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Approach to Sustainability Assessment and Reporting

by Sarah Kirshy

In recent years, sustainability-focused investing has taken on many names and has been at the center of polarizing political conversations. CF Private Equity's approach to mandates surrounding sustainable investing is rooted in a practical, risk-assessment perspective with the goal of identifying positive environmental outcomes while prioritizing financial returns. It is our belief that operational risks—whether related to environmental, social, governance (ESG) factors or other business challenges—must be taken seriously to protect and grow the value of our investments.

THE PROCESS

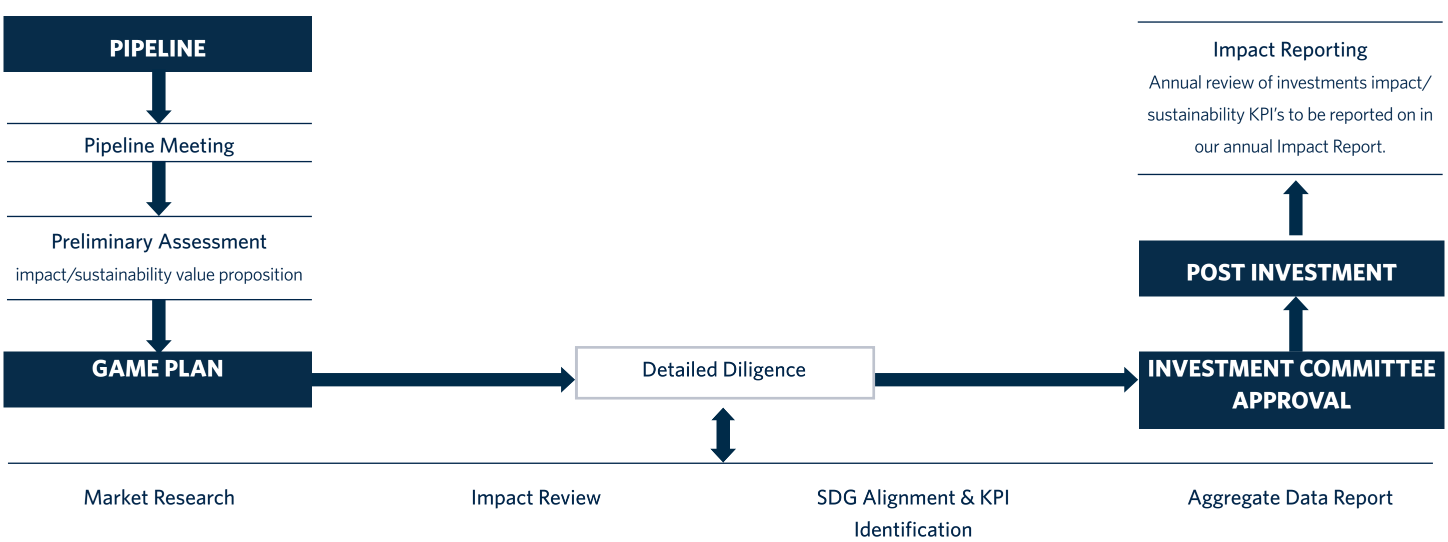
Our approach was designed to identify and assess the most material and relevant risks for each investment. In an effort to evaluate investments for potential environmental risks and benefits we follow a tailored assessment framework that complements our diligence efforts. To identify material risk, we conduct industry research and supplement our findings with third-party frameworks. The goal of the risk assessment is to identify instances within the sector or business where negligence or liabilities have led to significant financial consequences. For example, a solar developer in California may face criticism for excessive water use in drought areas, leading to regulatory scrutiny, public backlash, and costly conservation measures. Risks like these, where poor management could lead to financial losses, are core to our due diligence process. Each risk is evaluated individually, as different investments may have varying levels of risk tolerance, we do not apply a blanket materiality threshold. We then supplement our market research with the Sustainability Accounting Standards Board (SASB) Materiality Map, to identify industry risk factors that could impact the operating and financial performance of an investment. Once material risks are identified and discussed, we conduct an impact assessment using the Impact Frontiers' Five Dimensions of Impact—who, what, how much, contribution, and risk—to frame the investment's potential environmental impact.

All investments are aligned with the UN Sustainable Development Goals ("SDGs"). We expect investments may align with, in many cases, multiple SDGs. As such, we focus our alignment in this area on the SDG's that we believe are associated with environmental outcomes, though there are certainly instances where investments might align with other SDG's that are less expressly environmental in nature.

REPORTING

Approaches to metric collection can – and do – vary widely across the investment industry. Some asset managers rely on a standardized set of ESG KPI's applied uniformly across all investments, while others take a more tailored approach. Regulatory frameworks, such as the EU's Sustainable Finance Disclosure Regulation ("SFDR") can also influence reporting obligations. Article 8 funds are those that "promote" environmental or social characteristics, but do not necessarily have sustainability as their core objective. Whereas Article 9 funds explicitly target sustainable investments as their main goal. Some Article 8 funds do focus on sustainability as a core objective but look to avoid the more rigid Article 9 requirements that could limit the execution of some mandates, yet still appealing to investors interested in ESG considerations.

IMPACT ASSESSMENT PROCESS IN ACTION



We seek to balance the value of data collection with the relative maturity of data capture capabilities, recognizing the complexities of developing organizational resources and tools to track an extensive set of ESG KPI's. Data collection is of paramount importance – but it can be helpful to focus on the environmental KPI's that most meaningfully demonstrate the investment's impact and are best aligned with the core operating metrics of a business. Where possible, we collect impact metrics in line with guidance from both the ESG Data Convergence Initiative ("EDCI") and the Global Impact Investing Network ("GIIN"). However, if we believe an investment's true impact is better captured by a metric not found in EDCI or GIIN databases, we will propose the tracking and reporting of that metric.

Environmentally sustainable investment themes can cover a broad array of business models, spanning sectors including renewables, agriculture, water, and resource efficiency. This lens can in turn result in a wide range of relevant KPI's. For example, in the renewables sector, it may make sense to track metrics like megawatt-hours of renewable energy generated. In agriculture, we may measure acres of sustainably managed land, and in resource efficiency, recycling ratios for certain investments Benchmarking sustainability metrics has been a key topic of discussion in recent years to measure progress for both public and private companies. However, benchmarking remains a challenge, particularly for private companies operating in niche industries with varying levels of maturity, making direct comparisons difficult. Organizations like the ESG Data Convergence Initiative (EDCI) are working to consolidate industry data and develop useful benchmarking tools to support better decision-making. Over time, we expect the usefulness of this data to increase, along with the expansion of the KPI's collected and reported by portfolio companies.

ENGAGEMENT

The prioritization and assessment of the most material environmental, social, or governance (ESG) risks during the diligence process is an important step toward ongoing monitoring and future engagement. We actively engage with our partners, often through longstanding relationships, using meetings and data requests to assess their commitment to managing and mitigating sustainability risk. Businesses can be at a variety of stages of relative maturity, where some may lack the resources to prioritize the collection of specific ESG metrics, even if their product or service has a clear positive environmental impact. In such cases, we work closely with the company or manager to help establish a realistic metric that accurately reflects the true impact of the business, ensuring this metric is tracked year over year for ongoing accountability. When appropriate, it is possible to sometimes secure legal obligations around the reporting of annually collected KPIs.

CONCLUSION

Investors and stakeholders demand greater transparency and accountability in how portfolio companies address and report material ESG topics. Some firms choose to engage third-party consultants for sustainability diligence and reporting, while others prefer to rely on in-house expertise, depending on their specific needs and fund structure. At CF Private Equity, we leverage in-house expertise to manage a comprehensive and reliable framework that not only aligns with industry standards but remains realistic for our investment approach around those mandates targeting sustainability themes. This ensures that sustainability is fully integrated into our process, with dedicated attention at every stage of the transaction lifecycle.

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Published November 2024

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