Guidance for drafting an ESG Policy

Introduction

ESG matters are operational and strategic risks and opportunities of varying materiality, probability and relevance to a company and its stakeholders. While the term "ESG" is relatively new, the actual operational risks (and opportunities) referred to are not.

ESG ambitions vary due to both internal and external factors, such as 1) sector exposure to ESG matters, 2) size of company, 3) stage of company, 4) company ESG track record, 5) regulatory requirements applicable to the company, 6) competitive pressure/market demand, and 6) stakeholder expectations.

SmartCap has an ambition to add value to its portfolio funds and their respective fund managers (hereinafter the **Portfolio Fund Managers**), as well as to the companies where these portfolio funds invest (hereinafter the **Underlying Companies**), including within ESG matters. Value adding activities are a matter of continuous, structured improvements and performance management throughout the ownership period. SmartCap expects its Portfolio Fund Managers and their Underlying Companies to over time establish ESG routines, including a comprehensive ESG management system and ESG policy or policies governing the relevant aspects of ESG integration and application.

On management system

To implement ESG matters effectively and consistently over time, either at a portfolio or company level, an ESG management system is necessary. The management system needs to be proportional considering the ESG ambitions described above and should be evolving in time. Key elements of a well-structured ESG management system include the following:

- **Policies.** Policy or policies are developed, maintained, and updated by the Portfolio Fund Manager as well as Underlying Companies on overall ESG objectives and principles, as well as on how ESG matters are managed and specific ESG areas are addressed in their respective activities.
- **ESG risk and opportunity identification.** Processes to identify and manage ESG risks and opportunities for all investments are be described, showing a reasonable balance between the likely level of ESG-risk exposure and scope or structure of the investment process to handle these based on the risk appetite of the Portfolio Fund Manager.
- **Organisational capacity and competency.** The organisational structure to manage ESG internally by the Portfolio Fund Manager as well as by Underlying Companies is outlined, explaining competence requirements, owners of the ESG policies and processes, resources committed to managing matters, etc.
- **Processes.** All investment and portfolio management processes involving ESG matters are described, KPIs, metrics or targets for key ESG matters are stated, and ESG performance reporting processes are outlined. The investment process includes a requirement for a dedicated ESG section for every investment proposal.
- **Performance management and monitoring.** Underlying Companies are encouraged to work towards continuous improvements in ESG areas as appropriate. This should be carried out, inter alia, by:
  - working with Underlying Companies to improve their ESG performance and ESG management system;
  - monitoring the performance and continued compliance with Underlying Companies' ESG policies or other requirements;
  - working with Underlying Companies who are not in line with their ESG covenants to reach compliance in a verifiable manner within a reasonable timeframe. Right to exercise remedies, as considered appropriate, should be reserved, if a failure to re-establish compliance within an agreed grace period occurs;
  - conducting periodic meetings and/or site visits; and
  - bringing in outside expertise as and when necessary.
- **Reporting.** At least annual reporting of ESG performance. Serious ESG incidents are monitored and identified immediately.

On policies

Policies are necessary to establish a common definition of ESG risks and events. They can have different labels and cover different matters. As a minimum, an Underlying Company should cover the following topics (note that several topics may be combined in one policy):

- Environment
- Health and safety
- Business and professional conduct
- Bribery and corruption
- Cyber security/IT
- Privacy

Additional matters which may become important as companies grow include whistleblowing, external complaints management, discrimination, and equal opportunity.

The structure of a policy should at a minimum cover the following:

- The objective of the policy and the specific risks it covers;
- The intention to be compliant with applicable laws, regulations and standards, as defined in the policy;
- The accountability for implementing the policy;
- The approval of the policy by the board or senior management;
- The process for deviations and remedial actions;
- The reporting and review procedure.

Business needs, ESG track record, strategy or other factors could naturally motivate additional topics to be addressed in the company's policies. The above list should thus be seen only as a minimum, and not as a comprehensive list of ESG topics for consideration in the company's set of policies.

Appendix A

The below table is not a requirement. It is only meant to be helpful in establishing an overview summary of the company's set of policies.

Name of policy	Areas covered under policy	Accountability