KEYNOTE INTERVIEW

Ending the scourge of greenwashing

In a world where sustainability pledges are proliferating, truly sustainable managers must prove their credibility through objective impact measurement and intentionality, says Vantage Infrastructure senior partner Valeria Rosati

Q There has been a flurry of sustainability commitments made by infrastructure managers. What is behind that move?

It is partly being driven by regulation and partly by LP demands for sustainable products. The push to deliver a net-zero-carbon economy is now considered to be one of the most urgent imperatives of our time. The world is demanding climate action. The substantial reduction in pollution observed during the pandemic was also a contributing factor, as was the push among governments towards a green recovery post-covid. And, of course, we have had COP26.

At the same time, extreme weather events like the windstorms that swept through the UK and Northern Europe in February are testament to the physical risks that climate change poses. Investment in sustainable infrastructure, meanwhile, is recognised as an enabler of the long-term environmental objectives that countries are setting around the world.

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Q Amid all these sustainability claims, what sets credible sustainable managers apart?

It can be challenging for investors to discern genuine commitment from sustainability being used as a branding slogan or marketing strategy. In our view, the litmus test of a sustainable manager is the combination of objective measurability and intentionality. It is no longer enough to have ESG policies and practices in place. Credible sustainable managers need to set concrete targets and an intentional impact strategy. They need to demonstrate how

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each investment is making a measurable contribution to a net-zero-carbon economy and how risks and opportunities are being robustly captured.

For instance, we view emerging regulation such as the SFDR, the EU taxonomy and TCFD as more than mere reporting obligations. Instead, we see them as tools we can leverage to achieve that objective measurability. And this is a differentiating factor.

Q GRESB has indicated that, in its 2021 annual infrastructure benchmarking, only 23 percent of funds participating had an asset in the portfolio with a net-zero target, and fewer than 9 percent had set science-based targets. Why are those figures so low?

Because it is a very demanding process. With binding targets, there is always the risk that new sector-specific guidance will emerge or that the perimeter of a manager's relevant investment activities will change. Some managers take a bottom-up approach when they make a net-zero pledge, mapping out all the delivery risks. Others take a top-down approach centred around the necessity of making a long-term commitment in order to deliver impact and be truly sustainable. No commitment, no impact.

Because it is so complex, it is important to collaborate with like-minded peers and to leverage investor organisations such as the IIGCC and the initiative Climate International. The insight these groups provide will be critical to raising the numbers cited in the GRESB report and incentivising others to join in on this journey.

Q So, how are you driving decarbonisation across your equity portfolio?

Thankfully, there are reference frameworks that one can relate to, in particular, the Institutional Investors Group on Climate Change, or the IIGCC. The IIGCC has a framework that outlines how to deliver a net-zero strategy for a portfolio using a two-pronged approach, covering both the decarbonisation of existing investments and an increased exposure to climate solutions through new investment. At Vantage, we prefer to frame it differently and consider this more as a continuum across the lifecycle of each investment, existing and new. However, it certainly makes sense to consider each element in turn.

Q Let's start with your approach to decarbonisation in the asset management phase.

There are three systematic stages to decarbonisation in the asset management phase: assessment, measurement and then execution. Assessment of climate risks and opportunities, and their integration into the governance, strategy and risk management of each portfolio company, is preferably done in accordance with TCFD guidelines. It is important to work closely with portfolio companies to explore those risks and opportunities in detail, not just as a desktop exercise. Qualitative assessments should then be elevated to quantitative scenario analysis, preferably with a minimum of three relevant pathways considered. Lastly, progress against gaps should be tracked using a clear reference dashboard in order to ensure that these assessments are effectively incorporated into strategic decision making.

Measurement, meanwhile, involves conducting a robust greenhouse gas inventory for each investment, including Scope 3 emissions, with a target-setting mentality from the outset. This is also preferably done in collaboration with portfolio companies and may sometimes also involve specialist external support, particularly if data is being collected for the first time.

Finally, execution involves raising climate ambitions by setting measurable emission reduction targets, accompanied by carefully judged, long-term action plans.

Vantage started this work a few years ago. But we were not aiming to achieve everything in one day and we were guided by materiality to value. We have since achieved significant progress and in 2022 we will be running four parallel climate initiatives in order to align our investments and close any residual gaps. Our objective, ultimately, is to put robust, assured and ideally science-based net-zero targets in place for all of our investments, in line with the Paris Agreement and with limiting global warming to 1.5C.

Q How do you apply your climate practices to the selection of new opportunities, the second prong of the IIGCC approach?

Climate is often thought about in terms of risk and cost – something that is a potential challenge to future financial performance. But decarbonisation can also represent an opportunity for investors to access a diversified portfolio of both current and next-generation infrastructure across multiple sectors. We believe, as I said earlier, that it is important to have a consistent approach across the whole lifecycle of an investment, right through to exit optimisation, and so we use the same tools pre- and post-acquisition.

For example, a few years ago we developed an EU taxonomy tool for assessing both the current and future alignment of activities. We first tested it on existing portfolio companies as a pilot, and then integrated it into the due diligence process for our most recent acquisition.

We also use the EU taxonomy framework to identify sustainable sectors within our investable universe, through their thresholds and measurable contribution to net zero. In parallel, we also believe that robust target setting can be adopted for prospective investments to further underpin sustainability.

Q What are the greatest challenges to implementing decarbonisation?

It is a long list. If it were easy, it would already have been done. I think about implementation challenges in terms of those that are controllable and those that are uncontrollable.

The controllable challenges come down to the three Cs: complexity, co-operation and comprehensiveness. Complexity because guidelines are inconsistent and changeable. Applying frameworks such as the EU taxonomy requires in-depth knowledge, good preparation and access to robust data.

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Co-operation, because you need alignment with management teams to pursue these climate ambitions. You also need to co-operate with the supply chain in order to tackle Scope 3 emissions reduction, which cannot be achieved by the portfolio company in isolation.

Comprehensiveness, because climate-related information is often incomplete, particularly during due diligence, and risks and opportunities need to be assessed in detail in order to evaluate implications for the business and actions required. For example, if you have an investment that is not EU taxonomy aligned, but that could become so, you need comprehensive information to judge what it will take to get the company to where it needs to be, and the impact of that transition on financials and growth.

The uncontrollable challenges can be daunting because, by definition, you can do little about them. The first uncontrollable challenge is the continued evolution of regulation and sector-specific guidelines, which means targets set today may need to change.

The second involves the absence of mature and clear delivery mechanisms for decarbonisation in some circumstances. The IEA has stated that half the carbon efficiency required by 2050 will be powered by technologies that are currently unavailable, immature or insufficiently rolled out. Committing to targets when you don't have access to the delivery mechanisms to achieve those targets is obviously a significant challenge.

Q How are LP attitudes towards sustainability evolving?

Most LPs have a clear imperative: to earn an attractive and appropriate risk-adjusted return whilst increasing their contribution to long-term environmental change. That objective is becoming more and more widespread. At the same time, the questions that LPs are asking are becoming increasingly sophisticated. They want to see clear, measurable actions and targets. It is no longer enough to have due diligence policies and processes. They want to understand a manager's carbon actions, as well as the competitive advantage that one sustainable investment strategy has over another making similar claims.

Q How do you measure an investment's impact on net zero, and how do you create alignment between LPs and GPs?

As I said at the outset, objective measurability is what separates sustainable managers from those simply making sustainability claims. We leverage objective third-party frameworks to achieve this. We are also setting emissions reduction targets using established methodologies. These are all important tools for measuring impact in a way that is not subjective and which can be verified. We believe third-party assurance is also very important.

To make a credible pledge and reinforce the objective measurement of impacts, the manager should also link part of its remuneration to the achievement of those sustainability objectives and enhance alignment between LPs and GP. ■