ESG Engagement and Disclosure Report 2019

Summary of the Results

Responsible investment is core to our approach across BMO Global Asset Management. With over three decades of experience, we believe that Environmental, Social and Governance (ESG) factors can reduce risk and underpin long-term returns, and we are committed to integrating ESG in all asset classes. As a strong supporter of the Sustainable Development Goals, we also believe in using our influence as an investor to promote long-term sustainability. We were a founding member of the United Nations Principles for Responsible Investment (UN PRI) and have held an A+ rating for Strategy and Governance for the past three years. As part of this ESG integration BMO Global Asset Management (EMEA) Private Equity (BMO PE) actively engages with its underlying fund managers (General Partners or GPs) to encourage them to develop responsible investment policies that address ESG risks, both during the pre-investment due diligence phase and throughout their tenure as shareholders.

Continued improvement

We have seen improvement on all the metrics we are tracking over the last 12 months.

- Over 90% of our managers now have a formal ESG policy outlining a clear approach to integrating ESG factors into their investment framework.
- GPs continue to show commitment towards adapting processes to keep up-to-date with best practice ESG integration, and find ways to measure impact of good ESG management.
- Even early stage managers (including those who are raising their first fund) are aware of the importance of ESG and are already incorporating this into their processes.
- Almost 50% of our managers provide training to employees on ESG matters, with many highlighting that training is scheduled in the future.
- Responsibility for ESG is moving from a "single person" to a group/team approach and involves input from senior members who act as oversight for firm wide ESG processes.
- Now 70% of GPs report to LPs on ESG to some degree. Some GPs are taking reporting to the next level by providing "impact" style reporting.

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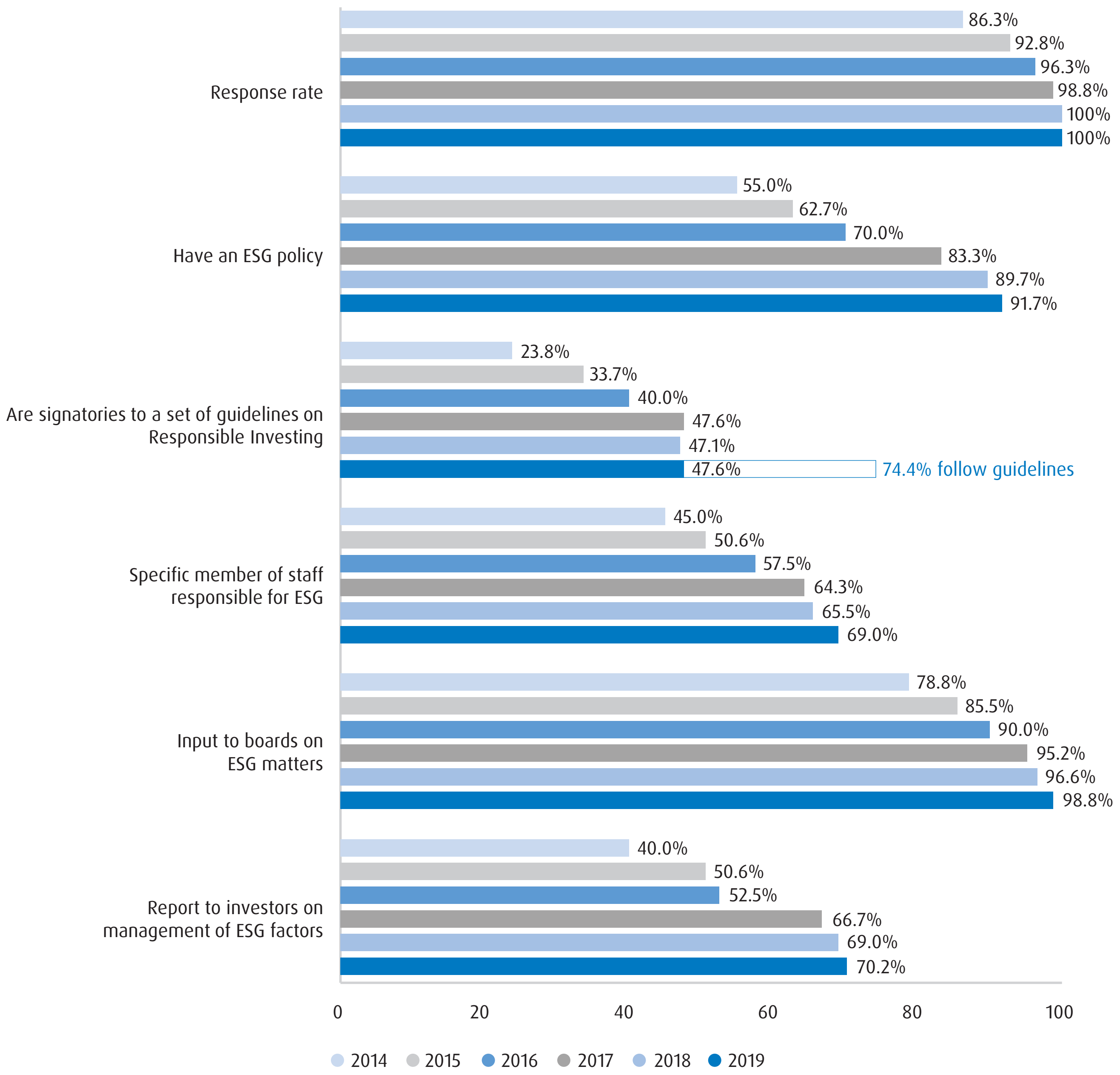
Results of the 2019 Survey of Managers



ESG Policies

Policies are developing

Over time we have seen that engagement has achieved good results, 91% of our managers now have an ESG policy compared with only 55% in 2014.

Of the seven managers who do not have a policy, two mention that whilst there is no official policy, ESG is not neglected in the investment process, and they work on making ESG a part of the corporate culture for their portfolio companies. We will continue to engage with managers to encourage the adoption of a formalised policy.

Another of our managers updated their policy in 2018 to align with several global frameworks, notably UN PRI, UN Global Compact and Invest Europe. This method of cherry-picking best practices between frameworks appears to be becoming increasingly common.

Of the European managers we cover, only one does not have an ESG policy in place. This is an improvement, especially with regard to our southern European GPs who had previously been slower to integrate ESG into their processes. Three of our US managers do not have a formal policy in place. Of these, one manager is of concern as they highlighted that the importance of ESG within the firm is expected to stay the same over the next three years. However, we believe improvement is needed as there is no formal ESG policy in place or method of implementing an industry recognised ESG approach throughout the firm. As previously indicated we will continue our engagement with the firm.

Codes of Conduct

Majority of managers now follow recognised codes

This year the number of managers who are signatories to a code of conduct or recognised set of guidelines continued to hover around 47-48%, which suggests the measurement may have reached a natural peak. Of those that are signatories, the UN PRI remains the most favoured set of guidelines to follow. As mentioned before, whilst as a founding signatory we are committed to promoting the acceptance of the Principles for Responsible Investment, we do not require all our managers to sign up to UN PRI or similar. We are more concerned about the adoption and following of guidelines. For example, two of our managers are not signatories but meet our expectations with regard to good ESG integration. One manager specifically mentions that whilst not a signatory to UN PRI, they believe its ESG practices are strong, continually evolving and closely in line with the principles underpinning UN PRI. The manager stated that given their already strong commitment to ESG, the administrative cost and burden of being a formal UN PRI signatory would be disproportionate to the benefits of membership. This is understandable, and we recognise this may be the case for other GPs. As such, we believe it may be more relevant to measure which GPs follow a recognised code, rather than if they are formal signatories. For 2019, this equates to 74% of managers. This gives an improved indication of the number of managers who follow codes of conduct from a recognised body.

Specific staff responsibility for ESG

Responsibility for ESG is increasingly being spread throughout firms, with oversight from ESG Committees.

The percentage of firms having a specific member of staff responsible for ESG has risen to 69% from 66% last year. Limited Partners (LPs) expect firms to have a dedicated resource towards the implementation of ESG policy and processes as well support for ESG integration at a senior level.

There are two main ways we have seen our managers incorporate ESG into their organisational structure. Either directly integrated into investment teams whereby the investment staff will conduct the ESG analysis. Or, as with many more established managers, a dedicated ESG team that conducts the analysis and shares this with the investment team. It is becoming more commonplace to see GPs spread accountability for ESG rather than have responsibility resting on a specific person to champion the implementation of ESG within the firm. We are now seeing more GPs amending the organisational structure of the ESG management process to include some form of oversight function, usually in the form of an ESG committee. We can see benefits to the ESG committee oversight structure as it gives investors a clear understanding of the responsibility and accountability for implementation of a GP's ESG policy and gives a clear message that managers are serious about the importance they attach to ESG integration.

Whilst it can be quick and easy, we believe it is advisable to avoid a situation where ESG responsibility rests with one member of non-investment staff, for instance the Head of Investor Relations or Head of Compliance. Assigning complete ESG responsibility in this way poses the risk that ESG is not fully integrated into the investment process.

Training of staff on ESG

Engagement has been a useful prompt

We have been monitoring data regarding staff training within our managers and can report that 46% of managers state they provide training to staff within their firm. Our engagement on this subject appears to have served as a useful prompt, with a number of GPs planning training over the coming months. It will therefore be interesting to monitor progress in this area going forwards.

We have started to track this as a metric to highlight the importance of training on ESG to investment staff. A critical outcome of training is that all staff know where to get assistance and/or guidance on ESG matters. Senior staff members who sit on boards of the portfolio companies are particularly well placed to help mitigate potential risks and protect company performance. It is therefore important to provide these staff with training to help identify and mitigate risks and help drive value creation.

Many of our managers have not limited training to annual in-house sessions. Some of our GPs are also sending employees to external conferences and seminars discussing the implementation of ESG in practice. A handful of our managers provide external training via a specialist consultant. We will engage with these managers to encourage them to keep up regular training sessions to allow for continuous improvement in their approach, and to ensure they keep up to date with new and emerging ESG trends.

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Reporting to LPs

Comprehensive ESG reporting of increased importance to LPs

The percentage of GPs reporting to LPs on ESG factors has risen from 69% last year to 70%. Whilst this is a small increase, it is a leap up from the 40% of managers who reported to LPs in 2014. In prior years the highest quality reporting was from our more established managers, whereas now we see high quality reporting from firms much earlier in their development. This may be due to encouragement from many LPs who require comprehensive ESG reporting to ensure their investments conform to their ESG requirements, as well as those who use ESG metrics from GP reporting to conduct a more in-depth assessment of risk and materiality concerns.

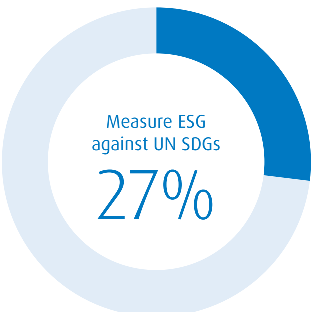
To improve further, there should be standardisation in the detail of information and frequency of reporting. Our managers generally present an annual report monitoring and tracking progress against ESG Key Performance Indicators (KPIs). In some cases, the GP provides a matrix highlighting any new risk areas with commentary showing recent initiatives, risk scores/ratings and ESG scorecards.

Many managers who are not yet providing annual reports provide information on material changes or the emergence of any material risk factors in the portfolio. However, as ESG integration continues to gain credence in the industry, an increased focus on regular reporting will be required. The best-in-class GPs often use multiple channels to report to LPs.

It is interesting to see portfolio managers in the industry moving a stage further, systematically collecting ESG KPIs across the portfolio and using the data to examine the impact of ESG factors on portfolio returns. This follows the belief by many of the positive correlation between good ESG practices and better risk adjusted returns. We believe that GPs with stronger ESG practices in place are likely to outperform, however proving this statistically will require further work.

Measuring ESG impact and linking investments to UN SDGs

GPs beginning to include impact-style reporting



The United Nations Sustainable Development Goals (UN SDGs) provide a global framework for addressing the most urgent social and environmental challenges. They set out a pathway to inclusive growth and represent a call to action for society. Private equity is in a unique position to invest in and influence businesses in a manner that creates positive change and work towards achieving the SDGs given the relatively long holding periods of the investments, pure play business models and levels of influence and control. Many of our managers realise this and align their performance indicators to the SDGs. For example one of our Spanish managers has a reporting tool developed with the support of PwC which includes KPIs based on the SDGs.

Some GPs are going a stage further and including "impact" style reporting to LPs. One of our Nordic GPs, rated as excellent by BMO Private Equity for ESG integration, states in its ESG policy that its investment strategy targets megatrends related to SDGs. The manager links each megatrend to one or more key SDG and measures the impact of the fundamental societal or environmental problem that the company is aiming to solve, showing how this quantifiably creates value for society and for the business itself. We do realise however this may not be relevant for all our GPs and that measuring impact can be difficult. This is an area that still requires significant development and standardisation.

There are many groups who are leading in the impact area who can provide resources and advice to those managers looking to raise the bar on their ESG reporting, such as the Global Impact Investing Network who recently launched IRIS+, a new reporting system with sets of core metrics around certain key SDG themes such as clean energy access, financial inclusion, health, and affordable housing.

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Conclusion

Our managers continue to develop ESG processes within their firms, and we have found that GPs are considerably more proactive in providing a thorough overview of their processes than just a few years ago. It is encouraging to see managers delving into some granular points of their specific policy, which they believe set them apart, when asked. Our results show 97% of our managers believe ESG importance will increase or significantly increase in their firm over the next three years, which is a strong indication of the change in attitudes towards ESG from GPs. We will work alongside the 3% of managers who state they expect the importance of ESG in their firm to stay the same, as there are some who we believe have room for improvement. Overall, we are noticing it is becoming easier to encourage GPs to consider further improving ESG in their processes.

Over the next year, key areas we will look to monitor are the level of training within firms and the reporting processes our managers have in place. We will also encourage managers to consider use of SDG targets where relevant, and we will continue to analyse any correlation between those managers with best practice ESG processes and those who consistently provide superior returns.

We are pleased with the year-on-year progress we have seen since launching this engagement report in 2014. The figures continue to improve as private equity participants place increasing emphasis on ESG as a tool to generate long-term sustainable returns.

BMO Private Equity Team

Survey Method

Our survey was sent to 86 GPs. This year we have included some additional areas of focus, such as whether GPs provide training on ESG for employees and how GPs view the relative importance of ESG.

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