KEYNOTE INTERVIEW

What investors want

Investor scrutiny of ESG is intensifying, driven by regulation, stakeholder demands and an awareness that environmental and social issues impact value, say Igneo Infrastructure Partners' Sarah Cole, Sophie Durham and Maria Castro

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Q How are investor attitudes towards ESG evolving and what is driving that?

Sarah Cole: Right now, inflation and climbing interest rates are obviously front of mind for investors. But beyond that, the biggest challenge that investors face today is how to track and measure ESG impact, and that is a challenge that they naturally pass on to us. Even as a specialist infrastructure manager, we are receiving more questions about ESG than ever before. This scrutiny has become standard for all allocations, not just those labelled as ESG, impact or sustainable.

Sophie Durham: I think that is being driven partly by regulation and partly by demand from investors' stakeholders, for example pensioners. There is heightened awareness of environmental and social issues across society, particularly as we see the effects of climate change first hand. I also believe that there is an increased recognition of the effect that environmental and social issues have on the value of assets and therefore the value of pensions. If you want to protect, and indeed create, sustainable long-term value, you have to manage those risks effectively.

Q How do you integrate ESG into your investment strategy?

SD: Scrutiny of ESG is increasing across all asset classes, but I think it is particularly relevant for infrastructure because these are long-term assets, we are long-term investors and our clients have long-term horizons. We are talking about timeframes where you really do see environmental and social risk playing out and impacting value.

In addition, these are large, physical assets that have impacts on the environment and society, both positive and, potentially, negative. They are also assets that are impacted by the environment and society themselves. Managing ESG risks and opportunities is a prerequisite for good business and good investment and is something we have prioritised for the past 30 years.

ESG integration, therefore, starts at the earliest stage of the investment process: screening. ESG is one of eight criteria that we assess potential investment opportunities against. That carries through to due diligence and investment decision-making, but it is in the asset management phase where ESG skills really come into play.

We usually acquire a majority shareholding and always have board representation, which positions us to have a proactive approach, and we work closely with every company on ESG issues. We have five minimum standards for ESG performance that we believe are relevant to every asset regardless of sector or stage of maturity. Those cover environmental performance, health and safety, diversity and inclusion, good governance and employee engagement. Beyond that, we take a pragmatic approach and focus on the ESG risks and opportunities unique to each business.

Q There are infrastructure assets that are highly carbon intensive and therefore require investment to support their energy transition. Is this something that you would consider to be acceptable, given your ESG screening?

SD: Our approach is one of improvement and not exclusion, and we view improving ESG performance and managing energy transition very much as value creation opportunities. Yes, infrastructure assets can be high carbon emitters and may operate in the oil and gas value chain. But these are the assets that are critical to the energy transition.

For example, we are shareholders in a regional German utility that still has some gas and coal-fired power generation in its portfolio. These energy transition risks were identified during due diligence and we are working with the management team and our co-shareholders, the city of Mannheim, to accelerate the decarbonisation strategy that was already in place.

As a result, coal will be phased out five years earlier than planned and the net-zero target has been brought forward to 2040 from 2050. A whole suite of interim emissions reduction targets, approved by the Science Based Targets initiative, have been introduced, making this the first German energy company to have approval under SBTI. As the third-largest provider of district heating in Germany, the changes we are making through our investment will prove critical to the country's energy transition.

Meanwhile, we also have a fund-level target of reaching net zero by 2050 or sooner, supported by an initiative called Climate Action 123.

Q What types of investment and value creation opportunities is this focus on ESG leading to?

Maria Castro: Right now, we have a unique opportunity to rethink Europe's energy infrastructure. On the supply side, it is clear that a move away from fossil-fuelled generation will require diversification of energy production, with renewable energy the star of the show. Renewables are expected to account for 85 percent of global power generation by 2050, which equates to nine times the generation capacity in place today. That will require enormous investment.

But renewables are inherently intermittent, which is opening up other investment opportunities for things such as grid balancing and storage. Hydrogen and carbon capture are also going to become incredibly important

Q What do you believe the future holds in terms of ESG integration and what plans do you have as an organisation in this regard?

SC: ESG has been integral to the way we operate long before it became fashionable. Given the type of assets that we invest in, managing those risks and opportunities has always been essential to our ability to generate the returns that our investors are looking for.

The proliferation of regulation and frameworks around ESG in recent years has increased the prominence of environmental and social issues across the industry, but for us these are issues that have always been critical. That said, increased focus on ESG from governments and regulators, as well as investors, has definitely led to new opportunities for us as a business and I have no doubt will continue to do so.

to help decarbonise energy-intensive industries, and the EU is developing regulatory frameworks to support the growth of these.

On the demand side, meanwhile, biofuels and biogas are creating investment opportunities, alongside EV charging. District heating is another extremely interesting area for investment, supported not only by EU regulation, but by regulation being put in place at a member state level as well. The French Energy Transition Law, for example, is targeting a 30 percent reduction in fossil fuel generation by 2030, with specific targets for district heating.

All of these tailwinds are creating opportunities for investment, as well as opportunities for value creation in our existing portfolio companies. Not just adding renewable production in many of them, but also increasing their strategic relevance in this transition.

Nordion Energi, for example, aims to be the first 100 percent green gas network in Europe, and is working on hydrogen and carbon capture projects. There is also EVOS, our liquid storage asset in the Amsterdam-Rotterdam-Antwerp region, Germany and the Mediterranean; as well as enfinium, an energy-from-waste producer of baseload energy with waste as fuel, instead of other fossil-related ones.

Q Are investors still primarily focused on the E, or is there now also more focus on social issues as well?

SC: Diversity and inclusion is an issue that has really shot to prominence this year. In 2021, we received a handful of requests relating to DE&I. This year, those requests have increased dramatically. Investors are clamouring for data and that is starting to take us beyond the E of ESG, on a material basis, for the first time.

What I would add, is that there is still relatively little attention explicitly placed on the G, which surprises us, especially as it is something we do very well. I think investors almost take good governance as a given.

> *"There is heightened awareness of environmental and social issues across society"*
>
> **SOPHIE DURHAM**

Q Do investor attitudes to ESG vary by geography?

SC: ESG is a priority everywhere, but we do see a couple of hotspots including Australia, where the superannuation funds have to be incredibly transparent with their members. Another country that really stands out is Germany. We receive a lot of questions from there as investors grapple with meeting their own ESG obligations.

Q What impact has regulation had on ESG?

SC: SFDR and the EU Taxonomy have naturally been an area of focus for us. We see more and more investor questions stemming from that regulation.

MC: In addition to that transparency and reporting regulation, there are also regulatory frameworks affecting different sectors that we pay close attention to. That regulation is designed to tackle decarbonisation, of course, but energy security as well. The EU, for example, launched its Fit for 55 legislation to reduce GHG emissions and, more recently, RePowerEU, as it looks to rethink energy supply chains and move away from reliance on Russian gas, and with a focus on increasing efficiency in businesses. There is also additional regulation supporting the demand side, and promoting electrification, all of which create tailwinds for our assets in these areas.

Q What are investors expecting in terms of reporting and benchmarking, and what challenges can that represent?

SD: We are seeing a significant increase in demand for ESG reporting from investors and that drive for transparency is important. But there are so many different frameworks and ratings systems that, if you were to sign up to all of them, you would need a small army to tackle the workload. For us, the challenge, therefore, is to identify those frameworks that actually have a positive impact for our portfolio companies, but that aren't too onerous for them to take on.

One positive outcome of SFDR and the EU Taxonomy is that we are starting to see a coalescence around that regulation as a reporting framework. The hope is, therefore, that we will start to see more standardisation as a result.

SC: We try to focus not only on quantitative analysis, but on qualitative case studies as well. We want to give our investors that depth of insight and understanding of both how we do things and why we do them. ■

Sarah Cole is managing director, investor relations; Sophie Durham is managing director, head of ESG; and Maria Castro is managing director at Igneo Infrastructure Partners

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