

THE LP-GP RELATIONSHIP IN PRIVATE DEBT: ENGAGING THE GP ON RESPONSIBLE INVESTMENT

SIGNATORY TYPE

Investment Manager

OPERATING MARKET

Europe

AUM

€4.7 billion*

AUTHORS

Lauren Kahn,
Development & ESG
Associate, and Natalia
Rey Vidal, Senior
Associate

SWEN Capital Partners (SWEN CP) is a European fund manager that specialises in sustainable investments in private equity, private debt and infrastructure. SWEN CP offers a range of investment programmes for institutional and private clients through primary, secondary or direct co-investment. The company is owned by OFI Asset Management (a subsidiary of French insurance companies which include Macif and Matmut), Federal Finance Gestion (a subsidiary of Arkea Group) and by its own employees. SWEN CP integrates environmental, social and governance (ESG) criteria in its investment selection, monitoring and reporting process. In 2017, the fund manager implemented a climate strategy.

Oquendo Capital, founded in 2007, is an independent firm specialised in private debt for Spanish lower mid-market companies. Funds advised by Oquendo provide flexible financing solutions tailored to the requirements of its companies and main stakeholders. Investments are structured through a range of instruments such as common equity, preferred equity, payment in kind loans, mezzanine or unitranche debt.

ESTABLISHING AN ACTIVE LP-GP RELATIONSHIP

The partnership between SWEN CP and Oquendo began in 2013, with the first investment in Oquendo II, a €157 million fund. The relationship between the LP and GP further strengthened with the re-up investment in Oquendo III (€200 million, 2017 vintage) and quarterly calls and meetings between the two partners. SWEN CP serves on the advisory committees of both funds.

SWEN CP applies its responsible investment policy to all its institutional investment strategies and across asset classes, including private debt. As part of the first due diligence process concerning Oquendo II, SWEN CP asked the GP to complete a questionnaire to establish the manager's responsible investment practices.

* committed

The main results of the initial assessment were:

- Oquendo has been a Principles for Responsible Investment (PRI) signatory since 2009, but has ramped up its efforts around ESG consideration over the years.
- Oquendo had not formally documented its responsible investment policy but included in the fund prospectus the relevance of ESG issues to its investment processes.
- The annual report did not contain information on ESG issues at the management level, nor at the underlying portfolio company level.
- The investment term sheet did not reference ESG criteria requirements.
- Environmental, social or governance audits were only carried out based on the sector in which the target company operated, and on a case-by-case basis.

Oquendo seized the opportunity to work with SWEN CP, recognising the company as an advanced manager in ESG consideration for unlisted assets. Oquendo was inspired after members of its management team attended SWEN CP's annual [ESG Best Practices Honours](#) conference.

WORKING WITH OQUENDO

Ahead of the inaugural investment, SWEN CP reinforced to Oquendo that ESG consideration must not be compromised, adding that addressing responsible investment internally would be beneficial for Oquendo due to rising demand for this approach by institutional investors. Indeed, Oquendo had not hitherto integrated ESG criteria in its investment process.

For the first investment, SWEN CP shared its ESG expertise with Oquendo, with the expectation that it would adapt said expertise to its underlying portfolio companies. As a mezzanine debt investor with less influence than a private equity investor, SWEN CP's minimum expectations included:

- 1) Oquendo would try its best to influence the wider adoption of ESG consideration in Spain (a less developed market in terms of ESG consideration at that time), specifically in the SME market; and
- 2) Oquendo would have a real impact on its portfolio companies owing to its sponsorless strategy, allowing the GP to directly access portfolio companies' management.

These expectations were outlined in SWEN CP's initial side letter.

Oquendo also had to commit to SWEN CP's sectorial exclusions, prohibiting investments in: companies that manufacture weapons and ammunitions, including cluster bombs and anti-personnel landmines; and any corporation or company with a core business directly engaged in activities resulting in severe and/or systematic breaches of internationally-recognised conventions, norms or protocols regarding environmental protection.

Finally, Oquendo had to commit to participate in SWEN CP's annual ESG data collection campaign, which includes a questionnaire for the asset manager and underlying portfolio companies.

Oquendo ultimately used SWEN CP's underlying portfolio questionnaire as a baseline for gathering information from its portfolio companies for its own ESG reporting, later enlisting the help of Foretica to adapt the questionnaire for the Spanish SME market.

In 2017, with the successful performance of Oquendo II, and the solid relationship established between SWEN CP and Oquendo, SWEN CP invested in Oquendo III.

A combination of improved ESG data quality, SWEN CP's minimum requirements and increased sophistication of ESG consideration in the Spanish market incentivised Oquendo to take its commitment to the next level. Having seen the impact it could have if it adopted its own responsible investment policy, it was inspired to go beyond Spanish market practices.

Oquendo's progress can be seen in comparing its answers to SWEN CP's annual questionnaire in 2016, 2017 and 2018, through which Oquendo identified KPIs in its underlying portfolio companies to include in its own internal reporting (see Figure 1). Oquendo began regularly asking the board of its investee companies about these ESG topics in order to meet the demands of SWEN CP's ESG questionnaire. This type of access also allowed it to have greater influence, in line with the sponsorless strategy.

SWEN CP's ESG questionnaires allowed Oquendo to identify the following KPIs:

Figure 1: Oquendo ESG Portfolio Review

Governance



18%

independent board members**. 25 percent in 2017



41%

of companies take into account ESG aspects in their risk management process**



59%

of companies have a code of ethics or conduct**



Social



11%

average rate of employee ownership*



39%

female representation of the workforce, and remuneration policies aim to avoid a gender pay gap**



44%

of firms apply diversity initiatives proactively**



Environmental



82%

of companies have energy efficiency programmes*



88%

of companies re-use waste**



25%

of analysed companies have a formalised environmental policy and an additional 12 percent are preparing it**



* 2017 data

** 2018 data

POSITIVE OUTCOMES AS A RESULT OF THE COLLABORATION

Since the first investment in Oquendo II, SWEN CP has noticed a remarkable improvement in the asset manager's ESG practices. Because of the LP's requirements, notably the annual questionnaire, Oquendo has itemised its ESG practices and implemented a formal and active policy at each level of the investment process. With its partner, Foretica, Oquendo developed its own questionnaire for all underlying portfolio companies.

Oquendo also began publishing its ESG reports on its website. It also meets with CFOs/HR departments of underlying portfolio companies in person once a year to check in on ESG practices. Taking the lead from SWEN CP, Oquendo helps its underlying portfolio companies to create ESG roadmaps.

In 2017, Oquendo was honoured for its outstanding ESG practices as a private debt/mezzanine European fund by SWEN CP (ESG Best Practices Honours) for the year-on-year progress it had made. What started as an effort by just a few employees has become a core value for the entire Oquendo team.

Oquendo also made its PRI reporting and assessment score publicly available in 2017, and joined Spainsif, the Spanish forum for responsible investment. Furthermore, Oquendo prepared its first progress report for UN Global Compact in 2018, and subsequently formalised its ESG policy, making it publicly available.

Oquendo's efforts equally inspired SWEN CP. Their LP-GP relationship has illustrated that even through the limited influence of a private debt stakeholder, a GP that is willing to do things differently can have a positive impact on portfolio companies, and catalyse the introduction of new standards and best practices. The Spanish market has evolved rapidly owing in part to active investors like Oquendo.

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