Principles for Responsible Investment

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

INFRASTRUCTURE

OVERVIEW

- This guide summarises the approaches to responsible investment for direct and indirect infrastructure investors.
- It outlines how to include ESG issues throughout the investment process and in the relationship between asset owner and investment manager.
- Selected further reading is provided throughout. Feedback and questions regarding this guide can be sent to infrastructure@unpri.org.

Infrastructure is particularly compatible with responsible investment because of the long-term nature of the asset class, its focus on essential services, and its contribution to achieving key sustainability outcomes, such as investments in assets / portfolio companies that support an energy transition in line with the UNFCCC Paris Agreement.

2023 PRI reporting data suggests that infrastructure investors are committed to responsible investment: for example, 72% of infrastructure investors incorporate responsible investment commitments into their Limited Partner Agreements (LPAs) or equivalent as a default practice.

Infrastructure investors take a range of approaches to responsible investment. For direct investors, these include using ESG due diligence and post-transaction value creation plans to improve assets' / portfolio companies' ESG and financial performance. For indirect investors, responsible investment considerations can be included throughout the selection, appointment and monitoring of external managers.

AN INTRODUCTION TO
RESPONSIBLE INVESTMENT

EXPLORE THE SERIES

The guide is split into two parts:

Part one: direct investors		
Pre-investment	**Post-investment**	
■ Conducting due diligence ■ Developing investment memos ■ Making investment decisions	■ Managing ESG risks, opportunities and impacts ■ Working with third-party operators ■ Reporting ■ Exiting the investment	
Part two: indirect investors		
Selection (of asset managers)	**Appointment**	**Monitoring**

PRI resources

Policy briefing: sustainable infrastructure

Bridging the gap: how infrastructure investors can contribute to SDG outcomes

Are national infrastructure plans SDG-aligned, and how can investors play their part?

PART 1: DIRECT INVESTORS

PRE-INVESTMENT

Conducting due diligence → Developing investment memos → Making investment decisions

CONDUCTING DUE DILIGENCE

When an opportunity is first identified, investors can assess whether there are serious ESG issues that could rule out the deal immediately – for example, harmful environmental practices, or fraud and corruption cases leading to significant fines and ongoing liability or loss of operating licences.

Investors may also have firm-wide sector exclusions or screening lists that should be reviewed to confirm the deal complies with such policies. Even at this preliminary stage, it is good practice to signal to the vendor and / or project partners that ESG issues are important to your firm.

Once a deal progresses, ESG issues can be investigated more thoroughly. Investors should consider ESG factors throughout the relevant stages of the asset life cycle (development, construction, operation and maintenance, and decommissioning), and assess the impacts and risks in the supply chain, such as manufacturing and transport. ESG factors may also vary according to an investor's specific strategy, for example whether they are greenfield or brownfield investors.

Common ESG factors to investigate during due diligence:

ENVIRONMENTAL

- Climate change
  - Energy consumption
  - Greenhouse gas emissions
  - Resilience to extreme weather events
- Resource degradation and biodiversity loss
  - Waste management
  - Water consumption

SOCIAL

- Health and safety standards
- Labour standards and working conditions, including in the supply chain
- Land rights, indigenous rights
- Diversity, equity and inclusion

GOVERNANCE

- Corruption and bribery
- Cyber security and data protection
- Board independence and accountability
- Remuneration (including ESG-linked incentives)
- Tax practices

Due diligence should also cover the asset / portfolio company's ESG policies, governance and processes, and track record, including:

- policies and systems relating to ESG issues, the coverage of these policies and processes for reviewing and updating them;
- responsibility for ESG within the asset / portfolio company;
- training and education for employees on ESG issues; and
- monitoring and reporting to the board, shareholders and other stakeholders on ESG policy implementation and progress on performance targets.

For new or greenfield projects, investors should consider the general ESG track record of any project partners (such as engineering, procurement and construction (EPC) firms), as well as any co-investors. Investors should also conduct comprehensive environmental and social impact assessments in line with international best practice, as well as comprehensive stakeholder engagement, in order to secure necessary operating permits, approvals and a social licence to operate.

The information required to assess these issues can come from a variety of sources, including:

- **Local and international media reports** can give a high-level view of many potential ESG issues.
- **Management meetings and site visits** allow investors to gather greater insight into how ESG policies are put into action.
- **Sustainability reports** detail companies' ESG practices and performance.
- **Monitoring reports and guidelines from regulatory bodies and non-governmental / civil society organisations** can show how companies comply with environmental regulations, labour standards, and conduct community engagement.
- **Independent audits and certifications** can provide third-party verification and assurance regarding ESG practices.
- **Dedicated sustainability and / or risk consultants and technology providers** offer independent expertise and assessment on a range of ESG issues.

DUE DILIGENCE FOR MINORITY SHAREHOLDERS AND DEBT INVESTORS

When investing as a minority shareholder or lender, the investor should undertake ESG due diligence on the lead sponsor. It is important to assess whether the majority shareholder is aligned with your views on responsible investment and whether it is willing to listen to minority shareholders or debt investors. Often, an environmental and social action plan (ESAP) is included in the investment agreement or financing documents to detail the issues that require correction post investment.

PRI resource

Private Credit-Private Equity ESG Factor Map

DEVELOPING INVESTMENT MEMOS

The investment memorandum ('memo') typically includes a commentary and / or a risk rating, management and remediation strategy and associated costs and assumptions for each material ESG issue, as well as ESG value-creation opportunities. This information helps ensure that ESG factors are incorporated into the decision-making process and understood by the investment committee.

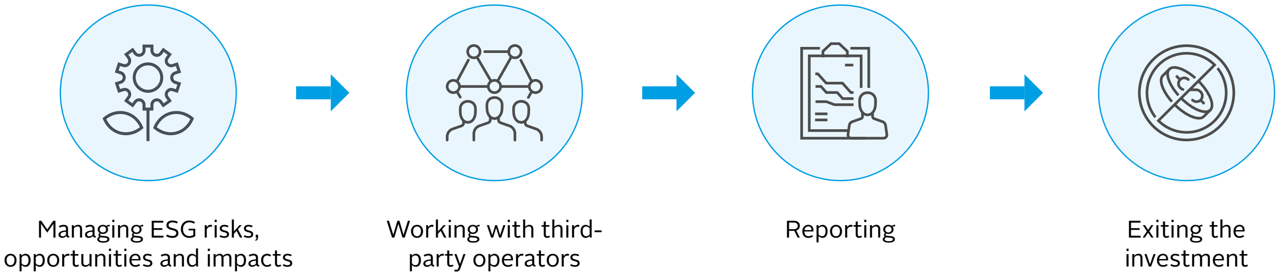
MAKING INVESTMENT DECISIONS

It is important that investment committee members have ESG expertise. This helps ensure that material ESG risks and opportunities for value creation are considered as part of any investment committee decision and are incorporated into post-acquisition plans.

ESG-related factors can impact transactions in several ways. For example, ESG considerations often require additional capital and / or operational expenditure to implement sustainable practices and resilience measures at the asset / portfolio company. ESG-related uncertainties, such as climate risk, changing regulations or evolving societal expectations, can also make future revenue streams from assets / portfolio companies more uncertain.

On the other hand, identifying gaps in existing ESG practices and performance may offer significant opportunities for value creation during the investment. Several types of infrastructure assets, for example, renewable energy projects, also contribute to key global sustainability outcomes.

POST-INVESTMENT



MANAGING ESG RISKS, OPPORTUNITIES AND IMPACTS

For majority or control investors, the ownership phase involves actively monitoring and assessing the asset's ESG performance, engaging with management to address ESG-related risks, opportunities and impacts.

Minority investors should also seek to influence the ESG performance of the asset / portfolio company, but this is most likely done through engaging with co-investors rather than directly.

EXAMPLES OF RI APPROACHES TO MANAGING RISK AND CREATING VALUE

CLIMATE CHANGE

- Investing in measures to increase the resilience of assets to physical climate risks – the potential for physical damage and financial losses due to increased exposure to climate hazards – can enhance operational continuity and worker health and safety, for example.
- Identifying ways to reduce an asset's carbon footprint can often lead to better financial performance through lower costs and potential new business opportunities, and contribute to the goals of the Paris Agreement.

PRI resources

- **An introduction to responsible investment: climate metrics**
- **Incorporating climate change in private markets: an investor resource guide**
- **Infranity: assessing climate performance to build sustainable infrastructure portfolios**
- **Real assets investing and climate change: implementing the TCFD recommendations**
- **TCFD for real assets investors**

HUMAN RIGHTS

- Demonstrating respect for human rights, for example, by conducting social and human rights impact assessments and engaging effectively with key stakeholders, can reduce the risk of conflicts, protests or legal disputes, and help projects gain and retain a social licence to operate.
- Understanding social risks and impacts can lead to further benefits for investors, assets / portfolio companies and key stakeholders, such as more engaged workforces, better retention rates and the development of targeted initiatives that support wider socio-economic benefits in affected communities (for example, local skills training programmes, development of local supply chains etc).

PRI resources

Human rights due diligence for private markets investors: a technical guide

Managing ESG risk in the supply chains of private companies and assets

Research conducted prior to acquisition gives investors a starting point for where to focus, but new issues will emerge during the holding period. It is important to have appropriate systems to manage issues on an ongoing basis. Possible actions to take include:

- **Developing a post-acquisition value creation or 100-day plan (or equivalent)**. Integrate the management of material ESG risks, opportunities and impacts, identified during due diligence, into asset / portfolio company-level policies and strategies.
- **Setting performance targets**. Decide on targets for enhancing environmental and social outcomes, and regularly report to the board and investors. Consider linking ESG performance-related KPIs to management's financial incentives.
- **Undertaking stewardship**. Develop and implement an ESG-focused due diligence and engagement strategy. Use available stewardship mechanisms, such as board seats, meetings with management, and dialogue with other investors and key stakeholders.
- **Monitoring**. Systematically collect, analyse and evaluate relevant data to assess an investment's performance on ESG factors.
- **Allocating responsibility for ESG management**. Advocate for a governance framework that includes board accountability and clear responsibility for ESG management at the asset / portfolio company.
- **Building asset / portfolio company capacity on ESG issues**, through training and knowledge-sharing.

PRI resources

BlackRock: Active community engagement in infrastructure investing

Lighthouse Infrastructure: Delivering sustainable social infrastructure in Australia

Meridiam: Sustainability Impact Measurement Platform

An introduction to responsible investment: Stewardship

THIRD-PARTY OPERATORS

Where day-to-day management of infrastructure assets is outsourced to a third-party operator, the successful management of ESG issues will rest on how effectively the investor selects and monitors that operator. This process can be broken down into three stages.

Selection – assessing the third-party operator's track record and expertise. This could include their overall approach to ESG, engagement processes with stakeholders, ability to collect data, ESG resourcing and internal training programmes and sustainable procurement practices. Some investors compile the assessment criteria into a score.

Appointment – drafting the legal agreement between the third-party operator and the investor. This could include a basic commitment to improving ESG performance or specific actions, such as stakeholder engagement. Some investors also link financial incentives for the third-party operator to ESG targets or performance levels.

Monitoring – creating systems to examine the third-party operator's performance and working with them to improve it. This could include:

- aggregating performance information to create annual scorecards and / or to benchmark different third-party operators;
- conducting site visits;
- establishing awards for outstanding performance;
- providing manuals / guides on best practice; and
- delivering training and workshops.

REPORTING

Several ESG reporting frameworks are widely used in the industry, and they may apply to both investors and / or their assets / portfolio companies.

Many investors face mandatory reporting and disclosure requirements through regulations such as the EU's Sustainable Finance Disclosure Regulation (SFDR). An increasing number of investors choose to report to GRESB, an industry body that benchmarks ESG performance in infrastructure. Investors may also encourage their assets / portfolio companies to report against voluntary sustainability standards such as the GRI Standards and the International Sustainability Standards Board (ISSB).

Investors can seek appropriate disclosure on ESG issues from their assets / portfolio companies by:

- including ESG disclosure as a topic of engagement throughout the investment process;
- featuring ESG performance monitoring as a regular agenda item at board meetings and discussing any material risks at risk committee meetings;
- setting clear expectations for when and how the asset / project company should report material, adverse ESG incidents, as well as how these should be remediated; and
- encouraging assets / portfolio companies to disclose in line with the Taskforce on Climate-related Financial Disclosures (TCFD) and the Taskforce on Nature-related Financial Disclosures (TNFD) recommendations.

EXITING THE INVESTMENT

Responsible infrastructure investing can yield many benefits when it comes to selling assets / portfolio companies, including:

- identifying and managing material ESG issues, preventing a buyer from raising unforeseen risks to negotiate a lower price;
- setting KPIs at the beginning of the holding period, and tracking these KPIs, to help support claims that ESG issues are well managed;
- implementing measures that anticipate future ESG trends or regulatory changes, to present the asset / portfolio company as a forward-thinking investment, appealing to buyers looking for long-term sustainability; and
- demonstrating a history of positive engagement with the community and other stakeholders to enhance the asset's social value and its market appeal.

PART 2: INDIRECT INVESTORS

INVESTING IN A FUND

When an asset owner chooses to invest in a fund managed by an external investment manager, a different approach to responsible investment is required. The asset owner generally cannot make, or materially influence, specific investment decisions, but it can still influence the investment manager's decision-making process through fulfilment of its fiduciary duties and, where applicable, its ESG or responsible investment policy. The asset owner should therefore include responsible investment considerations in its selection, appointment and monitoring of external managers.

How asset owners can implement responsible investment via external managers

SELECTION

As part of their due diligence, asset owners can require investment managers to disclose how they will incorporate ESG factors into their investment decision-making, monitoring and reporting processes, for example, in their offering documents. Asset owners can use these documents to assess managers' approaches and check they are aligned with the owner's responsible investment policy.

However, investment managers and asset owners all have different philosophies, drivers and liabilities. ESG-related disclosure is therefore best achieved through dialogue, rather than checklists. (A due diligence questionnaire, such as our DDQ for infrastructure investors, can help guide such a dialogue).

No matter the specific process, asset owners should take the opportunity to encourage fund managers – even if they are not appointed – to improve how they manage ESG risks and impacts.

APPOINTMENT

Investment managers can incorporate responsible investment provisions in fund terms, including Limited Partnership Agreements and side letters. Placing responsible investment clauses in legal contracts during the appointment process may also help to consolidate the asset owner's commitment to relevant principles (such as the six Principles for Responsible Investment), industry reporting requirements on ESG issues (e.g., climate reporting), engagement practices and human rights.

In our investment manager appointment guide, written in collaboration with law firm Grant & Eisenhofer, we provide a series of clauses that could be used or adapted in fund manager agreements.

Here are two examples:

ESG integration

> "The IM agrees to take into account the six PRI Principles in connection with each Portfolio Investment. Specifically, the IM agrees to integrate financially material ESG factors – which should include climate change, corporate governance and other relevant risks and opportunities – into its investment analysis, decision-making and stewardship policies and practices, including by engaging with management (or equivalent) of the issuers (or equivalent) in which the AO is invested to improve ESG performance."

TCFD and climate scenario analysis

> "The IM will commit to the Final Recommendations of the Task Force for Climate-related Financial Disclosures to provide the AO with a clear and comparable overview of how the investment process incorporates climate-related risks. This should, as outlined in the guidelines, include reporting on governance, strategy, risk management and metrics and targets."

MONITORING

Regular communication on responsible investment throughout the fund's life cycle will help to strengthen the relationship between asset owners and their external managers. The commitments made during the appointment process should be the basis for this communication. Additionally, asset owners can:

- request periodic reports on engagement activities and ESG performance;
- set clear expectations for when and how the fund manager should report material, adverse ESG incidents;
- provide examples to illustrate what they consider severe and what constitutes a material ESG incident; and
- engage with managers on ESG issues through forums such as Limited Partnership Advisory Committees (LPACs).

PRI resources

Responsible investment DDQ for infrastructure investors

An introduction to responsible investment: selecting, appointing and monitoring investment managers

Incorporating responsible investment into private equity fund terms

CREDITS

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