

EXPERT COMMENTARY

*Action-oriented engagement and a flexible approach are the key to an effective sustainability strategy, say **Angela Roshier**, partner and head of asset management at DIF Capital Partners, and **Alastair Scott**, partner at ERM*



The path that leads to ESG

How do you develop an effective environmental, social and governance action plan for your assets? That was the question we at DIF Capital Partners, a €5.6 billion infrastructure fund manager, sought to answer when we embarked on a project with ESG consultant ERM to better understand the sustainability impact of our investments. The resulting programme has created a flexible and focused approach that contributes positively to the local community while delivering returns for investors. It proves that action-oriented engagement and flexibility are the key to an effective sustainability strategy.

At the core of our business, and fundamental to DIF's culture, is an appreciation of the connection between our assets and their "users". Indeed, our early funds focused primarily on social and transportation infrastructure and renewable energy

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projects, some of which may be viewed as inherently sustainable.

However, our industry has changed greatly since our founding in 2005 and although sustainability has always been part of what we do, we understood that more formally incorporating an environmental, social and governance framework into our investment decision-making process was critical to address the expectations of our investors and other stakeholders.

Acknowledging that we had significant room for growth with respect to our ESG programme, we set a target to achieve an A+ score from the UN-supported Principles for Responsible Investment by 2020 and

developed a plan to achieve that target. This involved defining an ESG policy, assessing our current investments, and developing an ESG framework that could govern our approach moving forward. To put this approach into practice, we engaged the consultancy ERM, who demonstrated a commercial understanding of DIF's business as well as the principles of sustainable investing.

Moreover, being an active member of key sustainability and industry associations, such as the PRI, the World Business Council for Sustainable Development and a consultant to the Task Force of Climate-related Financial Disclosures, ERM is well placed to keep DIF informed on ESG trends and on industry best practices.

Forming policy priorities

Traditionally, our industry has focused on

the environmental aspect of ESG but we felt that an environmental focus was too one-dimensional and neglected a core issue for our investments: safety. We therefore developed a multi-dimensional ESG policy that has five priorities: environment, people and communities, governance, safety and climate resilience (the latter added in 2018).

The overall objective of this approach is to contribute to the well-being of local communities, to provide safe working environments for our employees and contractors, and to address local and global environmental challenges. Achieving these objectives provides benefits in itself but we also believe that the result is a portfolio of assets that deliver sustainable returns to our investors.

Establishing a baseline

We believe that delivering value to our investors and communities requires a real understanding of the sustainability impacts of our assets. However, we also wanted to avoid collecting data for the sake of data. As such, DIF and ERM developed a focused survey for our assets that concentrated on identifying actions on material issues with reference to existing sustainability frameworks, guidelines and standards.

As illustrated, the first survey in 2017 set the baseline and defined goals for progress, while the second survey in 2018 revealed some interesting developments triggered by our engagement with assets.

Within governance, the proportion of our assets with a dedicated ESG resource grew from 56 percent to 84 percent between 2017 and 2018. On safety, the proportion of assets with specific health and safety policies increased from 89 percent to 94 percent, while the proportion of assets providing health and safety training has increased from 85 percent to 91 percent.

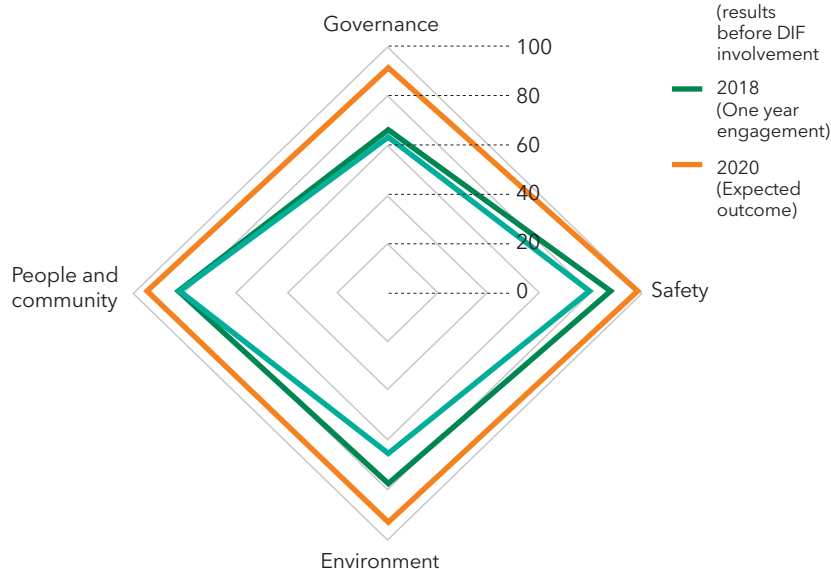
With ERM's input we added climate resilience to the survey in 2018, and found that 42 percent of our assets have plans in place to deal with the impact of extreme weather and 50 percent consider the impact of climate change on their long-term business plans. These survey results have been used to develop mutually-agreed objectives and action plans for each individual asset, which we call the ESG Path.

Driving progress

Each asset's ESG Path includes:

- A framework for action including specific goals, the activities that need to be

Progress against our baseline goals (%)



Source: ERM/DIF

ESG performance of initial 26 assets surveyed in 2017

Note that this diagram does not include the 'climate resilience' focus area as this was only added in 2018

On the road to wildlife recovery in Germany

The A6 West highway in Germany - a 50km stretch of federal highway connecting Rauenberg and Weinsberg - now sources all of its electricity from renewable sources.



Most of the milled asphalt of the old carriageway has been recycled and reused in the asphalt base layer under the new tarmac. Sheep graze the lawn around rain retention basins and there are artificial lakes to help manage stormwater runoff and prevent flooding. As part of upgrades to the highway, we are creating a 40,000 sq m wildlife sanctuary a few kilometres from the motorway near Offenau that will provide a new habitat for insects, birds, amphibians and other creatures. Many of these practices have been shared with DIF's other road assets around the world.

implemented and related timeframes (defined by the asset)

- Suggestions for best practices implemented by other assets where appropriate
- A flexible and focused approach, with priorities and the level of engagement requested varying based on the maturity of the asset and the sector.

The benefit of this approach is that it is measurable, repeatable and evidence-based, while remaining flexible enough to apply to different geographies and sectors. For example, assets in North America and Australia require attention to the rights of indigenous populations that often are not relevant for European-based investments.

Ongoing engagement with our assets also helped us to identify areas of best practice. In early 2019 we organised, and ERM facilitated, a conference where we brought many of our asset managers together to discuss ESG initiatives, with a specific focus on sharing best practices among our road assets.

An ESG-smart deal team

Making genuine progress on ESG issues, however, requires us to go beyond supporting our existing assets to make improvements. As such ERM and DIF also worked together to develop an ESG screening tool for new investments, while ERM developed a series of interactive training modules to support DIF staff in using this and other ESG tools. These tools and training have helped our deal team to quickly identify potential environmental, social or governance elements that might require focus throughout the due diligence process and to guide investment committee members to ensure all new investments are aligned with DIF's ESG policy and objectives.

The final piece of our framework for progress involves going beyond our day-to-day business to make a contribution to the communities where we live and work. This has taken on a number of forms and includes time spent volunteering with an endowment fund with a mission to develop renewable energy solutions for economic, social and environmental humanitarian projects in the developing world or mentoring students from underprivileged areas.

Taken together, our new investment screening tool, our asset-level engagement and our internal capacity building ensures that we are continuously improving our approach to sustainable investment.

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ANGELA ROSHIER
DIF Capital Partners

Looking forward

We can take heart from the progress we have made on our ESG Path, and from the positive difference our work makes to people's lives.

In 2018 over 2 million patients were treated by the hospitals and healthcare assets we fund and over 64,000 students have benefited from our education assets. This progress has been recognised as our PRI score has increased from a C in 2017 to an A overall in 2019, including an A+ score in the infrastructure module. This puts us ahead of schedule in achieving our stated goal of an A+ score in 2020.

There are still, however, a number of challenges that we must address to continue delivering value through our approach to ESG. These challenges include:

- Avoiding survey fatigue to ensure that managers are focused on tracking and improving performance on ESG items rather than continuously filling out paperwork
- Continuing the process of scaling-up initiatives that have been successful on one, or a small number, of our assets

while addressing the differences between geographies and asset sectors, especially as DIF continues to expand into new geographies like Latin America

- Recognising the continued expectations of investors for improved disclosure.

On the latter point, investors have become a significant voice in calling for climate change risk disclosure. In this context, frameworks like the TCFD are quickly bringing shape to a once amorphous discussion. This is one area where DIF and ERM expect to work together to identify further opportunities to drive a sustainability-focused agenda.

In the coming year DIF will also continue to work with ERM to develop opportunities for investments that support the Sustainable Development Goals, the blueprint for sustainability adopted by all United Nations member states in 2015. As illustrated above, DIF has now a good understanding of where it stands on ESG and has established a framework and process to continue its responsible investment journey.

With ERM's support, we are considering sector best practices and sustainability guidelines, maintaining a scalable, pragmatic and adaptable approach, and focusing on tangible and effective actions to address key ESG issues.

Overall, we believe we have developed a tailored ESG programme that will deliver value to investors as the programme evolves with the environmental, social and governance needs of our stakeholders. Our most recent ESG developments are presented in our 2019 ESG report: *Digging Deeper on Sustainability*. ■

ERM is the largest global pure-play provider of ESG, sustainability, environment, health, safety, social and process risk and asset integrity consulting services across the investment life cycle. Its experience of working with 100-plus general partners and limited partners was crucial in assisting DIF meet its objective of developing a market leading ESG programme. For DIF's ESG programme, ERM assembled a global project team with a mix of experience of working strategically and tactically with infrastructure funds, sector and technical expertise, knowledge of local regulations and asset-specific sensitivities

DIF Capital Partners is a fund manager that invests in a wide range of international, high-quality infrastructure projects that generate stable, long-term cashflows. It currently manages around €5.6 billion of assets across seven investment funds and has invested in over 200 infrastructure and renewable energy projects since its establishment in 2005