (55% of our active GPs) and we were pleased that 23 of them showed significant improvement. In 2020 and beyond, we intend to engage with all of our active GPs at least once per year.

ESG scores of GP



Over time, the GP Integration Assessment scores in PGGM PE's portfolio have improved, due 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 61% as of H2 2018 to 73% as of H2 2019.

While not all GPs in the PE portfolio are UNPRI signatories, their share has been steadily increasing over the past years. As of 2019, 17 (24% of our 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 Integration 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, 70% of our GPs report on ESG, although at different frequencies and level of detail. 47% of our GPs report in an annual ESG report, 31% in their general quarterly reports and 24% report specifically on company-level KPIs (with some GPs reporting in a combination of these). Another 16% of our GPs have agreed to start reporting company level KPIs in the future.

We are pleased to see that GPs reporting on company-level KPIs increased from 14% in 2018 to 24% in 2019 as this was a focus area for us in 2019. 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 this trend to continue with even more GPs providing more detailed ESG reports in the coming years.

Improvement in GP reporting KPIs

14% in 2018 | **24% in 2019**

"Since investing in 2013, PGGM PE has built a strong relationship with a global private equity fund which focuses on control-investments in the upper-end of the market. From our first due diligence meetings onwards, we have constructively engaged with the GP to improve on ESG initiatives. As a result, the GP has made substantial improvement in this area over the years. Amongst others, the GP made ESG due diligence, coupled with an ESG action plan, an integral part of its investment processes, and introduced an annual report that covers corporate citizenship and its approach to ESG. More recently, the GP has focused on tracking investee company-specific ESG KPIs and will share these metrics with investors in the future. Based on these positive developments, we have adjusted the GP's ESG score from 2 to 3 (5 being the highest) and have decided to commit to the GP's latest fund. Overall, we believe that ESG collaboration with this GP has been fruitful and going forward we aim to jointly further develop the ESG initiatives."

Gust van der Meeren
Associate

Memberships

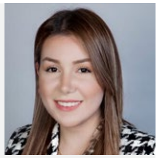
PGGM actively promotes ESG integration, both in PE and other investment classes, through initiatives such as presenting at conferences, participating in panel discussions on ESG and stewardship, and explaining the importance of ESG integration to clients.

Signatory of:

As one of the organizations which helped found the UNPRI, PGGM has been a signatory since 2006 and participates actively. 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 like-minded 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 2019, there were five material incidents logged. We are still monitoring the situation in three of these incidents.



Lilit Aslanyan
Analyst

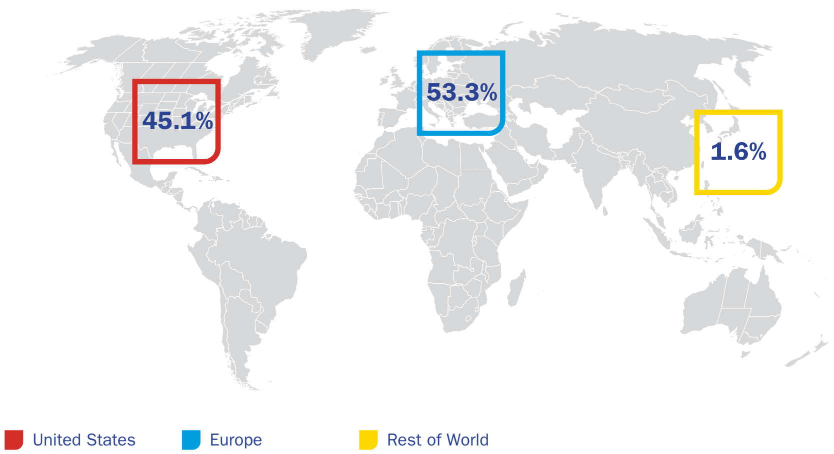
"In 2019, one of our GPs reported that there had been allegations that one of their portfolio companies' technology was embedded in products that were being used by a foreign government to spy on an ethnic minority group. Although this related to a minority investment for the GP with no governance rights, we were pleased that following the allegations the GP was active in encouraging the company to take all the necessary steps to ensure that this was not the case as well as in clarifying the company's role and policies."

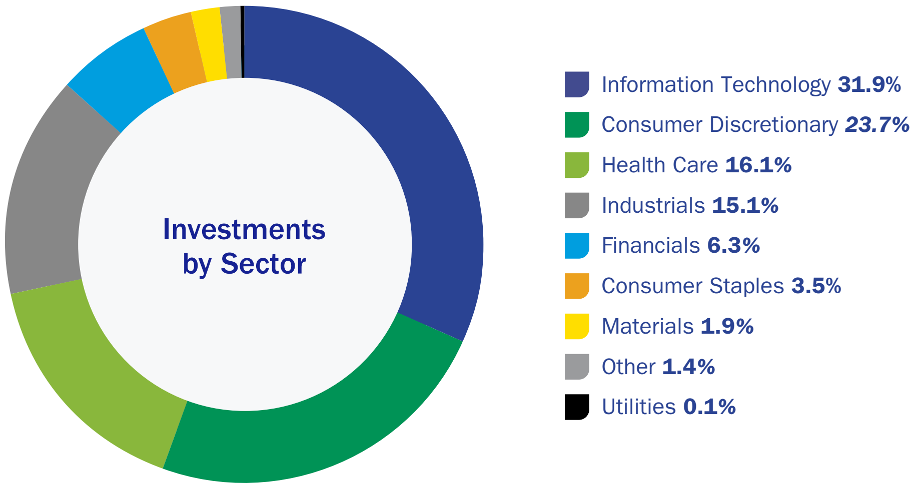
7. ESG in our Co-investments

In addition to the GPs in the PE portfolio, PGGM has to date completed 54 co-investments (including add-ons which required additional equity funding). Of these, only two investment has thus far been in an emerging market, with the remainder headquartered in Europe or the US. A breakdown of investments 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. We engage on ESG for co-invesments 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 these, we request that the GP tracks, reports and improves specific ESG metrics over the life of such investments.





8. Investing in Solutions

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. €17.3 billion has been invested for PFZW as per the end of 2019. 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.

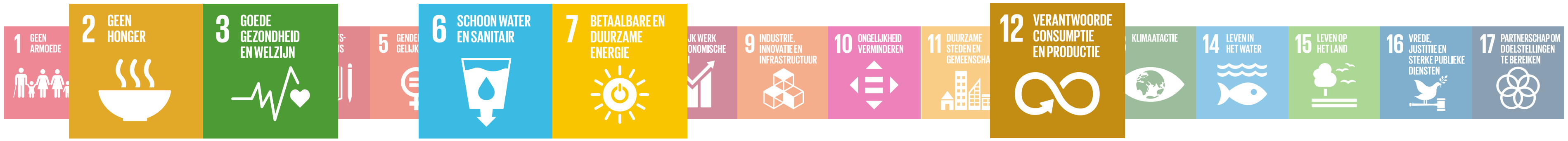
Each year we calculate the impact of these investments over the previous year: in addition to the financial return, we indicate how these investments contributed to the selected themes. We use impact data reported by companies and impact data based on impact models for this purpose.[2] In this calculation, 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, please visit our website.[3] During 2019, there were three new co-investments and one fund investment that contributed to Investing in Solutions investments in the private equity portfolio.

8.2 Our contribution to the SDGs

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

In 2019, we analysed for the second time which of the investments on behalf of our clients contribute to the 17 UN SDGs. We estimated that by the end of 2018, PE had invested €1.5 billion in companies that contribute to at least one of the SDGs. This is 12% of the total invested capital within the fund. We call these investments SDI: Sustainable Development Investments.

Please see the taxonomies we used to determine whether an investment contributes to an SDG here. We developed this together with APG in order to have more comparable results. While the SDI taxonomy leaves room for different interpretations, we are keen to further align impact standards with our peers via the Asset Owner Platform for Sustainable Development Investments (SDI-AOP).



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.

Please read more about the SDIs and the challenges in the PGGM Responsible Investment Annual Report 2019.

8.3 New initiative for Investing in Solutions in private equity

To contribute towards the Investing in Solutions goal, private equity has started 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 of these investments. 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 works 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, of which it invested €94 million in 2019[4] .

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

The investments are 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 is initially 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 private equity 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.

In next year's report, we intend to calculate and report on 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.

4 USD 50m in Paine Schwartz Food Chain Fund V, USD 25m in Wawona, USD 22m in NSM and EUR 6m in SCW. FX rate used 1.10

9. Outlook

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 2020 on encouraging our GPs to take steps to measure and report on their carbon footprint as well as their diversity and inclusion initiatives.