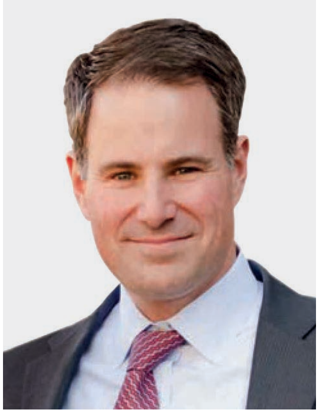
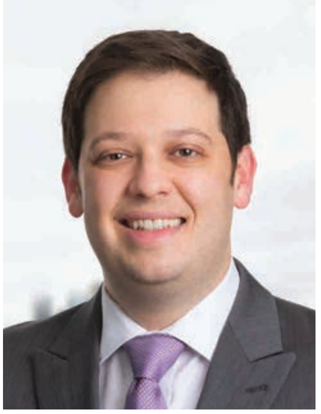
EXPERT Q&A

A multidisciplinary approach is the key focus for a successful responsible investing programme, say Oak Hill Advisors' Adam Kertzner and Jeff Cohen





Benefiting investors through responsible investing

No investment firm can single-handedly solve the various environmental and societal challenges the world is facing. While the industry is still in the midst of defining itself through both market-driven and multi-jurisdictional regulatory efforts, investors continue to expect more from their asset managers. And, in this era, many investors aren't satisfied with boilerplate language nestled deep in the LPA where it can be swiftly forgotten. Today, lip service without concrete demonstrable process and outcomes are not good enough.

In the private credit space, Oak Hill Advisors (OHA), has been named the winner of our Responsible Investor of the Year award for the Americas. OHA has formalised its ESG and sustainability efforts into its own dedicated department and is an active participant in industry-wide efforts. An important priority for OHA is to help ease the burden on companies and to ensure that an ESG programme is more than a PR initiative.

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We sat down with OHA's Adam Kertzner, portfolio manager and senior partner, and Jeff Cohen, head of ESG and sustainability, to learn how the firm is integrating ESG into its investment practices.

Q In this space, consistent definitions can be elusive. How does Oak Hill Advisors define its efforts on behalf of ESG and sustainability?

Jeff Cohen: It's true. How managers choose to put ESG and sustainability efforts into practice can range dramatically. To be fair, no individual approach is necessarily wrong, because everyone thinks a little differently about this field, focusing on different applications or themes.

This is in part because the shape of the field and practice has been market-led, with various stakeholders approaching these concepts with different perspectives. Additionally, the recent emergence of standards and frameworks, which define the field, are beginning to find their way into global regulation.

We think about the industry-specific, financially-material ESG factors that are critical to a business's operations and financial condition, and which ultimately impact how we assess a company's creditworthiness.

The lens of financial materiality has long been a core part of good credit underwriting, even if a specific factor hasn't historically been labelled as E, S or G.

Factors range from supply chain resilience, employee health and safety, energy management, ecological impacts and diversity, equity and inclusion, to name just a few. These factors and others may ultimately result in severe risks to companies based on the industry in which they operate and their relative exposure.

These factors may affect a company's licence to operate, have meaningful implications for customer loyalty or employee retention, and may lead to regulatory scrutiny. Effectively, they have genuine implications for financial drivers such as cost of revenue, capex, industry divestment risk and other manifestations in a company's financials – it's what impacts the top and bottom line.

Adam Kertzner: It's about appropriately weighing all those risks and fully integrating them into our process. Once we analyse the risk and opportunities these factors pose, we may identify opportunities to engage with companies or their interested parties, which is essential for prudent monitoring and ongoing assessment. Our primary focus for engagement is anchored around better collection of data and information because to effect change, a company must first take accurate measurements. In ESG and sustainability, the measurement component is vital because transparency has historically been lacking.

Q What prompted OHA to formalise ESG and sustainability into a distinct department at the firm?

AK: We've had a formal programme, policy and ESG committee in place since 2015 and since have established training programmes, assessment process, reporting and participation in industry initiatives. Jeff leads our programme and the ESG and sustainability team. In addition, we have an active ESG committee made up of senior members of the firm including two of the four senior partners, 10 total partners and eight investment professionals.

Investment side participation is important because we want ESG matters discussed where the investment decisions are made, so it's quite integrated into our process. Prior to formalising the department, we had a team working part-time on ESG and sustainability, both on record-keeping and process. We realised we wanted to institutionalise the effort, and we were fortunate enough to meet Jeff along the way, transitioned Erin Hartney, our principal, ESG and sustainability, into a full-time role and recently added a senior analyst to the team.

Jeff has come in and really spearheaded taking our programme to the next level, which we view as a multidisciplinary effort that pulls on operations, investor relations, legal and compliance, and both our US and European offices.

Given Jeff's previous role as director of capital markets integration at the Sustainability Accounting Standards Board (SASB), we felt his background lent itself to enhancing our assessment and scoring process through a structured method informed by the most reputable market standards and frameworks, which are aligned with OHA's fundamental bottom-up analysis on companies. This has helped us to develop a scoring process we feel is a beneficial outcome of rigorous materiality-based analysis.

JC: While having our own scoring process is important, if 20 different firms have 20 different proprietary scoring methods then it's difficult for an LP to aggregate – the practice can lose its value if not informed by industry standards and frameworks that the markets value. So while we have a scoring process, we're very transparent about the structure and the inputs that feed into how we arrive at a score.

Q One of the clear priorities of your programme has been climate issues. What are the concrete ways you've been pursuing that?

JC: We partnered with a group called Persefoni, which is a carbon accounting software platform, to build out GHG emission estimates for key benchmarks for high yield and leveraged loan indices. And that allows for better comparability, not just for OHA's portfolios to see where we stack up, but for any of Persefoni's customers.

If you examine these benchmarks, a fair number of actual emissions are being measured, but the overwhelming majority are estimated. While estimates are essential in the near term, we want to help create resources to facilitate actual data disclosure.

To address this, OHA is co-leading the global private credit working group of the Initiative Climat International (iCI), which is a global community of private markets investors who seek to better understand and manage the risks associated with climate change. Through this working group, we aim to facilitate practical resources for companies to collect GHG emissions data, measure it, report it. A richer data environment can allow any manager to better assess how to mitigate risks tied to excessive emissions and determine opportunities for setting reduction targets where it's financially material and appropriate.

"We now have a business that is one of the top 10 private forest owners in the US focused on reducing carbon"

ADAM KERTZNER

Of course, we'll have our views on the relative exposure and risks a company faces, and that's to be expected. But by sharing the inputs that feed into our methodology, we believe our process becomes increasingly known and has significantly contributed to how trade associations and NGOs advocate for borrower communication of ESG metrics.

Ultimately, we're aiming for alignment of interest pertaining to information access, not only within alternative credit, but also with private equity owners of many of the companies in which we invest.

So we're really focused on harmonising the field, and we've done this through supporting an initiative called the ESG Integrated Disclosure Project (ESG IDP). We're pleased to serve as the inaugural vice-chair of this initiative alongside other prominent investors.

This isn't just OHA going at it alone. This effort is building off of a collaborative private equity and private debt factor mapping. We've done this with dozens of other prominent asset managers, and with the Alternative Credit Council, which is the credit arm of the Alternative Investment Management Association (AIMA); the Loan Syndications and Trading Association (LSTA); and the PRI (Principles for Responsible Investment), which all serve as the Secretariats of the ESG IDP. We're fortunate enough to also have the support of investment consultants, asset owners and other key stakeholders. We think that this is going to be a huge step for the field in time as the initiative gains awareness and further endorsement.

Q Your climate priorities are certainly present in the investment in Bluesource Sustainable Forests Company (BSFC). What was attractive about that investment, and carbon markets in general?

AK: As it relates to ESG efforts, credit investors are often more focused on 'avoidance' versus proactively providing credit or capital to higher growth businesses that might have some risk in technology or nascency in other areas. With BSFC, we believe we have an opportunity to achieve the best of both, with potential downside protection and potential upside from carbon offset markets, all while providing meaningful environmental benefits.

BSFC is a joint venture with Anew (formally Bluesource). Anew is one of the largest carbon development and marketing organisations. They partner with landowners and forest owners to help develop sustainable plans for their forests. Our joint venture was formed to purchase timberlands and truly change how they are managed.

Our approach is to shift the future of these forests commercially harvesting timber to instead preserve the timberland to sequester carbon. Over time, trees are a great way to take carbon out of the atmosphere – that's just science. We now have one of the top 10 private forest owners in the US focused on reducing carbon.

We view offsets as part of the solution. We believe there is going to be a tremendous desire and need on the part of corporate America to purchase offsets to help achieve their carbon-neutral goals. At the same time, it's been an opportunity to generate attractive risk-adjusted returns for our investors, with some nice downside protection. ■