Reporting21
A Cority Company

ESG Software Buyer's Guide for Private Finance

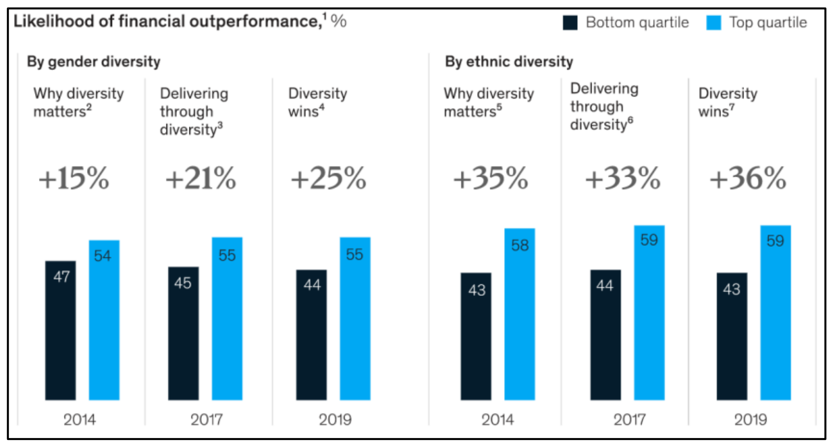
Table of Contents

Introduction

The latest report from the Intergovernmental Panel on Climate Change (IPCC) states that global GHG emissions should peak in the next three years if we stand a chance of meeting the Paris Agreement's 1.5 degrees C (2.7 degrees F) target. Failing to curb emissions below current levels would have unprecedented and disastrous effects to all life on the planet.

In response, many nations have implemented new standards and rules for companies regarding their level of pollution, water use, carbon footprint, and other climate indicators. The Sustainable Finance Action Plan (SFAP) in the European Union, Sustainable Finance Disclosure Regulation in the United Kingdom, and the Securities and Exchange Commission in the United States have all proposed or implemented regulations.

Additionally, often the focus of ESG data rests heavily on the E – Environmental – and skims past the Social aspects of sustainability. In the face of political upheaval around the world, growing income inequality, and a rise in social unrest, private equity firms have an opportunity to not only measure, but shape the future of Diversity, Equity, and Inclusion. And – DE&I is good for business. Recent McKinsey research shows more diverse organization outperform by as much as 36%.



Source: McKinsey & Company, *Diversity wins: How inclusion matters*, 2020

Private markets investors have unique challenges with monitoring the ESG performance of their investments. They may hold hundreds of assets across different asset classes and the relevant ESG metrics to track can vary quite significantly based on the asset class and maturity of their investments.

Unlike the public markets, there is limited access to information on private companies other than getting it directly from the company. And using spreadsheets to manage data collection is cumbersome and does not scale well.

This guide was designed to help investment firms think through how to evaluate their tracking and reporting options. Many – especially in the United States – are just beginning to think through how they might track the ESG attributes of their portfolio companies.

First (and most important): Identify your own priorities

The proliferation of ESG tracking software on the market can be overwhelming. Sifting through vendors that promise the sun, moon, and stars only to disappoint upon execution is a frustrating experience.

While the functionality of your solution is important, determining what you want to track at the outset can be even more important. Platforms use diverse methodologies and track ESG metrics to varying levels of depth.

When embarking on the evaluation process, it’s important to understand your own key priorities first.

Questions to ask:

- Do you only need a bolt-on to your financial reporting that provides a high-level view of ESG metrics to satisfy regulatory obligations? If a general reporting solution will meet your current needs, are you confident it will meet your ESG requirements over the next 2-3 years?
- Is analyzing performance over time important to you?
- How will you use the data once you’ve collected it? Would you like customized output reports per company or per fund for reports and presentations?
- Do you want a solution that requires each company to fill out a spreadsheet? Or are you looking for something that is accessible online?

- How important is security for your ESG and/or impact data?
- Are you looking to map to established reporting frameworks, have customized KPIs, or a combination of the two?
- Do you need a system that can support sector specific KPIs, company specific KPIs, and target setting and action plan development for companies?
- Does your firm use its own methodology to determine ESG compliance and therefore need customization?
- Are you looking to calculate the carbon footprint of your investments in addition to tracking broader ESG metrics? Would it be more efficient for you if you could do both in one platform?
- Would you like to connect your ESG software to your data lake or other systems via an API so that you can either send data you already have on portfolio companies to the ESG software our to transfer your ESG data to other systems
- Are you looking for campaign management tools that enable you to monitor the progress of your investments and send reminders of deadlines for providing data?
- Do you need an audit trail to understand who updated each KPI and when?
- Are you also looking for an ESG partner that can provide advisory services when needed for data analysis and validation, strategy, due diligence, or target setting?

Adaptive to changing regulations

Countries around the world will continue adding, tweaking, and tightening their sustainability regulations, so it's critical to have a system in place that can evolve with these changes.

As your portfolio companies grow from local to national (e.g. reporting requirements in California are different than South Carolina) to global (e.g. the U.S. is largely behind in measuring and reporting ESG metrics so if your investment companies grow internationally, there will be additional requirements) your solution will need to adapt.

Questions to ask:

- How does the solution adapt to new regional rules?
- Does the solution offer training to your internal teams about new rules and what they mean for your business?
- If your investment portfolio or fund includes companies with an international presence, is the solution accessible for them with language and metric translations?
- How many languages can the solution support?
- Is the solution taking a forward-looking view and able to provide predictions based on regulatory developments?

Ease of use and flexibility

Private Equity firms in the U.S. are largely nascent in their approach to ESG. Many do not have a dedicated Chief Sustainability Officer, Head of ESG, or commensurate role.

As your processes to align with ESG standards evolve, keep in mind that your choices affect the people on the ground doing the work. Each portfolio company – and perhaps a team of people within each individual company – will need to do upfront legwork to capture relevant ESG data. At times, the person providing the data may be an individual at a specific site with little to no experience tracking this information before.

These people will expect a smooth user-interface. Something simple and self explanatory. They don't want to deal with the version-control headaches involved in individual spreadsheets. Look for a reporting solution with a seamless interface that allows customization and flexibility.
Many firms start out with an idea of what they want, but switch gears once they begin the project or as ESG protocols evolve. Finding a solution that is not rigid, but flexible and adaptable will be key.

Questions to ask:

- What are the cost, time, and resource implications for adding metrics, users, or companies to the platform over time?
- For current customers, how long did it take to be fully functional from a signed contract to deployment?
- How do they ingest data from portfolio companies and how are those companies asked to collect their data?
- What training is available for the solution? Is it ongoing or just upon inception?
- Does the solution have seamless API integrations for your other systems to upload and download data?

Alignment to established frameworks

Established ESG frameworks encourage best-practices for contributing to a more sustainable future.

While different countries – and organizations within those countries – use different frameworks to track ESG metrics, over time there will likely be a consolidation of frameworks. The International Sustainability Standards Board (ISSB) has communicated plans for building upon the Sustainability Accounting Standards Board (SASB) industry-based standards development approach into their standards development process.

You may also want to set you firm apart from peers through aligning with various industry groups and initiatives. Investors want to know that you are not only are aware of these issues, but are making progress in alignment with global norms. Many of these initiatives have reporting requirements necessary to maintain signatory status or membership.

As you look for a solution to ESG data tracking and management, you need to understand which frameworks are supported.

Questions to ask:

- Which ESG frameworks does the solution support?
- Is the system sophisticated enough to consolidate this information and support multiple frameworks without duplication of efforts?
- Do you want to become a signatory to certain initiatives?
- Do you need guidance in determining which frameworks and initiatives make sense for your business?
- How does the solution stay on top of changes to the leading frameworks?
- Are your investors asking to report out on impact? In alignment with the SDGs or other frameworks?

The most well-known global ESG frameworks

- Global Reporting Initiative (GRI)
- CDP
- Climate Disclosure Standards Board (CDSB)
- International Sustainability Standards Board (ISSB)
- Partnership for Carbon Accounting Financials (PCAF)
- Principles for Responsible Investment (PRI)
- Science Based Targets initiative (SBTi)
- Sustainability Accounting Standards Board (SASB)
- Task Force on Climate-related Financial Disclosures (TCFD)
- World Economic Forum (WEF) Stakeholder Capitalism Metrics
- Sustainable Finance Disclosure Regulation (SFDR)
- Data Convergence Project (ILPA)
- UN Sustainable Development Goals (UN SDGs)

Reporting 21 In Action

The #1 ESG platform for private equity, investment banks, and asset managers.

Translated into 6 languages and deployed in 120 countries

- Carbon Footprinting
- Scope 1, 2, & 3 Emissions

Secure read and write API

Mapped to all major ESG frameworks

Platform + Advisory

The end of spreadsheet inputs

Compendium of questions

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