

# Lost in ESG. Unlocking VC potential



29th of May, 2024

# Today's Topics

- How we look at ESG angle from the Baltics perspective?
- The main ESG principles in VC. Legal and Practical perspective:
  - Fundraising
  - Deployment
  - Portfolio management
  - Exit
- Q&A

# Introduction

Regulatory framework:

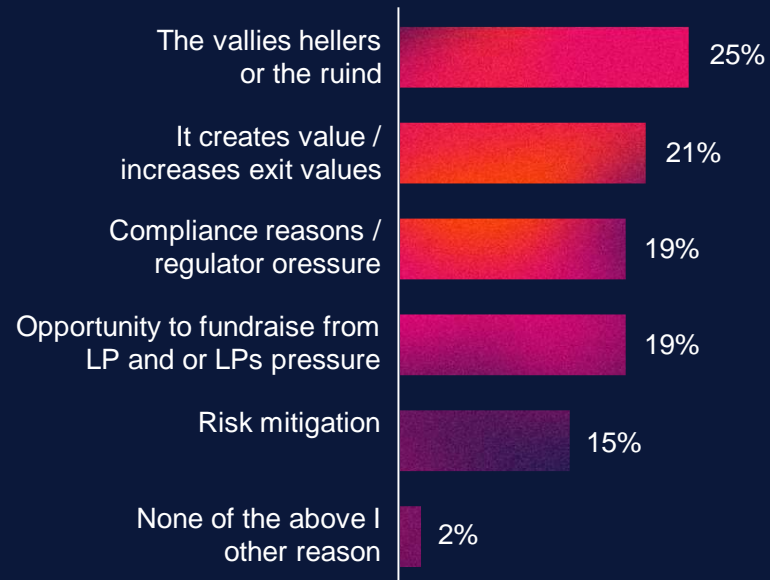
- Sustainable Finance Disclosure Regulation (SFDR)
- EU Taxonomy

Different fund classifications based on their level of sustainability:

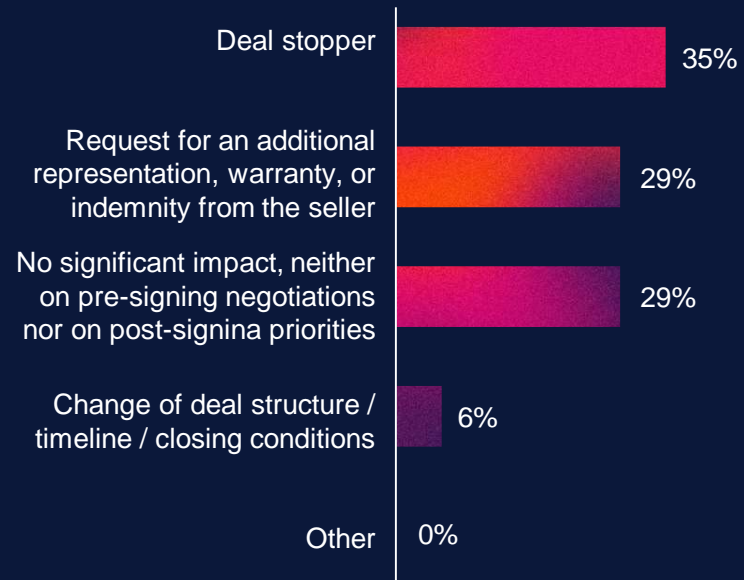
- Article 6 - funds without a sustainability scope
- Article 8 - funds that promote environmental or social characteristics (light green)
- Article 9 - funds that have sustainable investment as their objective (dark green)

# ESG considerations for Baltic PE & VC funds

## Key motivations behind the fund placing more importance on ESG



## What consequence did negative material ESG findings have on a potential investment?



# 75%

of fund managers that responded to the survey confirmed that ESG was high on their investment agenda

# SFDR overview



# Investment process steps



Deployment Stage

# Step 1: Fundraising

## Legal / Practical

- ESG DDQ - what is necessary and what to expect from institutional investors?
- Side letters and LPs requirements - ESG clauses, investment restrictions and reporting requirements
- Policies - ESG and responsible investment policy, code of conduct, anti-bribery policies and others

# Integrating ESG & Impact within Investment Process





# Step 2: Deployment

## Practical and Legal

From the Fund perspective: after receiving the initial DD questionnaire and supporting documents from a Target company, we engage in a thorough review to ensure compliance and alignment with fund's investment criteria / policy

Regulatory requirements will depend on the fund type – Article 6, 8 or 9

1. **Initial Screening Stage**
  - Investment Restrictions Screening: Assess compliance with investment restrictions outlined in the Limited Partnership Agreement (LPA) and Side Letters
  - Key Assessments Conducted
2. **Main Due Diligence (DD) Phase (post Term Sheet steps)**
  - ESG Questionnaire
  - ESG clauses in term sheet
  - Assess co-investors' approach to ESG & Impact
  - Documentation concluded with the Target/ Portfolio Company should reflect undertakings in Side Letters, LPA and legal requirements
3. **Evaluate Impact KPIs:** measure the effectiveness of the investment in achieving intended social and environmental outcomes, essential for reporting and strategy adjustment
4. **Forming of the investment portfolio**
  - Ensuring adherence to fund's sustainable investment limits

# Step 3: Portfolio management

## Legal

### SFDR information disclosures:

- SFDR pre-contractual disclosures
- SFDR periodic disclosures (annual)
- Website disclosures

### Investor information:

- Annual and periodic fund reports, as well as reporting agreed to in Side Letters

## Practical

### Reporting:

- Regular updates on compliance and performance against ESG metrics
- Monitoring and management of ESG risks

### Collecting data:

- Data collection from portfolio companies

### Impact Management:

- Setting Impact KPIs (Key Performance Indicators) based on material ESG risks identified
- Approval of Impact Goals, Targets, and Weighting by LPAC (Limited Partner Advisory Committee) within 6 months post-closing

# Exit

## Practical

### Pre-Exit Assessment :

- Assess the potential impact of the transaction on ESG issues during the review of offers from potential buyers

### Transaction Terms:

- Consideration of ESG implications in addition to financial and operational terms

### Responsibilities:

- Investment Team oversees the execution of exit strategy, ensuring alignment with ESG commitments

## Legal

- Reports from sell-side on ESG due diligence/ performance to highlight growth opportunities and maximise brand value
- Target's good ESG performance can increase its long-term value
- Poor ESG performance can also create reputational and financial risks for the buyer
- ESG clauses in sale agreements

# SFDR Annexes

## Template pre-contractual disclosure for the financial products:

**Article 8:** [https://ec.europa.eu/finance/docs/level-2-measures/C\\_2022\\_1931\\_2\\_EN\\_annexe\\_acte\\_autonome\\_cp\\_part1\\_v5.pdf](https://ec.europa.eu/finance/docs/level-2-measures/C_2022_1931_2_EN_annexe_acte_autonome_cp_part1_v5.pdf)

**Article 9:** [https://ec.europa.eu/finance/docs/level-2-measures/C\\_2022\\_1931\\_3\\_EN\\_annexe\\_acte\\_autonome\\_cp\\_part1\\_v5.pdf](https://ec.europa.eu/finance/docs/level-2-measures/C_2022_1931_3_EN_annexe_acte_autonome_cp_part1_v5.pdf)

## Template periodic disclosure for the financial products:

**Article 8:** [https://ec.europa.eu/finance/docs/level-2-measures/C\\_2022\\_1931\\_4\\_EN\\_annexe\\_acte\\_autonome\\_cp\\_part1\\_v5.pdf](https://ec.europa.eu/finance/docs/level-2-measures/C_2022_1931_4_EN_annexe_acte_autonome_cp_part1_v5.pdf)

**Article 9:** [https://ec.europa.eu/finance/docs/level-2-measures/C\\_2022\\_1931\\_5\\_EN\\_annexe\\_acte\\_autonome\\_cp\\_part1\\_v5.pdf](https://ec.europa.eu/finance/docs/level-2-measures/C_2022_1931_5_EN_annexe_acte_autonome_cp_part1_v5.pdf)

# ESG integration: until signing

Stage	ESG Procedure	Actions	Outputs
1 <b>Sourcing and screening</b>	<ul style="list-style-type: none"> <li>• Exclusion list</li> <li>• Negative screening</li> </ul>	<ul style="list-style-type: none"> <li>• Assigning the deal to the Fund and team</li> <li>• Discussion by IC, in case of conflict or potential overlap</li> </ul>	<ul style="list-style-type: none"> <li>• Decision whether to proceed</li> </ul>
2 <b>Initial evaluation</b>	<ul style="list-style-type: none"> <li>• Initial memo</li> </ul>	<ul style="list-style-type: none"> <li>• Discussion by the investment team</li> </ul>	<ul style="list-style-type: none"> <li>• Decision whether to proceed</li> </ul>
3 <b>First IC meeting</b>	<ul style="list-style-type: none"> <li>• Preliminary Investment Memorandum</li> <li>• Other mandatory IC materials</li> <li>• Q&amp;A</li> </ul>	<ul style="list-style-type: none"> <li>• Discussion by IC</li> </ul>	<ul style="list-style-type: none"> <li>• Decision whether to proceed</li> <li>• IC meeting minutes</li> </ul>
4 <b>Second IC meeting</b>	<ul style="list-style-type: none"> <li>• Final Investment Memorandum</li> <li>• Other mandatory IC materials</li> <li>• Q&amp;A</li> </ul>	<ul style="list-style-type: none"> <li>• Discussion by IC</li> </ul>	<ul style="list-style-type: none"> <li>• IC decision whether to proceed</li> </ul>
5 <b>Third IC meeting</b> <i>(when applicable)</i>	<ul style="list-style-type: none"> <li>• Updated Investment Memorandum</li> </ul>	<ul style="list-style-type: none"> <li>• Discussion by IC, needed in case of adverse DD findings or materially changed conditions after last IC meeting</li> </ul>	<ul style="list-style-type: none"> <li>• IL meeting minutes</li> </ul>
6 <b>Investment</b>	<ul style="list-style-type: none"> <li>• Standard legal clauses related to obligations of the portfolio companies</li> </ul>	<ul style="list-style-type: none"> <li>• Negotiations on standard legal clauses related to obligations of the portfolio companies</li> </ul>	<ul style="list-style-type: none"> <li>• Executed transaction documents information to investors and other outside parties, as relevant</li> </ul>

# ESG integration: from signing the deal to exit

Stage	ESG Procedure Inputs	Actions	Outputs
1 <b>Periodic review</b>	<ul style="list-style-type: none"> <li>Periodic review memo</li> </ul>	<ul style="list-style-type: none"> <li>Review by investment team</li> </ul>	<ul style="list-style-type: none"> <li>Decisions/advice from IC</li> </ul>
2 <b>IC meeting for follow-on investment by the Fund (when applicable)</b>	<ul style="list-style-type: none"> <li>Add-on investment recommendation</li> </ul>	<ul style="list-style-type: none"> <li>Discussion by IC</li> </ul>	<ul style="list-style-type: none"> <li>Decision whether to proceed</li> </ul>
3 <b>Quarterly performance review</b>	<ul style="list-style-type: none"> <li>Quarterly review report/memo</li> </ul>	<ul style="list-style-type: none"> <li>Discussion by the Fund's investment team</li> <li>Notify IC in case of adverse events</li> </ul>	
4 <b>Annual performance review</b>	<ul style="list-style-type: none"> <li>Annual review memo on annual review template</li> </ul>	<ul style="list-style-type: none"> <li>Review by IC</li> </ul>	<ul style="list-style-type: none"> <li>Decisions/advice from IC</li> </ul>
5 <b>IC meeting on exit</b>	<ul style="list-style-type: none"> <li>Exit recommendation</li> </ul>	<ul style="list-style-type: none"> <li>Discussion by IC</li> </ul>	<ul style="list-style-type: none"> <li>IC meeting minutes</li> </ul>
6 <b>Exit</b>	<ul style="list-style-type: none"> <li>IC approval (resolution)</li> </ul>		<ul style="list-style-type: none"> <li>Executed transaction documents</li> <li>Information to investors and other outside parties, as relevant</li> </ul>