VANTAGE POINT

HOW TO PRODUCE ESG RATINGS FOR INFRASTRUCTURE DEBT

Across the entire finance industry, investors are increasingly concerned about the sustainability of their investments. However, whilst a multitude of public ESG-related surveys and initiatives exist, no market standard has emerged for assessing the ESG performance of private infrastructure debt investments.

Infrastructure debt is a particularly challenging asset class to assess, as issuers are often SPVs or private companies which produce no or limited ESG-related reporting for debt providers, let alone the type of standardised information envisaged by initiatives such as the TCFDs or the CDP. Meanwhile, lending is typically over a long-term horizon and to assets which are likely to have a direct impact on society, so the issue of sustainability cannot be ignored.

At Vantage, following a survey of leading public ESG assessment methodologies, we concluded that none truly addressed these challenges. We therefore decided to design a tool, tailored to our requirements and the information we are typically able to extract from our investee companies, that we could integrate into our investment and asset management process.

Drawing from our experience, here are 5 steps on how to produce infrastructure debt ESG ratings

Identify your objectives. Are your ESG ratings driven by a fundamental requirement to manage and mitigate risks? If so, the methodology may be akin to a credit rating assessment. Or should the tool help identify assets that reflect social or ethical values, or drive positive impact?

Look for precedent. Whilst you may not find the perfect off-the-peg solution, existing approaches published by research houses such as MSCI, credit rating agencies and ESG survey specialists (e.g. GRESB and PRI) are all valuable resources for the factors and criteria that you may wish to incorporate into your own rating.

Utilise available information. The research above may inspire a long list of factors for consideration, but the level of information you receive as a debt investor is likely to affect your ability to rate investments in a meaningful way. Sponsors, advisers and general industry reports are typically excellent sources of additional insight, and engagement with issuers, particularly prior to financial close, can lead to improved transparency and reporting.

Select the most relevant factors. With all that research compiled, conduct a materiality assessment to choose which factors to employ and how to weight them. Considerations across the E, S and G spectrum are all relevant to infrastructure debt. However, the protection afforded by the robust governance typically present in project finance documentation means that analysis may be more focused on issues such as exposure to climate change risk, relative levels of emissions and water usage, impact on society and resilience to various transition risks.

Review and repeat. Reviewing your methodology will be critical to its success. Back-testing and benchmarking the results for their effectiveness will help refine your rating tool over time, leading to enhanced analysis and the ability to make investment decisions or exclusions that truly reflect the sustainability objectives most pertinent to your investment strategy.

This last "Review and Repeat" stage is embodied in Vantage's 360º ESG framework. As we have integrated our own ESG rating tool into our investment processes, we find that increased data and visibility across the sector not only enables us to assess individual transactions, but also to utilise that data to encourage issuers to improve their own ESG credentials and reporting. Over time, we believe the act of ESG rating can also enhance ESG performance – a key tenet of our overall ESG strategy.