

Disclosure on the promotion of environmental or social characteristics

LCL PME EXPANSION 3

19/06/2023

# Transparency of the promotion of environmental or social characteristics

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    1. **Summary**

The LCL PME Expansion 3 fund (hereinafter the “**Fund**”), managed by the Management Company (hereinafter “**idiCo**”), supports companies in their growth and buy-out operations. The Fund invests mostly in French companies and primarily through majority or minority buyout and, to a lesser extent, growth capital deals, and through corporate financing more generally (which may take the form of leveraged buy-outs (LBOs)). The Fund generally invests in companies with an enterprise value mainly in the range of eight million euros (€8,000,000) to forty million euros (€40,000,000) (as assessed on the date of the Fund's first investment in the company in question). A portion of the investments, which cannot exceed 50%, has been delegated to a third-party company in order to invest in listed assets.

To promote environmental and/or social characteristics, the Fund has undertaken not to invest in companies active in any of the following sectors:

* + 1. Production, trade or services relating to the cloning of human beings for reproductive purposes or genetically modified organisms
    2. Tobacco production
    3. The manufacture and trade of military weapons and ammunition
    4. The manufacture of anti-personnel mines and/or cluster bombs and the manufacture of key components for the assembly and operation of such weapons
    5. Games of chance and casinos
    6. Pornography
    7. Production of electricity from coal, oil and natural gas
    8. Extraction of conventional oil and gas
    9. Extraction of thermal coal and unconventional oil and gas

Moreover, in order to monitor the environmental, social and governance characteristics of its unlisted investments, the Fund conducts an annual campaign to collect ESG data from all its unlisted portfolio companies. A questionnaire including, but not limited to, the following questions is sent to unlisted investments:

## Environmental criteria:

* + GHG reduction policy
  + Environmental initiatives to reduce the carbon footprint of portfolio companies' products and services
  + Initiatives to reduce water consumption

## Social characteristics:

* + Employee shareholding (as % of employees)
  + Gender equality (% of women in the company)
  + Prevention of occupational injuries

## Characteristics related to the principle of good governance:

* + Transparency of executive remuneration
  + Independence of the board of directors/supervisory board
  + Implementation of a CSR policy

The Fund then uses the responses to the questionnaire to establish an ESG rating for all its portfolio companies and observe changes in their non-financial performance.

A new ESG rating methodology has been developed with an external service provider in order to be as objective as possible. This will take effect from 2023 on the 2022 data.

At the end of the investment period, the amounts called by the Fund will be invested at least 75% in companies that contribute to the attainment of environmental or social characteristics[[1]](#footnote-1) and at most 25% in cash or in listed assets.

During the selection phase, the Fund’s team recommends that portfolio companies, where necessary, implement good governance practices. These recommendations follow ESG due diligence, which highlights the companies’ corporate governance practices. As far as possible, CSR is included on the agenda at least once a year at meetings of the Board of Directors or Supervisory Committee.

The Fund may face certain limitations with the above methods, including insufficient quantity or quality of data captured from the annual ESG questionnaires.

The listed asset class uses the same exclusion policy as the Fund. However, we are unable to monitor the ESG indicators, although they are analysed by the service provider. The data for the listed asset class is therefore not included in the sustainability indicators.

The Fund may face certain limitations with the above methods, including insufficient quantity or quality of data captured from the annual ESG questionnaires.

# **No sustainable investment objective**

This financial product promotes environmental or social characteristics but does not have as its objective sustainable investment within the meaning of the SFDR.

# **Environmental or social characteristics of the financial product**

The Fund is a financial product which falls within the scope of Article 8 of Regulation (EU) 2019/2088 in terms of pre-contractual disclosures followed by annual disclosures until the end of the life of the Fund.

Under the Fund’s investment strategy, environmental, social and governance (ESG) criteria will form part of the Management Company's assessments without being a determining factor in decision-making.

Before each financial transaction, the Management Company's exclusion policy is applied. The assets of the funds managed by idiCo are not directed towards companies whose main activity is in any of the following sectors:

1. Production, trade or services relating to the cloning of human beings for reproductive purposes or genetically modified organisms
2. Tobacco production
3. The manufacture and trade of military weapons and ammunition
4. The manufacture of anti-personnel mines and/or cluster bombs and the manufacture of key components for the assembly and operation of such weapons
5. Games of chance and casinos
6. Pornography
7. Production of electricity from coal, oil and natural gas
8. Extraction of conventional oil and gas
9. Extraction of thermal coal and unconventional oil and gas

The Fund also invests in listed assets through a third-party company. That company applies the Fund’s exclusion policy but we are unable to monitor the environmental and/or social characteristics described below. Listed assets may account for a maximum of 50% of the Fund's investments.

The environmental and/or social characteristics monitored by the Management Company for each investment through an annual ESG questionnaire include:

## Environmental criteria:

* + GHG reduction policy
  + Environmental initiatives to reduce the carbon footprint of portfolio companies' products and services

## Social characteristics:

* + Employee shareholding (as % of employees)
  + Gender equality (% of women in the company)
  + Prevention of occupational injuries

## Characteristics related to the principle of good governance:

* + Transparency of executive remuneration
  + Audit committee Independence of the board of directors/supervisory board
  + Implementation of a CSR policy

The Fund has also decided to measure the carbon footprints of all unlisted companies in its portfolio. It has therefore commissioned an external service provider to measure the Scope 1, 2 and 3 carbon emissions of all its investments and to derive a carbon footprint from them based on the framework prescribed by the French Environment and Energy Management Agency (ADEME). Suggestions for improvements are made to the company at the feedback meeting. In addition, the Fund finances the cyber rating issued by an external service provider to all its unlisted investments. The service provider also suggests areas for improvement and raises the teams’ awareness of cyber risk.

# **Investment strategy**

The Fund invests mostly in French companies and primarily through majority or minority buyout and, to a lesser extent, growth capital deals, and through corporate financing more generally (which may take the form of leveraged buy-outs (LBOs)). The Fund generally invests in companies with an enterprise value mainly in the range of eight million euros (€8,000,000) to forty million euros (€40,000,000) (as assessed on the date of the Fund's first investment in the company in question).

The Fund focuses on companies with the potential for transformation, through growth (organic and external) and improved performance (including on ESG factors). The Fund is involved in a wide range of sectors and invests in companies operating in the following fields and markets, among others: (i) business services, (ii) software as a service (SaaS) and (iii) technology.

The Fund invests mainly in companies whose registered office and/or commercial interests are located in France.

The Fund has established an ESG management process involving the following measures to meet the promoted environmental and social characteristics:

* An exclusion policy,
* Annual monitoring of ESG performance throughout the life of the funding based on information gathered from an ESG questionnaire for unlisted investments. This questionnaire forms the basis of an ESG rating and an annual ESG report on the progress of the portfolio companies and areas for improvement.
* A “cyber rating” for 100% of unlisted investments that promote environmental or social characteristics. This rating is issued by an external service provider which then offers companies suggestions on ways to improve and raises the cybersecurity awareness of the teams.
* A carbon footprint for 100% of unlisted investments. This carbon footprint will be produced by an external service provider and will give rise to focuses for improvement to enable companies to reduce pressure on climate change.

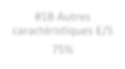
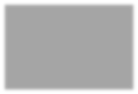
The Fund has also introduced several measures to evaluate the good governance practices of the portfolio companies:

* The ESG questionnaire sent annually to the portfolio companies includes questions on corporate governance, including the independence of the Board of Directors or Supervisory Board, gender parity on the Board, controversy monitoring, remuneration and ethics. The ESG rating calculated from the questionnaire also incorporates governance-related criteria.

The Fund also invests in listed assets through a third-party company. That company applies the Fund’s exclusion policy but we are unable to monitor environmental and/or social characteristics or good governance practices. Listed assets may account for a maximum of 50% of the Fund's investments.

# **Proportion of investments**

At the end of the investment period, the Fund must be at least 75% invested in companies within the category "#1 Aligned with E/S characteristics" and more specifically within the category "#1B Other E/S characteristics". The Fund may invest up to 25% of its net assets in cash to cover certain expenses, including management fees. Such cash belongs to the "#2 Other" category.



The category **#1 Aligned with E/S characteristics** includes investments of the financial product used to attain the environmental or social characteristics promoted by the financial product.

The category **#2 Other** includes the remaining investments of the financial product which are neither aligned with the environmental or social characteristics, nor are qualified as sustainable investments.

Investments

#1 Aligned with E/S characteristics

75%

#1A Sustainable

0%

#2 Other

25%

#1B Other E/S characteristics

75%

# **Monitoring of environmental or social characteristics**

The sustainability indicator used by the Fund to measure the achievement of each of the environmental or social characteristics promoted by the Fund is the ESG ratings of the investee companies, the methodology for which was developed by an external service provider. These proprietary ratings can therefore be accessed and monitored by the Fund’s portfolio managers at all times.

The Fund has put in place a number of controls on environmental and social characteristics:

* The sector exclusion policy, which limits the Fund's exposure to certain sectors presenting ESG risks that are considered significant.
* The ESG questionnaire sent to unlisted portfolio companies each year is used to monitor compliance with environmental and social characteristics, and if any material issues are identified, to follow them up. Moreover, since 2022 the ESG questionnaire has covered all 14 Principal Adverse Impacts (PAIs) as well as two optional ones[[2]](#footnote-2). The issues addressed include:

## For the Environment pillar:

* + Has the company identified the main risks associated with raw materials in its value chain?
  + If the company operates in a high impact climate sector, what is its total energy consumption? Has the company already measured its carbon footprint? If so, please provide the total Scope 1, Scope 2 and Scope 3 emissions
  + If the company is exposed to one or more significant risks, specify these and state what risk management measures have been taken.
  + Does the company have a water management policy?
  + Has the company measured its biodiversity footprint?
  + Has the company drawn up an environmental policy? If so, has the company drawn up a GHG reduction policy?
  + Etc.

## For the Social pillar:

* + State the total number of permanent FTE employees at the end of the previous year
  + State the number of permanent FTE hires over the period
  + State the number of female permanent FTE employees
  + State the number of permanent FTE workers with disabilities
  + Has the company calculated its gender equality index?
  + Proportion of employees who have received training.
  + Proportion of employee shareholders (as % of the company's workforce and excluding executives)
  + What was the frequency rate of occupational injuries during the year?
  + Does the company have an occupational injury prevention policy?
  + Etc.

## For the Governance pillar:

* + What is the percentage of independent members on the Board of Directors or Supervisory Board?
  + How many women are on the Board of Directors or Supervisory Board?
  + Does the company have transparency rules in place on executive remuneration?
  + Does the company have a CSR policy?
  + Has the company drawn up a code of ethics/conduct?
  + Does the company take social criteria into account in its supplier chain analysis?
  + Has the company been involved in a dispute regarding business ethics over the past year?
  + Etc.
* The ESG rating derived from the ESG questionnaire is used to assess compliance with the environmental or social characteristics of the investment.

# **Methodologies**

The attainment of social or environmental characteristics is determined by the following:

* The exclusion policy which ensures that the company is not engaged in sectors excluded by the Fund.
* The annual ESG questionnaire and the rating derived from it, which are used to measure changes in social or environmental characteristics and the attainment thereof.
* A “cyber rating” for 100% of investments that promote environmental or social characteristics. This rating is issued by an external service provider which then offers companies suggestions on ways to improve and raises the cybersecurity awareness of the teams.
* A carbon footprint for 100% of unlisted investments. This carbon footprint will be produced by an external service provider and will give rise to focuses for improvement to enable companies to reduce pressure on climate change.
* Participation on the boards of companies to ensure that good corporate governance is in place, address ESG topics at meetings and be aware of the decisions made at the end of the meetings.
* Measuring the carbon footprint of all the portfolio companies and proposing areas for improvement

# **Data sources and processing**

An ESG questionnaire is sent to the unlisted portfolio companies each year to gather the data needed to measure the attainment of the Fund's environmental or social characteristics.

The data is then analysed internally by the portfolio management team, which also checks the quality of the data gathered. The data is then used to calculate the portfolio company’s annual ESG rating and thus its performance on ESG issues.

# **Limitations to methodologies and data**

The main methodological and data processing limitations are:

* Data quantity: the portfolio companies may leave out some of the questions in the ESG questionnaire or not answer them fully;
* Data quality: some responses may be imprecise;
* The fact that data is not audited by a third party.

Notwithstanding these limitations, the portfolio management team checks that the questionnaires provide sufficient data coverage and that the data is of sufficient quality to be analysed and provide an ESG rating. In addition, the data gathering does not concern listed investments.

# **Due diligence**

For each investment, the Fund’s exclusion policy is applied to ensure that investments are not directed towards companies whose main activity is in one of the following sectors:

* + 1. Production, trade or services relating to the cloning of human beings for reproductive purposes or genetically modified organisms
    2. Tobacco production
    3. The manufacture and trade of military weapons and ammunition
    4. The manufacture of anti-personnel mines and/or cluster bombs and the manufacture of key components for the assembly and operation of such weapons
    5. Games of chance and casinos
    6. Pornography
    7. Production of electricity from coal, oil and natural gas
    8. Extraction of conventional oil and gas
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# **Engagement policies**

The Fund has implemented an engagement policy, which is reflected in:

* The participation of a representative of idiCo in the supervisory or administrative committee of each portfolio company, providing opportunities to ensure that good corporate governance is in place, address the subject at meetings and be aware of the decisions made at the end of the meetings.

# **Where an index is designated as a reference benchmark for the attainment of the environmental or social characteristics promoted by the financial production, “designated reference benchmark”**

Given the Fund’s investment objective, no index has been designated as a reference benchmark.

1. Attaining the Fund’s environmental and/or social characteristics means applying the exclusion policy and monitoring ESG indicators. [↑](#footnote-ref-1)
2. The 2 optional PAIs considered by the Fund are:

   * Investments in companies that have not taken action to reduce their carbon emissions
   * Accident rate

   [↑](#footnote-ref-2)