ASSET OWNERS NETWORK

EMBEDDING ESG FACTORS INTO INFRASTRUCTURE INVESTMENTS

A summary guide for pension trustees

Investing in infrastructure can offer pension schemes long-term, contractual cash flows and potentially some protection against inflation.

Infrastructure is a varied asset class that is rapidly changing. As the pipeline of low-risk, mature, investable assets gradually declines, investors are turning to potentially riskier assets in emerging industries and broader geographies. Although there are political, sovereign and foreign exchange risks, investors are casting their nets wide, increasingly looking to fast-growing emerging markets where the demand for infrastructure projects is the highest. Similarly, the range of assets considered as infrastructure is expanding: from core to core-plus and opportunistic. The market is increasingly moving from simply owning an asset to operating a service or developing greenfield sites.

Like real estate, pension scheme investors hold infrastructure assets to provide a diversified stream of returns that are less dependent on public markets or to deliver long-term, contractual cash flows. As good infrastructure is the backbone of healthy and successful economies and societies, investing in it can help pension schemes contribute to building a sustainable world for their members. Tax incentives, such as those planned as part of the EU's Green New Deal, will make investing in renewable energy infrastructure more attractive.

Relevance of ESG considerations in achieving these objectives

ESG factors can impact an infrastructure investment's ability to pay a long-term cash yield and grow in value. Among other things, investors need to be mindful of a project's ongoing social license to operate; health and safety standards during and after construction; management of community relations; resource degradation and the potential for regulation or litigation; supply chain sustainability; political risk; and bribery and corruption.

Pension schemes also need to be aware that ESG risks exist across the infrastructure investment cycle. These risks need to be considered for both new and existing investments.

Climate change is also a long-term risk for infrastructure investors; for example, an investment might be exposed to physical risks such as flooding and fire damage. Similarly, infrastructure being built today might become out of date because of changing global trends, such as oil exploration and development assets.

ESG factors also present opportunities to pension schemes investing in infrastructure. The transition to a low-carbon economy is estimated to need at least US$7 trillion annually. Much of this would be for upgraded and new global infrastructure, particularly infrastructure to support alternative or renewable energy distribution and 'green cities'. The potential for infrastructure projects to create jobs for underserved communities can help pension schemes meet social impact objectives. Also, infrastructure that is made in an environmentally friendly way can help pension schemes meet climate-related objectives.

ESG maturity map

The A4S ESG maturity map, part of its ESG Toolkit for Pension Chairs and Trustees, sets out example behaviours for integrating ESG into infrastructure investment decision making. At the beginning of a pension scheme's journey, trustees might consider the opportunity to invest in infrastructure projects that could have a positive environmental or social impact for underserved communities; whereas at the leading edge of this journey, trustees may be active in promoting better standards and disclosures around ESG investing in infrastructure.

	Level 1 Understanding	Level 2 Adopting	Level 3 Deepening	Level 4 Leading
Example behaviours	The Board: • can confidently discuss the risks and opportunities related to ESG factors on infrastructure cash flows and returns • has considered the potential long-term implications of ESG factors on both direct projects and infrastructure funds • has considered how to integrate ESG analysis into the investment decision and risk management processes • has considered the opportunity to invest in infrastructure projects that could have a positive environmental or social impact for underserved communities	The Board: • is developing a framework for integrating ESG factors into infrastructure investments (both for direct projects and infrastructure funds) • has identified the material issues their investments are exposed to and have defined expectations of what its fund managers should be doing to manage and mitigate these- has identified sources of ESG information for infrastructure investments	The Board: • has implemented a framework for integrating ESG factors into direct infrastructure investments • has a process for continual assessment of external infrastructure managers' ESG investment capabilities through regular reporting against a clearly defined set of metrics • has a process for engaging with infrastructure companies or funds to embed ESG factors into their investment processes	The Board: • actively and publicly talks about the challenges and opportunities of ESG investing in infrastructure investments • is active in promoting better standards and disclosures around ESG investing in infrastructure

Practical actions that trustees can take

Area	Action
Education	• Arrange for all trustees to be educated about the ESG risks and opportunities associated with investing in infrastructure, such as: – The short-term governance risks associated with securing permission to build infrastructure projects such as potential exposure to bribery and corruption; – The risks associated with construction phases, such as breakdowns in community relations, environmental impacts, labour rights conflicts, uses of non-sustainable building materials, ongoing political risks and exposure to supply chain risks; – Longer-term ESG risks that will impact whether a piece of infrastructure degrades or becomes damaged or obsolete, such as physical climate / flood risks.
External manager expectations	• Where investing in infrastructure funds and companies, implement a system for identifying the extent to which any fund manager or investee business, which: – Is aligned with the scheme on overall ESG philosophy and objectives; – Has a responsible investment / business policy which covers key ESG risks and is aligned to recognized international standards; – Carries out extensive ESG risk due diligence on infrastructure investments made and is committed to ongoing review; – Explores measuring and reporting on ESG footprint of underlying investments / business activities; – Ideally, is committed to investing in sustainable infrastructure that can help pension funds meet net zero climate goals and is sensitive to social considerations.
Direct infrastructure investing	• When investing directly in infrastructure projects, ensure the scheme has a system to carry out ESG risk assessments on new and existing investments. This should cover short-term risks such as securing permission to build a project, and longer-term risks such as whether a project may degrade or become redundant. • Ensure due diligence has also been carried out on project partners to avoid risk of partnering with organizations previously involved in bribery and corruption.
Collective action	• Identify, participate and, if appropriate, provide a leadership role in collective action and investment platforms.
Measurement and reporting	• Actively explore ways for the scheme to generate ESG metrics from the infrastructure projects they are invested in, including: – Social metrics – people who have benefitted from a piece of infrastructure including those employed to build and those who will make longer term use of it; – Environmental metrics - including carbon emissions impacts as a result of the piece of infrastructure being built. • Trustees may choose to instil a requirement for transparent reporting on ESG performance, to enhance data availability and insights at both manager and asset level.

This summary guide for pension trustees is part of an ESG Toolkit for Pension Chairs and Trustees by The Prince's Accounting for Sustainability Project.