SUSTAINABILITY

From theory to practice

ESG has shifted from a good public relations move to a crucial financial criterion for both GPs and LPs. Asset managers which aren't on board may be left behind, **Kalliope Gourntis** finds

ESG IS A growing trend, but it's moved far beyond just being a signatory to the Principles for Responsible Investment," Ana Lei Ortiz, of private markets investment firm Hamilton Lane, tells *Infrastructure Investor* during a recent interview.

"It's a lot more focused on the detail, on what you're actually doing and being able to provide examples of how you've integrated ESG and implement these policies across the board, in all your portfolio companies, all your investments," Lei Ortiz, who is managing director, relationship management for Europe, explains.

Her statements sum up the experience and insights several other industry insiders shared with *Infrastructure Investor*.

No longer a new concept, environmental, social and governance initiatives have become an established part of corporate activity, increasingly appearing on LPs' and GPs' radars.

Obvious proof of ESG's growing prevalence is the number of asset owners and asset managers that have signed up to the United Nations-backed Principles for Responsible Investment. The current total stands at 1,506 signatories from 54 countries compared with roughly 200 institutional investors and asset managers that had signed up in 2006 when PRI was launched.

But going back to Lei Ortiz' statement, the evolution of ESG goes beyond these numbers.

Juhani Sillanpaa, infrastructure equity investment director at Sydney-based fund manager AMP Capital, says: "It's an important theme for us and our investors. We're also witnessing potential LPs becoming much more ESG-aware, especially over the last few years."

AMP Capital has been a signatory to the ESG principles since 2007. Having been active in the space for nearly a decade, Sillanpaa says the changes have been "massive".

"It took a while before people became aware of ESG issues, but especially in the past three to five years, there has been increasing focus on these factors," he says. "We have developed cases in our portfolio companies where we have been able to deliver good additional investment upsides by being more energy efficient and hence delivering positive environmental impacts as well."

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FINANCIAL DRIVERS

Jessica Matthews, head of mission-related investing at advisor Cambridge Associates, explains some of the factors that have led to ESG's growing importance and acceptance.

"It's a combination of motivations," she says. "There's certainly the values motivation, with environmental issues coming up and investors wanting to be responsive and mindful, but pension plans also have to comply with regulations. They have to be fiduciaries, so ESG for them is often being viewed as a financial decision as well, not just a values-based decision."

AMP Capital's Sillanpaa acknowledges that factors such as public opinion, rising sea levels and extreme weather events related to climate change as well as high-profile accidents such as the fires that broke out in a textile factory in Bangladesh, have contributed to ESG issues gaining traction.

"But rather than just being a public relations exercise, ESG compliance has become much more a financial matter, which makes it more viable," he says.

What's more, the financial aspect is not just limited to performance.

"I think we're getting closer to the point – and I think some LPs have already done so – where ESG becomes such an important part that LPs are saying: 'We won't invest with this GP if they don't meet our standards,'" Hamilton Lane's Lei Ortiz asserts.

INTEGRATION

As corporations and the investment community begin to realise that ESG makes financial sense, the next step is figuring out how to implement it.

"In the past three to five years, it's become increasingly important, rather than having a separate ESG function within the company, making sure it's fully integrated, not only in the investment decisions but also on the asset management side," Sillanpaa explains.

Hamilton Lane has taken the same approach. "We've integrated ESG into our own investment processes," Lei Ortiz says. "It was a conscious decision for us not to have a separate ESG-focused team so much as to have the investment team themselves look at ESG."

On the LP side, establishing and implementing a programme can be challenging, particularly for smaller institutional investors who do not have the necessary resources to do so.

In this case, they may rely more heavily on consultants for guidance.

"Frankly, that's why it's so important for us that we've built up this expertise around mission-related investing and ESG integration because many of our clients have a couple of people managing the entire portfolio while also trying to integrate ESG criteria into their processes," Cambridge Associates' Matthews says.

WHAT LPs WANT

LPs also lean on their GPs.

For Impax Asset Management, a UK-based renewables-focused asset manager, that means providing data to their LP clients on the environmental benefits of their investments.

"Impax manages two types of assets," David Richardson, the firm's managing director and global head of marketing and client service, states. "We manage listed equity strategies where we invest in stocks of companies that are having a positive environmental impact. We also manage private equity portfolios where we are developing renewable energy projects in Europe and selling those completed projects to long-term cashflow buyers," he explains, noting that in this latter capacity Impax operates as a sort of developer (see p. 42).

On the listed equity side, the metrics Impax provides to its clients include data such as carbon offset, amount of clean water produced, amount of material recycled and amount of renewable energy generated, per $10 million invested.

On the private equity side, an important metric for the firm's clients is the potential positive environmental effects of installing large wind energy projects, for example. "We provide data regarding climate change

Even wind farms are measured for environmental impacts, says Impax

> LPs are saying: 'We won't invest with this GP if they don't meet our standards'" Lei Ortiz

mitigation measures, the amount of power generated and the equivalent amount of carbon reduction in the atmosphere," Richardson comments, noting the firm provides additional data that may be specific to particular LPs.

"We also report on engagement with the companies that we're investing in," he says. "We're actually in partnership with other larger investors to try to collectively seek greater ESG-related disclosures from the companies we're investing in and that's certainly important to a lot of our investors," Richardson adds.

Mirova, an investment management firm exclusively dedicated to responsible investment, is also developing what Hervé Guez, head of socially responsible investment research at the French firm, describes as an 'engagement procedure'.

"We do not know how it will be implemented yet but we're working on an engagement procedure to make sure that when we invest we try to identify the things that could be improved during the lifecycle of the infrastructure asset," Guez explains.

The firm, a subsidiary of Natixis Global Asset Management, invests in listed equity, fixed income and infrastructure. Speaking specifically about its infrastructure investments, Guez states: "We have developed specific criteria to analyse each infrastructure asset looking at long-term and short-term performance. These criteria are based on sustainable development goals and we try to understand how each infrastructure asset will respond to a particular goal as well as ensuring that risk is managed and mitigated."

Speaking of the challenges smaller LPs face, AMP Capital's Sillanpaa focuses on the governance component of ESG.

"At the end of the day, it clearly starts with the 'G'. To have a meaningful conversation around the table, having good governance position is very important," he says. "I can understand why the small LPs would struggle to have a meaningful say, especially if they're investing directly or on their own since they would only be able to acquire small stakes and therefore have a limited say.

> There are certainly those who are sort of being dragged kicking and screaming into this whole [ESG] idea"
>
> **Richardson**

"A good way of delivering better ESG governance is through investing in ESG-aware funds as they will bundle together larger amounts of money leading to more have meaningful stakes in the companies. This will give them the ability to influence how the company will behave around the environmental and social issues as well."

But small LPs are not the only ones who may encounter challenges; the same can apply to the smaller players in the GP world. "Probably not all the small fund managers are able to put the same focus on ESG," Sillanpaa observes. "So then it may well be an awkward question rather than something they have integrated fully into their thinking."

However, GPs will need to do so, particularly as Lei Ortiz points out "if they want to go out to market again and raise funds. They have to have good answers to any questions that investors ask and ESG questions form a big part of that".

REGIONAL DIFFERENCES

How much thought both LPs and GPs have put into ESG matters also depends on geography.

"I think in Europe, you see more GPs who are thinking about ESG and are focused on it and starting to integrate it in their own process," Lei Ortiz remarks. "In the US, we've seen some larger fund managers who have done that but maybe the smaller ones have yet to start that process."

Europe, Australia and New Zealand are clearly ahead on ESG matters compared to the US, an observation that everyone *Infrastructure Investor* spoke to for this story confirmed and which is also illustrated by the number of PRI signatories by region.

Part of the reason, as Lei Ortiz explains, is because the LPs in Europe have prompted GPs to think about these issues. "I think the GPs in Europe rarely receive a request for information that doesn't include questions around ESG," Lei Ortiz says.

Matthews of Cambridge Associates says "it's hard to pinpoint why that has been the case." She notes that UN PRI took root in Europe – the organisation is headquartered in London – it was adopted rapidly in Australia but not as rapidly in the US.

One of the reasons behind the hesitancy to embrace ESG in the US could be the politicisation of climate risk in the country. "Climate risk here in the US is a far more political issue, while outside the US, it's a given," Matthews acknowledges.

But regardless of size, available resources or geography, the consensus is that ESG will only continue to grow in importance.

"There are certainly those who are sort of being dragged kicking and screaming into this whole idea and feeling: 'Oh, this is a nuisance that will go away if I ignore it,'" Impax's Richardson comments.

"I think that's false. I think it's only going to become more important. I think sustainability issues grow more important every day and investors recognise that. It's with any new evolution – some will be left behind." ■

UN-PRI SIGNATORIES BY REGION

Europe	810
North America	335
Africa	60
Asia	78
Latin America	63
Oceania	133
GRAND TOTAL	1506

Source: PRI.org