



# MyFiduciary

## Responsible Direct Investing

APAFS Webinar

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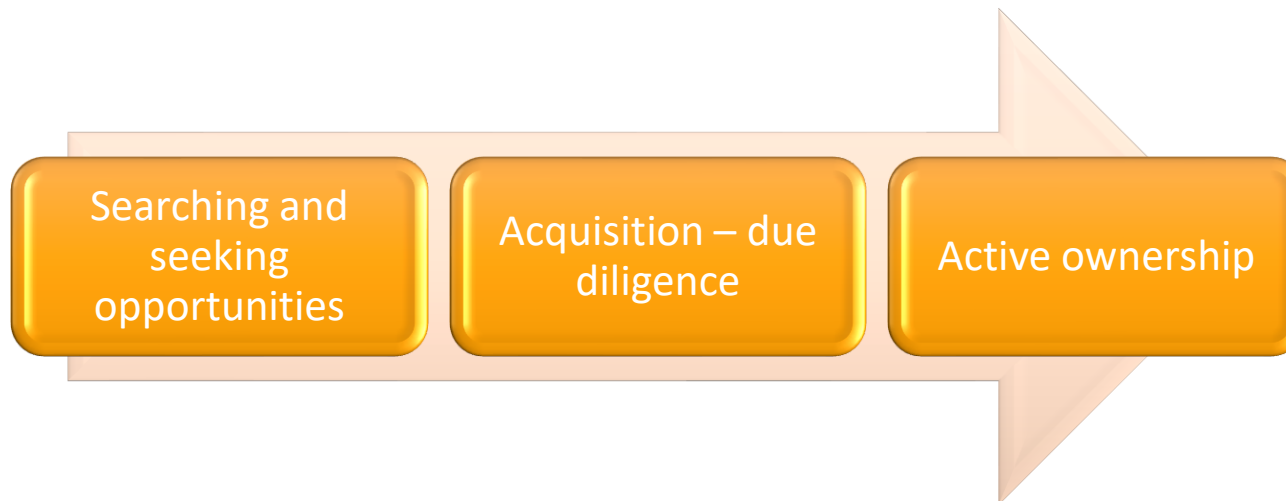
David Rae, 3 February 2021

## Intro – what is responsible investing

“ *Responsible investing is the practice of incorporating environmental, social and governance (ESG) factors into investment decisions and active ownership during the due diligence process, the investment holding period and upon exit*

*PRI Technical Guide for Limited Partners*

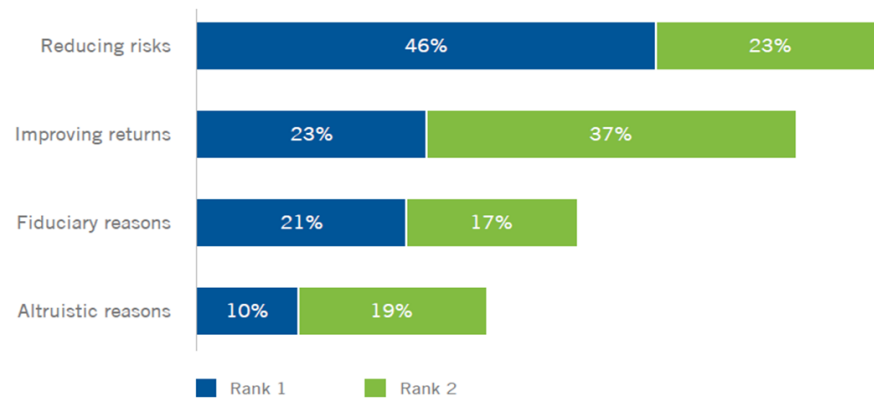
A Responsible Investing framework can be based on three parts:



# Why consider ESG factors?

FIGURE 1.3

What do you see as the main benefits of incorporating ESG considerations into your investment process?



Main benefits of incorporating ESG considerations (% citations). Sample size = 178.

“ Failing to integrate ESG issues in investment decision-making is a failure of fiduciary duty

*PRI, Fiduciary Duty in the 21<sup>st</sup> Century*

## Reducing risk

- Safeguarding a company’s “social license to operate”
- Earlier detection of risks, or detecting risks that could be overlooked
- Less legal and regulatory risk
- Managing reputation risk for the organisation

## Improving returns

- More consumer support for the company
- Better alignment between owner and manager, less principal-agent conflict
- More dynamic, innovative companies
- Investing early in the lifecycle of businesses with ESG tailwinds
- Companies can focus more on the long term

## Ethical reasons

- It’s the “right thing to do”

# Some ESG issues in private market and direct investing

## Environment

Resource depletion

Energy use

Pollution

Water quality

Carbon emissions

Biodiversity

Deforestation

Waste

## Social

Human rights

Indigenous rights

Labour standards

Health and safety

Diversity

Data protection

Produce safety

Supply chain

Mis-selling

## Governance

Board composition

Diversity

Risk management

Director independence

Accounting and audit

Legal compliance

Competitive behaviour

Political donations

Bribery and corruption

Chair and CEO separation

Ethics

Management remuneration

Risk management

Stakeholder engagement

## What's different about direct investing versus listed companies

- The underlying ESG risks and opportunities are the same whether the company is listed or privately held

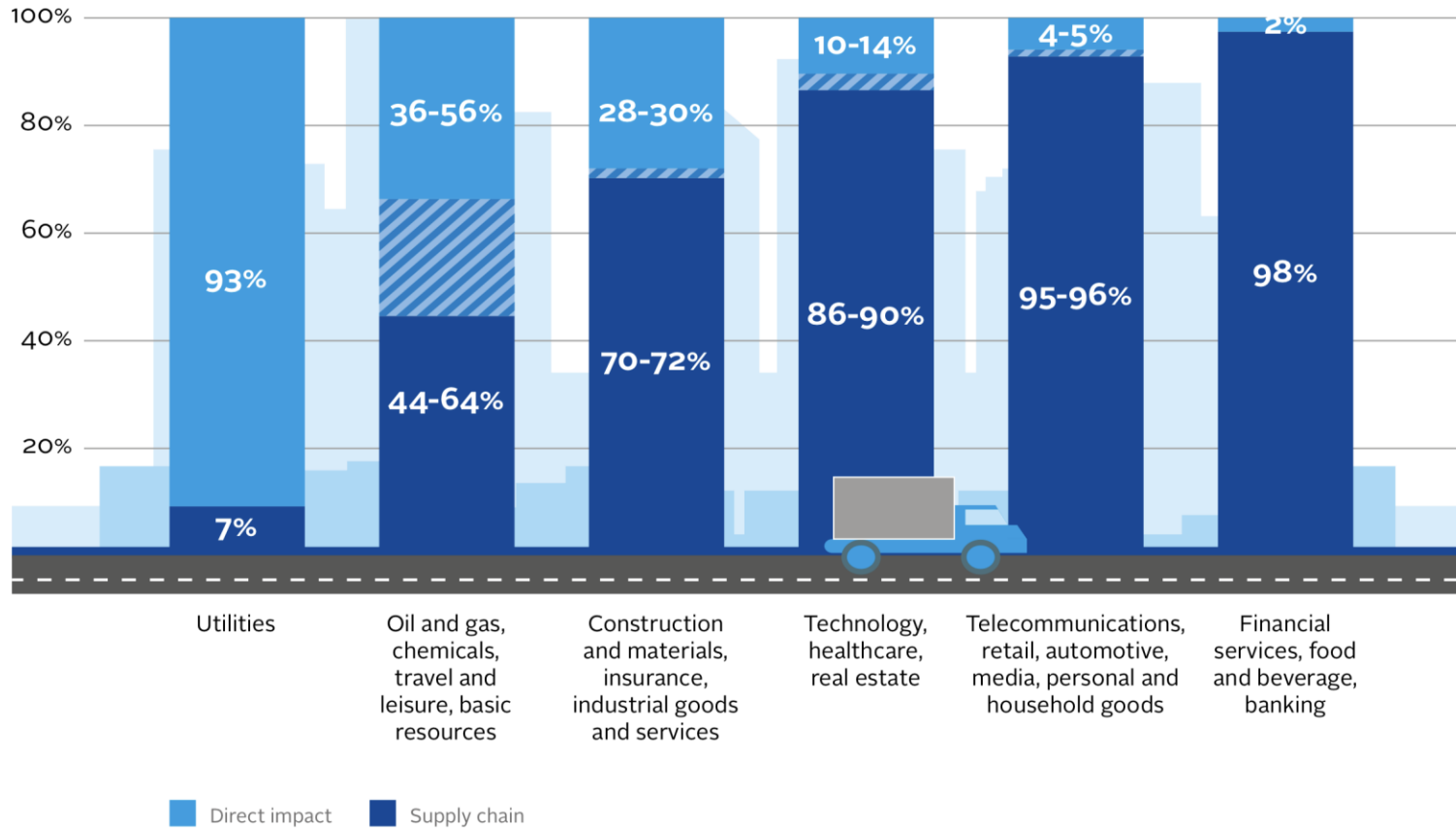
But...when you invest directly:

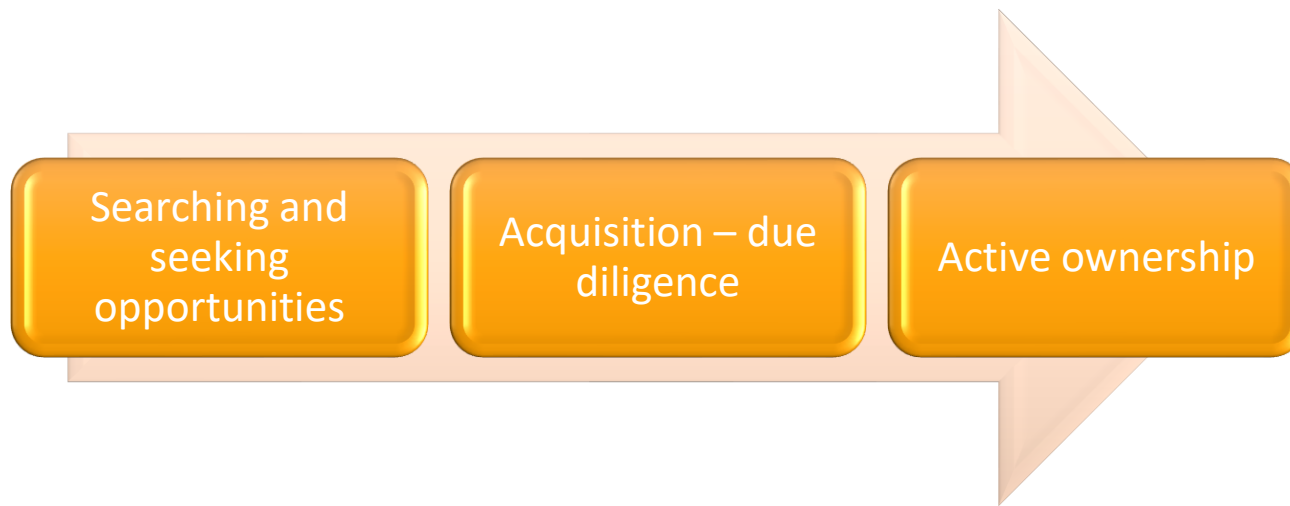
- You have greater control, and therefore greater responsibility
- If you are involved in governance – and you should be – then you will have legal responsibilities and risks
- You have greater reputational risk
- All your directly held investments will need to be leaders or even best in class in ESG issues

# The issues go beyond the company you are investing in

Investors face financial and reputation risks all along the supply chain

**Figure 1 – Share of a sector's environmental impact located in the supply chain**





## Part 1 – Active searching

### Top down

#### **Thematic investing**

Finding positive ESG opportunities by selecting sectors or industries with ESG tailwinds  
Analysing long-term trends that may be mis-priced by markets

Examples: Renewable Energy, Demographic Trends, Network Platforms, Electric Everything, The New Consumer, ...

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### Bottom-up

#### **Asset-level or asset-class level diligence**

Finding companies that are leaders in ESG

More detailed ESG due diligence

Rejecting investments in companies that have poor ESG factors, or...

...developing an action plan to improve a company through active ownership

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# Culture and toolkit

Good RI requires a new culture and toolkit in both the investment firm and the companies it invests in.

## Culture

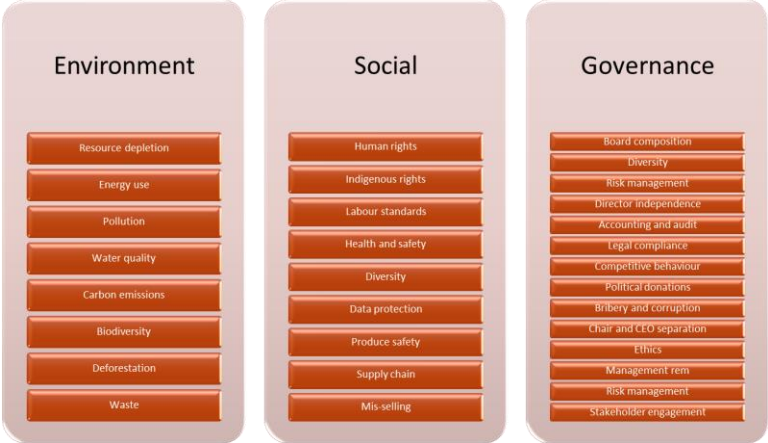
- **In the investment fund:** ESG factors fully integrated into the investment process; all investment staff have RI training; RI culture comes from the top (Board and CEO downwards); a clear RI framework and beliefs.
- **In the investee companies:** culture that comes from the top; prominence given to health and safety of staff and whoever else the company interacts with; clear policies that capture the E, S and G factors relevant to that company.

## Toolkit

- **In the investment fund:** ESG factors built into decision-making framework. Examples include initial investment screens, valuation models, risk analysis tools, due diligence checklist, and investment sizing criteria.
- **In the investee companies:** Adequate reporting on ESG to a Board level. For instance, an ESG dashboard, clear policies, annual deep-dive assessments, third-party reviews, enhanced engagement with shareholders and other key stakeholders.

# Part 2 – Due diligence

- Due diligence at company level is very specific to that company and the sector it operates in.
- It is difficult to generalise. But the basic rule is that prospective investors should spend considerable effort analysing environmental, social and governance issues that could apply to that company.
- It is common now to get third-party ESG review as part of technical due diligence, alongside legal, tax, accounting, etc.



## Part 3 – Active ownership

Investing directly brings greater control and greater responsibility.

- Governance of direct investments
- Direct legal responsibility for issues
- Risks for company directors and trustees
- Responsibilities around health and safety, environment, legal compliance

Ownership by SWFs and pension funds enables companies to focus on the long term

- Quarterly reporting cycle becomes less important
- Greater scope for investments that take time to pay off (long-dated cashflows)
- But, can be both easier and harder to get alignment with company managers (CEO) – their time horizon will always be shorter than yours.

Investor and trustees need better reporting and monitoring frameworks when investing directly.

- ESG checklist or dashboard

## Example – farmland



Standards include PRI's *Responsible Investment in Farmland*

### Issues include

- Fertiliser over-use
- Pollution of nearby waterways
- Livestock feed (e.g. palm kernel)
- Deforestation
- Labour standards
- Animal care and welfare

### Case studies

- NZ Dairy Farms
- TIAA-CREF

## Example – forestry



Standards include Forest Stewardship Council (FSC)

### Issues include

- Sustainable forestry – replanting
- Single species forests versus natural forests
- Loss of biodiversity
- Health and safety of workers
- Carbon capture – and “carbon farming” crowding out other uses

### Case studies

- Australian forest harvesting – Koalas



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