# HOW TO... ADDRESS BEHAVIOURAL BIASES IN ESG INTEGRATION FOR INFRASTRUCTURE

Behavioural economics has long covered how behavioural biases can impact investment decision-making. This should make sense intuitively also to anyone less familiar with this field. If our choices in day-to-day life are influenced by systematic patterns of irrational behaviour and beliefs, why would our investment decisions be any different? After all, investing relies on facts, which are then analysed and assessed by different individuals or organisations, leading to possible divergent conclusions. These assessments may appear entirely rational to those who make them, but they often are not and may lead to investment mistakes.

Whilst it is not possible to render the investment decision-making process entirely unbiased, biases can be managed and mitigated. This requires knowledge, active identification and management of processes designed to minimise their impact on investing.

At Vantage, we have considered whether the ongoing integration of ESG in the investment process for infrastructure equity and debt can be vulnerable to behavioural biases. These could be systematic errors in thinking based either on established concepts and beliefs regardless of information, or on emotional factors.

Here are 6 behavioural biases, which may more commonly affect ESG investment considerations for infrastructure assets:

| | ESG INFRASTRUCTURE APPLICATION | MITIGATION APPROACH |
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| **CONFIRMATION BIAS**<br>*The tendency to gather confirmatory rather than contradictory information.*<br>In other words, when faced with an investment decision, we seek out evidence that confirms our pre-existing beliefs, possibly overlooking other relevant facts. | During due diligence on a target company known to be a leader in specific aspects of ESG (e.g. a renewable generator with excellent environmental and community credentials), greater weight is placed on accolades, awards and obvious ESG strengths (where plenty of evidence exists) and limited questions are asked on other ESG areas. | Adopt a robust, comprehensive ESG due diligence framework and apply it consistently. Follow the basic principle of probing what is not supported by clear ESG evidence. |
| **INFORMATION BIAS**<br>*The tendency to use only the most readily available information.*<br>This bias is also known as observational bias or streetlight effect. | When considering ESG risks in the supply chain of a potential infrastructure investment, a reputable and experienced contractor is viewed quickly as low risk and limited further diligence is conducted. However, further analysis would have shown that the contractor's experience is mainly in other jurisdictions and that a fundamental misunderstanding of local working practices is leading to disputes and possible industrial action in connection with that project. | The most familiar or achievable solution to a problem may not be the most logical or correct one. Go back to basics and establish your understanding of an ESG issue from the start by asking a standard set of thorough questions. In the management of an existing investment, use a comprehensive ESG framework with proactive rather than reactive risk screening. |

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| **ENDOWMENT EFFECT**<br>*The belief that an asset is more valuable if one owns it.*<br>Also known as divestiture aversion, a consequence of this bias is also a tendency to keep an investment because one already owns it. | An ESG risk to an existing investment has increased, yet ownership of that investment is still viewed as strategic, its valuation is unaffected and the asset continues to be described as more attractive than both peers and alternative investment opportunities. | Ensure ESG factors are incorporated in periodic reviews of the strategic fit of investments with a client portfolio or fund strategy. Produce risk assessments, for credit or equity, that score ESG risks and explain changes. Look at alternative ESG scenarios and probabilities to revise a base case and, if needed, consult with an independent valuer to get recent, objective market benchmarking. |
| **HINDSIGHT BIAS**<br>*The over estimation of the predictability of a past event.*<br>In other words, the belief after the fact that we could have foreseen an event or circumstance that has already occurred. | *'Everyone could have predicted the Morandi bridge collapse in Genoa'* after years of continuous maintenance and patching up, given its age and similar precedents. Implication: this ESG risk would have never impacted us as investors, because we would have certainly foreseen it and prevented it (or avoided making the investment all together). | Look for early warning signs or red flags and back test actions and decisions. In addition to post-mortem reviews, consider borrowing from space flight best practice and conducting an 'ESG pre-mortem'. Projecting hypothetical ESG failures to your investments can help manage future risks. |
| **BANDWAGON EFFECT**<br>*The propensity to follow what others are doing, regardless of our own beliefs.*<br>We have included this bias also because it may appear counter-intuitive. Some may indeed dismiss the whole ESG thematic just a 'popular trend'. At Vantage, we approach ESG as an investment imperative to assess and manage long term risks and capture value opportunities. | A manager requiring all infrastructure portfolio companies to evaluate and pursue the issuance of indebtedness under green financing frameworks. | ESG investing is about substance, not form. An ESG strategy for infrastructure should be deliberate and pursue ESG initiatives only when valuable, without wasting time and resources that could have been better deployed. In this example, whilst acknowledging the wide-ranging benefit of accessing green or sustainable financing sources (e.g. reputational, capital diversification, societal purpose, etc.), be sceptical about the apparent benefits of 'greenwashing' every infrastructure investment. Consider objectively the intersection between a company's capex purpose and green financing availability. |
| **CONSERVATIVISM BIAS**<br>*The tendency to maintain a prior belief even when new information is available.*<br>In ESG, this can support the belief that the past is a good predictor of the future despite new emerging risks or opportunities. | Despite the more recent occurrence of rare or extreme environmental events, weather patterns continue to be viewed as consistent with past predictions. The estimate of frequency or magnitude of acute events remain unchanged. | Seek to run sensitivities and alternative scenarios on key ESG drivers, both at the time of acquisition and as part of the ongoing asset management of an investment. If an acute event occurs, where possible work with the investee company to gather information, draw conclusions and design an impact mitigation plan. |



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