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Sustainable Markets Initiative Private Equity Group Issues Guidance on ESG Metrics

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In May 2023, the Sustainable Markets Initiative (SMI) **published a new guide** setting out how to use ESG-related metrics effectively in private markets (the ESG Metrics Guide), and how measuring and monitoring these metrics can help drive resilience, growth and value. Launched at The World Economic Forum's 2020 Annual Meeting in Davos, the SMI is a CEO-led global forum through which industries coordinate efforts to achieve sustainability goals. The Private Equity Task Force, which compiled the Guide, was launched a year later to "align on ways the industry can effect change" across the group's three priorities: (i) climate change, (ii) biodiversity and (iii) ESG-related metrics.

The SMI describes the ESG Metrics Guide as neither a framework nor a standard, but a thought process informed by various market participants to address a fundamental question: "How to identify ESG metrics relevant to decision-making that have the ability to influence business strategy, investment opportunity, risk mitigation, and value creation." The ESG Metrics Guide is intended to complement and leverage metrics used in existing standards, frameworks and regulations. The "ultimate objective" is to make the industry "more resilient to a range of factors over the long-term, in line with the industry's fiduciary duties, and achiev[e] enhanced business outcomes." The Task Force hopes to achieve this goal by "suggesting an industry-led approach to ESG metrics," which in turn promotes "greater consistency, comparability, and understanding of the role of ESG as part of the investment process."

The ESG Metrics Guide focuses on the following three concepts:

1. **Data:** ESG data is an important aspect of investment analysis and portfolio company management in private markets;
2. **Materiality:** Materiality, which is defined by the ESG Metrics Guide as “information so important that its absence or misstatement could be reasonably expected to influence investor decisions,” offers a lens to help private equity firms, investors and portfolio companies leverage sector-specific ESG metrics for value creation and risk mitigation; and
3. **Structure:** Private equity offers a structure to facilitate data collection and active engagement to further sustainable development in private markets.

These concepts are then considered and applied in the context of ten areas: climate change; circular economy; biodiversity; diversity and inclusion; human capital and employee engagement; product quality and stewardship; health and safety; business resilience and supply chain management; data governance and cybersecurity; and corporate governance. The SMI states that these ten themes allow the considerations in the report to be made in the context of the wider regulatory environment and to leverage metrics in existing frameworks and standards.

Taking the Temperature: The important role that the private equity sector can play in data collection and active engagement is increasingly being highlighted. Industry wide collaborations as well as partnerships across asset classes have the potential of creating a more efficient process of measurement and valuation. A number of such collaborations are [currently underway](#) (including between Cadwalader, the Loan Market Association and the Loan Syndications and Trading Association with a focus on private debt, private equity and portfolio companies).