

Turning a ‘should’ into a ‘must’

Valeria Rosati, senior partner, walks us through Vantage Infrastructure’s approach to ESG and the main challenges to implementation

ON 14 AUGUST 2018 at 10:37am, the Morandi Bridge, an 80-metre section of the A10 motorway in Genoa, collapsed after a violent storm. A death toll of more than 40 victims is recorded, with hundreds evacuated from nearby homes. Three days later, the Italian Infrastructure and Transport Minister announces on Facebook the intention to revoke the motorway concession and seek significant sanctions, “because human lives come before corporate profits. Because citizens’ safety comes before shareholders’ dividends”.

Any responsible infrastructure asset manager or investor should have wondered: “Could this have happened to our investments? Could our asset management processes have prevented it?” Responsible investing goes hand-in-hand with managing ESG concerns and limiting reputational risks. The reputational damage to our clients of a similar event would have been incalculable, uninsurable and would have extended far beyond the immediate liabilities of a single accident.

A few years ago, the board of a portfolio company was advised of a road accident. Unfortunately, it involved a fatality. Although our company had no culpability, its involvement in court proceedings was likely, as it had been carrying out works nearby. Over many board meetings, the discussion among the directors focused primarily on possible reputational repercussions rather than corporate liability exposure.

The Genoa incident is a reminder of the potential ESG failures that can occur if robust responsible practices are not incorporated into the asset-management phase of the investment life cycle – ranging



Rosati: Vantage has been working to elevate its ESG practices above market standard

from health and safety and environmental incidents, to the social implications of underinvesting and ineffective governance processes.

Against this backdrop, Vantage has been working for almost a year on a programme to elevate our historical ESG strategy and practices above market standard. As an independent, solutions-orientated specialist manager, one of the core values our staff has chosen to embrace is to be ‘ambitious’ in all aspects of the business, including our ESG initiatives.

Responsible investing has become a well-known concept. Since 2006, UNPRI has grown from 100 to more than 2,000 signatories, and an extensive body of research now exists on the correlation between financial performance and ESG considerations. Are we then just following the herd?

At Vantage, we embrace ESG for three simple reasons:

- Responsible investing enables us to

achieve our clients’ strategic objectives;

- ESG factors can impact returns positively or negatively, and we believe systematic and effective risk management can contribute not only to resilience but also to long-term value creation for all stakeholders; and
- Most fundamentally, given the essential role infrastructure plays in the community, robust ESG processes are crucial to fulfil its social contract.

Our ESG mission at Vantage is to ‘turn a should into a must’, as Tony Robbins may say. Our ambition runs through identifying areas for innovation, taking systematic actions and establishing an ESG culture and finally a deliberate practice mindset to drive continuous improvement.

360° ESG

In 2015, the CFA Institute listed six approaches to bring ESG into investment decision-making: exclusionary screening, best-in-class selection, thematic investing, active ownership, impact investing and ESG integration.

At Vantage, we have invested our resources in reviewing market standards and guidelines, alternative methodologies (quantitative and qualitative) currently available for credit analysis and equity due diligence, other managers’ reports and proprietary data collected from our experience of investing in more than 100 infrastructure assets. Based on these insights, we have formulated an ‘active ESG integration’ approach, incorporating our firm’s ethos, which therefore combines key features of integration and active ownership.

Active integration allows us to focus on two types of infrastructure investments

from an ESG viewpoint. Firstly, on companies that already make a difference. Secondly, on opportunities where our team at Vantage can make a positive difference through our own actions as a shareholder. An example of the former is our natural-gas business in Northern Ireland, which for 20 years has contributed to the abatement of carbon emissions equivalent to almost one car taken off the streets of Belfast each time a new property is connected to its network. An example of the latter is our land registry business in Australia, which did not have a specific ESG philosophy pre-privatisation and which therefore provides us with the opportunity to apply our ESG framework to drive improvements.

Our framework, called '360° ESG', rests on the following three pillars:

- It is common across our debt and equity investment business;
- It pervades the whole life cycle of an investment, with a specific focus on asset management; and
- It is embraced at both the manager and the portfolio companies' level.

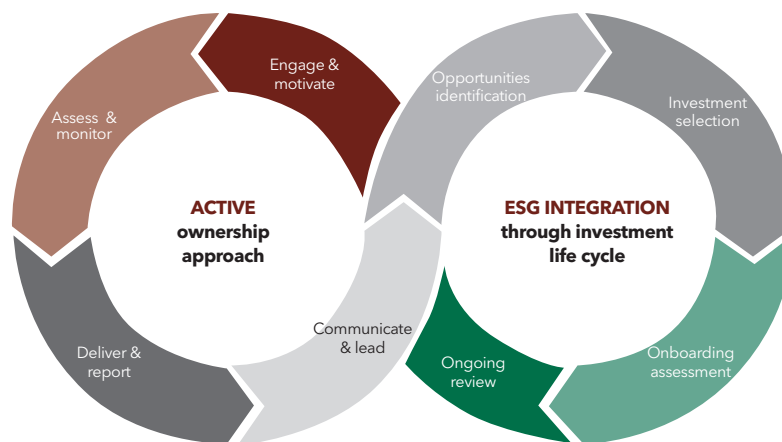
COMMON TO ALL INVESTMENTS

As a debt investor, we believe that traditional credit rating methodologies, although systematic and analytical, do not incorporate some of the challenges our investments may face. The same applies to traditional financial analysis and due diligence for equity investments. Therefore, we have extended that rigour to an ESG framework – in other words 'what we do' – which applies consistently across our debt and equity business.

We also share ESG toolkits, specifically 'how we do it'. For instance, the equity team is currently adapting a structured assessment tool that has been developed and tested by the debt team to measure, rank and report on ESG performance. This will facilitate our consistent identification of weaknesses and ESG best practices among issuers and equity portfolio companies alike.

Furthermore, incorporating ESG in periodic asset reviews allows equity and

ESG ACTIVE INTEGRATION - REVIEW & REPEAT



Source: Vantage Infrastructure

debt to identify, assess, monitor and take actions on the development of ESG matters.

APPLIED TO THE WHOLE INVESTMENT LIFE CYCLE

As part of a living programme, we believe ESG initiatives should embrace all phases of the investment life cycle. Based on our review of industry practices, managers of unlisted investments appear to most commonly place greater focus on two phases: the initial investment and regular client reporting. This may be perfectly adequate and already meet clients' expectations.

Conversely, as an active infrastructure manager, Vantage's 360° ESG centres on full life cycle engagement, from initial screening to realising an investment, with asset management being a key component of it.

Increasing our focus on data collection and measurement through the tools we are developing, as well as working with GRESB to improve our ability to benchmark ourselves and our investments, are important steps. However, this is not 'active' asset management unless it is followed by disciplined actions. Our purpose is to move from assessing an impact to making an impact.

A range of positive levers can be used

to drive our equity investments – from the adoption of board policies and board reporting, to ESG KPIs for management and the introduction of frameworks, to name a few. This year, all our portfolio companies have participated in the GRESB survey. Prior years' participants have all improved, and Vantage has already commenced an in-depth review of the GRESB reports to help tailor the action programmes we co-create with companies' management and stakeholders to drive further improvements. We have also found that leading knowledge-sharing workshops across management teams raises awareness quickly and can be effective also on ESG matters.

We do not agree with those who claim it is not possible to effect change as a debt investor. At Vantage, while acknowledging that the level of control over a company's actions is lower with debt than equity investments, we still believe active engagement has the potential to make a difference.

The collection of data and systematic identification of market trends and best-practice examples across our portfolio informs our discussions with issuers pre-investment, allowing us to seek improvements in reporting disclosures. Our influ-

360° ESG - VANTAGE FRAMEWORK



Source: Vantage Infrastructure

ence may peak during the initial investment period. However, we have found that continued engagement during the asset-management phase can also be impactful.

From our involvement with numerous PPP projects, we have identified that tracking the relationships between the key project stakeholders can be every bit as strong an indicator of future performance as monitoring financial ratios. The early identification of these issues positions us well to engage in more constructive dialogue and seek resolution to the benefit of all parties.

ADOPTED AT TWO LEVELS

An action plan needs to be embedded in the creation of an ESG culture to deliver long-term sustainable outcomes. Our 360° ESG approach adopts this both at the portfolio companies' level and within Vantage. This means treating ESG as a commitment with non-negotiable values and formulating a programme that ensures consistency of application, managerial accountability, building internal awareness and setting

objectives. To make ESG possible, a cultural programme should be clear, specific and collaborative.

In line with Principle 4 of the UNPRI, a tenet of this cultural programme is also the promotion of ESG in the marketplace. For us, this translates into an intent to communicate and lead in our infrastructure community.

THE HURDLES

We may have made our approach seem easy, but it is not. Active integration of ESG is not free of challenges.

Firstly, it can be costly. Last year, the Harvard Law School Forum on Corporate Governance and Financial Regulation published an article called 'The ESG Integration Paradox', about the J-curve faced by managers with upfront ESG integration costs, that deters many from full integration.

Secondly, ESG can be hard to measure. There are no shared standards and assessments often rely on qualitative judgments. In addition, we specifically strive to quantify

in monetary terms both investment risks and the value-add of our own actions. However, valuing ESG can be challenging in this respect.

Thirdly, we are not acting alone. A rounded approach requires co-operation from issuers, companies' management and other stakeholders.

Lastly, the notion of ESG continues to evolve, as political views and public opinion shift the boundaries of social responsibility, community engagement and legitimacy. For example, is diversity part of ESG? With a very diverse workforce and a strong gender balance, we believe so at Vantage, even if many exclude it from traditional definitions.

We are still progressing along our ESG path. Work continues on testing the framework, developing tools, reviewing actions, setting next steps and pushing present boundaries. Review & repeat. Over time, programmatic actions and a culture should together turn ESG into a habit, and the adoption of a deliberate practice strategy to find small but continuous improvements should drive meaningful cumulative gains. After all, it drove British Cycling's success in Beijing, London and Rio and most recently Team Sky's two grand tour wins this year.

It is hard to say categorically that embedding ESG robustly in asset management could have prevented a human tragedy such as that in Genoa. However, at Vantage we believe turning the ESG 'should' into a 'must' through our own framework should maximise the odds of driving positive impacts for all stakeholders. ■

Vantage Infrastructure (www.vantageinfra.com) is an independent investment firm comprising an experienced team, longstanding institutional relationships and a diverse equity and debt infrastructure portfolio, with more than \$3.6 billion invested in infrastructure assets across Europe, North America and Australia on behalf of global clients. Vantage infrastructure is part of the Northhill Capital Group.