



Podcast title: Institutional investors making an impact

Musical intro

Announcer:

Hello and welcome to another episode of ESG voices! This podcast series addresses the opportunities and challenges within ESG, through interviews with ESG specialists from KPMG and beyond. Throughout this series, we will discuss a broad range of environmental, social and governance issues, aiming to support governments, businesses, and communities in creating an equitable and prosperous future for all.

Institutional investors hold more than US\$1 trillion worth of infrastructure assets. Many take an active role in their investments. Some have evolved into massive infrastructure operators. And that gives them significant room to influence how the infrastructure sector achieves the world's net zero goals.

What is clear is that appetite for green and impact investments is strong amongst institutional investors and their clients. But what does impact actually look like? How are institutional investors assessing impact on their existing and new investments? And how are institutional investors and operators helping shape the net zero pathways of their assets and investments?

Today, I am joined by Stephen C. Beatty, Global Head of Infrastructure and Head, Global Cities Center of Excellence, KPMG International and Minh Dao, Partner, KPMG Australia to discuss how institutional investors and operators holding infrastructure assets are helping shape the net zero pathways.

1. To kick off our conversation, what does net zero really mean from an infra perspective?

Any given asset will have a carbon footprint, or a carbon pattern and that carbon pattern will be relevant during construction as well as during operations. Many, many, many people forget that the creation of the asset also involves carbon emissions, as well as the long-term operation of the asset. And so, it's really important that we consider both the creation of the asset, as well as the operation of the asset. And when we view assets as individuals, that's one thing but we also need to view portfolios of assets together, because each of those assets may be carbon neutral, they may be carbon positive, they

may be carbon negative, but we need to factor in the portfolio effect as well. Interestingly, also, we're actually seeing a number of big investors invest in carbon intensive businesses with a view to reducing their carbon footprint over time. This is not the way people normally think about this but that is a really important process that should be incorporated into the path to net zero for the planet

2. Could you explain to our listeners how institutional investors holding infrastructure assets could help accelerate the journey to net zero? What influence do they have?

Institutional Investors are the largest group of owners of infrastructure assets globally. They own assets directly and such funds are typically managed by infrastructure managers, but broadly as a class of owner's institutional investors are the world's largest class of owners in infrastructure assets. They have significant influence on the global journey to net zero. Many funds have publicly said that in line with their global market expectations and consistent with their country's goal of maximizing members long term investment returns, they have committed to billions of dollars into renewable investments, and some of these investments. You can see coming through even within the last couple of years into platform renewables and now a huge interest in offshore wind, not just in Australia, but more globally. From an Australian perspective, Australian funds have said that they will aim to achieve net zero through their direct engagement with companies, their portfolio companies, so they do have influence not just with the dollars in terms of investments into infrastructure asset, but in terms of the board positions on these portfolio companies to affect change across the infrastructure networks.

3. Are you seeing an appetite for green and impact investments amongst institutional investors holding infrastructure assets?

Certainly, going back 10 years ago, not a lot. But certainly, over the last five years, there's been a huge increase in the funds that have been deployed by institutional investors into renewable assets and impact investments. Many of the funds have committed over a billion dollars of their portfolio allocation to renewable investments. And I think the other thing that's changed a lot is that the technology around renewables has come a long way. And the returns

are more, I guess, stabilized compared to where they were three or four years ago. The other change that's really impacted the institutional investors because some of them are government owned. So sovereign funds is government policy. So government policy of their respective countries. So with events such as COP 26, and COP 27, you're seeing more and more nations, I guess, from a government perspective, join the journey on net zero and their countries commitments around carbon. So with the institutional funds where they are government owned and as such a sovereign fund, I think they feel more empowered to put money into renewable assets to achieve not only their funds objectives, from a net zero perspective, but more broader their nation's perspective on their journey to net zero.

4. How are institutional investors holding infrastructure assets assessing impact on their existing and new investments?

So, I think as we look at the investors, the first challenge is to properly measure the carbon content of their existing portfolio and what the impacts of changes within that portfolio or changes from outside that portfolio, create. As we look forward, the movement towards net zero really needs to be assessed in those terms. When we look at individual portfolios or individual investors all will be able to form their own view as to what path to carbon neutrality they are choosing to follow. The trick is proper measurement, proper disclosure, and then action in relation to the carbon footprint of that portfolio.

5. How important is it for institutional investors holding infrastructure assets to be able to transparently report against their impact? Minh can we start with you?

Institutional investors need to report their investments because they have a fiduciary duty to their members and therefore what they report needs to be as fair and accurate as possible. So, the issue here is around what standards do you use? So many of the funds have published on their website the standard by which they are measuring their own impact. And so as an example, the Climate Change report, which is aligned with the Taskforce on Climate Related Financial Disclosure Framework is being used by some of the institutional investors. It does include metrics on how they are managing low carbon transition and physical risk in relation to the portfolio asset. I think that needs to be very clear and transparent to members, because we are seeing more and more what I'd call member activism, whereby members are bringing up directly to their fund, to the institutional funds, or through the press, their desires around what assets and what carbon initiatives are being undertaken by their fund, because it's ultimately their money is how they see it, and it is their retirement funds that are being used in order to invest in these assets long term in order to make long term pension liabilities. So, I think transparency of reporting is really important. But what we also need is some sort of global consistency of reporting standards. And I think we are going to be moving in that direction whereby we will have global standards around how we record and disclose in a transparent way the impact of the investments that we're making into infrastructure.

Thanks Minh, and Stephen?

It is incredibly important on the reporting front, and it's incredibly important — Right now we're going through the phase where there are lots of different reporting conventions, and we need to find a way to generate a consistent and readily interpretable set of carbon reporting or ESG criteria reporting and that will take time and it will take time before the market is able to fully incorporate the meaning of some of these criteria and the long term implications of some of these criteria. But it is absolutely important that measurement be accurate, be consistent, and then be readily interpretable by those making the investments and by those looking at the quality of investments as a third party.

6. Decarbonization, carbon emissions and climate risk are certainly top of mind for institutional investors but are you seeing investors in infrastructure projects put a larger focus on the "S" and "G" of the ESG equation? If yes, why? Stephen if I can come to you first?

Right now, I think we are seeing an incredible focus on the E of ESG. S and G tend to be more implicit criteria. When we look at governance and particularly governance with respect to investment policy and the management of a company, that is an area that has a good history within the big funds of being well examined. I would say the one where the greatest gap is on the social and I think that is an area that is probably harder to measure and harder to accurately incorporate into a portfolio performance approach. Having said that, nothing is impossible. And I fully expect that once the system or the markets have digested the concepts of the "E" component, they will be ready to address the "S" component. As we move towards a circular economy model, we will see all of these things increasing in importance. It's really hard to get it right the first time and we will see evolution across E and S and G. Over the next couple of decades.

And Minh, would you add anything?

There is certainly an increase in the focus on the S and the G as an advisor to infrastructure investors. I am seeing more and more questions asked by our clients as to what we KPMG to from a social impact perspective because what we're seeing is that they are asking this of all their providers. So, I'll give an example being a questionnaire that was circulated to KPMG more recently on a very large infrastructure transaction. So, the questions that were asked included, were any incidents of modern slavery reported by KPMG employees or offshore vendors? What percentage if any of the services KPMG provides are undertaken by KPMGs offshore vendors and a last interesting question. What are the key mechanisms KPMG employs to ensure workers in their supply chain are paid a living wage? So, you can see from a social impact perspective infrastructure investors are very serious about this and are very keen to ensure not only their assets are falling what from their standards seen as socially responsible behaviours, but they're requesting that of all of their service providers. So from an "S" perspective, we're certainly seeing that from contractual relationships, making sure that whoever it is that they are using whether it's advisors, construction entities, or other suppliers that the supply chain is something that they've investigated to ensure that modern slavery is not apparent in the supply of their goods or the asset that they're investing into.

In terms of the “G” the governance aspect of it. I think that “G” has been around for a long time from any institutional investors perspective, they’re very, very strong on the governance of how they’re managed. And that’s because most of them are either pension funds and which are regulated or sovereign funds, which means that they’re representing the government of their country. So, the governance aspect of it, it has, I think, is a very strong focus in the institutional space. And what we’re also seeing in terms of governance, that also ties in the social is the ability to appoint board members and to ensure that board members on large infrastructure assets are diverse. So, diversity of composition of board members, I think, is a crossover, not just from a social but also from a governance perspective, because the view is that if you have diverse board members, you’re going to have diverse thinking and therefore you are much more able to make decisions that considers all aspects of how the infrastructure asset is governed. The other one is from a governance perspective is responsible tax and how the Risk and Audit Committee is dealing with tax. So reputational tax, ensuring that an entity is paying their fair share of tax has certainly been at the forefront of many board decisions. So, I’d say that there’s certainly a lot of focus on the “E”; but it’s not hard to find a lot of work that’s being done in relation to the F and the G in relation to infrastructure investments.

7. How are institutional investors and operators helping shape the net zero pathways of their infrastructure assets and investments?

I think they are definitely shaping the pattern and shaping the path to net zero, net carbon, or net lower. Some are saying we will only buy low carbon assets. Others are saying we will buy high carbon assets or more carbon intensive assets or more greenhouse gas intensive assets and help those entities morph into assets that have a lower carbon or a lower climate impact. It really comes down to the investment mandate of the individual portfolio managers the positions the boards and investment committees take. All of them will ultimately or should ultimately result in a lower carbon intensive, lower greenhouse gas intensive world. The question comes when you have to make the hard decisions between the fiduciary obligation of investors towards their beneficiaries. At the same time as managing the risks to the planet.

8. To wrap up our conversation today, what advice would you give to institutional investors holding infrastructure assets seeking to accelerate their decarbonization plans? Minh, can I start with you?

Starting with the portfolio company leaders, I think that it’s clear that companies that have strong policy settings around energy transition or net zero transition is going to be a more valuable company and leaders in these portfolio

companies, I think need to take not only accountability of what it is that their company is doing in relation to the net zero journey, but I think a lot of them are seeing value in their companies in doing so. And I think that also goes to the question of what are asset owners doing? Asset owners are putting the pressure on portfolio companies to transition, they are putting in place clear objectives from their own asset ownership objectives as to their returns. And again, going back to stranded asset owners do not want to be left with stranded assets in the long run. So, I think there is synergy between my advice to company leaders and asset owners and it’s the same with investors as well from an investor’s perspective where it’s not a member base, so not an institutional investor base, but if it’s a listed company, we are seeing members turn up at AGMs and putting really hard questions to the board, to the portfolio companies, around what is being done in order to transition to net zero. Clear evidence of this, is what’s happened in some of the Australian energy listed companies, where a lot of pressure is being put on these companies by the actual shareholders at AGMs, and either questioning or endorsing the company’s transition plans. So, we are seeing a lot of activism in this area, and it will impact value. So, my advice both to the asset owners, the portfolio leaders and the investors is to continue to be active in that market because we’re seeing value in it and we’re seeing companies that do take this seriously, increase in value substantially identities that don’t will decrease in value in the long run.

And finally, Stephen?

Ignore decarbonization at your peril. The real message here is that this has become an imperative within the investment community and within the investor community. Does that mean we will see people getting paid more money who have a lower carbon footprint or have had a bigger impact maybe? Will we ever fully get away from a fiduciary obligation that says you must earn X return on your assets? I don’t think so. It’s complicated. But at the same time, as we incorporate this, just as we incorporated anti-bribery and money laundering, just as we incorporated other moral tests These are tests that can’t be incorporated and must be incorporated. What we find and I think we will, we will increasingly find this is the people who ignore this become isolated in the community and isolated from their peers in terms of who will do business with them ultimately. So, again, back to my original point, ignore ESG, ignore carbon reduction greenhouse gas reduction at your peril.

Stephen and Minh, thanks again for speaking today, you’ve given our listeners a lot to think about! Join us again next time for more insights from ESG leaders and innovators. You can also find our latest insights covering a range of ESG topics by visiting kpmg.com/ESG. Thanks for listening!

Musical exit

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2023 Copyright owned by one or more of the KPMG International entities. KPMG International entities provide no services to clients. All rights reserved.

KPMG refers to the global organization or to one or more of the member firms of KPMG International Limited (“KPMG International”), each of which is a separate legal entity. KPMG International Limited is a private English company limited by guarantee and does not provide services to clients. For more detail about our structure please visit kpmg.com/governance.

Throughout this podcast, “we”, “KPMG”, “us” and “our” refers to the global organization or to one or more of the member firms of KPMG International Limited (“KPMG International”), each of which is a separate legal entity.

KPMG International Limited is a private English company limited by guarantee and does not provide services to clients. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Designed by Evalueserve.

Publication name: Podcast title: Institutional investors making an impact

Publication number: 138760-G | Publication date: April 2023