ESG IN THE INVESTMENT CYCLE: GUIDANCE

Action Plans

CDC GUIDANCE: ACTION PLANS

1. OVERVIEW

When is an ESG Action Plan required?

Where the due diligence (DD) process identifies gaps with respect to applicable laws and regulations and/or the fund's requirements (and hence, with the LP's requirements) and/or expectations, an environmental, social, governance (ESG) and business integrity (BI) Action Plan or plans, should be discussed and agreed with the company.

The Action Plan will detail the specific improvements ('actions') which a portfolio company will need to make within a reasonable timeframe in order to bring the business in line with the fund manager's requirements and expectations (including compliance with applicable regulations). Certain items may be considered sufficiently material to require the company to make changes prior to a fund manager investing (i.e. 'conditions precedent'). An ESG Action Plan may also contain items which can be completed post investment (i.e. 'conditions subsequent' to investing) and which a company will need to address within a time bound period. A company will need to be closely monitored to ensure focus on such items continues.

ESG Action Plans can also address opportunities to add value to the business. This can be done within a section of the ESG Action Plan or by preparing a separate 'Value Creation Plan'.

Frequently, E&S Action Plans and governance Action Plans are presented as separate documents. For the purposes of this document and the CDC Toolkit for Fund Managers, the term 'ESG Action Plans' refers to both Environmental and Social Action Plans (ESAPs) and governance Action Plans (including governance, business integrity and compliance), regardless of whether these are single or separate documents.

2. ELEMENTS OF GOOD ACTION PLANS

A good ESG Action Plan should be specific, measureable, achievable, realistic and time-delimited ('SMART').

Elements of good ESG Action Plans:

- ***Include concise (but suitably detailed), accurate and clear descriptions of the actions*** to be implemented. Very high level actions should be avoided (e.g. 'manage waste'). In some cases, one risk can require several actions to ensure appropriate risk management and/or capitalisation on opportunities (e.g. appropriate occupational health and safety management may require: (i) preparation of written management plans and procedures; (ii) delivery of a training programme; and (iii) purchase of protective equipment.
- ***Contain actions designed to address specific ESG gaps/opportunities*** and not simply an overarching action for the company to put in place an ESG management system.
- ***Set realistic and clear timelines*** for the completion of the actions required with the emphasis on achieving compliance with the applicable regulations and the fund's standards as soon as possible.
- ***Prioritise the actions*** so that those aimed at addressing the most relevant gaps are prioritised.
- ***Include clear indicators of completion*** for each of the actions (e.g. installation of a wastewater treatment system, documented, anti-corruption policy).
- ***Clear allocation of responsibility*** for each of the actions/tasks.
- In some cases, a cost estimate may be included.
- Where appropriate, include a reference to the relevant standards (e.g. a specific IFC Performance Standard).

3. DISCUSSING ESG ACTION PLANS WITH COMPANIES

It is key to discuss ESG Action Plans with companies in order to ensure that each of the actions is understood and that the company can allocate the necessary resources for implementation.

It is important that any ESG Action Plan is discussed and agreed with company management to ensure that: (i) cost/resource implications are understood; (ii) only realistic measures and deadlines are included; and (iii) management explicitly agrees to implementation.

Once agreed, ESG Action Plans should form part of the investment agreement. Prioritisation of the risks and impacts allows the investment team to also consider what action would be required if implementation schedules or efficacy targets are not met (e.g. would this trigger a material breach with requirements)?

Where gaps remain serious and a way forward cannot be agreed or where a company is not committed to improvement, the fund manager should decide not to proceed with the investment.

The presence of ESG risks and impacts or poor ESG performance or capacity in a target business does not exclude investment. In fact, in some cases, certain higher ESG risks can translate into greater rewards over the long term with rigorous, committed and conscientious application of appropriate management measures.