GREAT FUND INSIGHTS

Perspectives on ESG in the Middle East with Apex ESG Ratings

Kamar Jaffer

Welcome and thank you for joining us on the fourth episode of our series, "Perspectives on ESG in the Middle East". I'm Kamar Jaffer, a counsel in Allen & Overy's Funds and Asset Management practice in the Middle East. In this episode, I am delighted to be joined by Andrew Pitts-Tucker, managing director at Apex ESG Ratings. Andrew has specific responsibility for driving Apex Group's strategic ESG development through its subsidiary, Apex ESG Ratings. Apex ESG Ratings' purpose is to deliver an objective ESG rating for privately held companies, with a scoring methodology based across a set of pre-defined rules. Prior to becoming a managing director for Apex ESG Ratings, Andrew spent three years developing sustainable business models for protected areas and conservation initiatives in Sub-Saharan Africa. Andrew, thank you for joining. It's great to have you. We are keen to hear about your perspectives on ESG in the Middle East. I'll kick off with our first question. Momentum is building around the Middle East ESG agenda, driven by numerous government initiatives, efforts to diversify away from oil and gas and increasing requirements for disclosure on sustainable activities and reporting. How do you perceive ESG in the Middle East, and to what extent are S and G gaining the mindset of managers and investors in the region?

Andrew Pitts-Tucker

Thank you for the question, but first of all thank you for inviting me to speak today. It is a real pleasure to be able to share my thoughts and some of the observations we have from our global approach to ESG rating and reporting, but in particular, with regards to the Middle East, I think it is acknowledged that the area has lagged other countries and, no surprises, it is primarily due to the fact that it has historically been reliant on the hydrocarbon sector, but it is so clear that things are changing now, which is very exciting and that's not only due to divestment away from the hydro-carbon economy, but I think there are two other reasons which are, in my view, more important.

One is there seems to be a real moral drive to want to change, which is so important, and that's probably the most exciting point, but also because of the way the flow of money has changed and that the Middle East has opened up to much more international investment, so the fiduciary demands of the international finance sector have really started to impose themselves in the Middle East and really that's no bad thing, but what I see is the Middle East not only jumping on board with these changes, but actually becoming a real leader in this process, which is fantastic, and the speed at which they are doing it is also very significant.

The UAE became a signatory of the Paris Climate Agreement and UN Sustainable Development Goals, but there are other fantastic initiatives which are going on over there. You've got Vision 21, which really is about encouraging the environmental infrastructure, the Energy Strategy 2050, which is about wanting organisations to increase the contribution to clean energy, but then when you look at what the stock exchanges as well are doing, you've got the Abu Dhabi Stock Exchange and Dubai Financial Market: they are imposing ESG disclosure requirements for any companies that are wanting to list.

So, yes, although it might well be the case that the Middle East was regarded as a laggard when it comes to ESG, what is incredibly exciting to see is the pace at which it is not only catching up with the rest of the world, but also really becoming a leader in that sector as well, and this isn't just about the environment; your point at the end, to what extent are S and G gaining the mindset of managers, we are seeing a huge pick-up again in DEI. So the social aspect of it is incredibly important and the governance aspect of it is not something which you can overlook and those fiduciary demands, they come as a package, the ESG disclosure requirements, they come as a package and the international investing community needs to see that.

So, I think we are seeing a relatively equal focus across E, S and G, but the E bit is the one that tends to be getting more of the headlines at the moment.

Kamar Jaffer

Thank you Andrew, and with this pace of change that you are seeing, what are you seeing the GPs and their portfolio companies doing to integrate ESG and sustainability considerations in their investment decision-making process?

Andrew Pitts-Tucker

Yes, that's a great question. There is a lot of focus on GPs at the moment and, again, that is as a result of the pressure they are getting to disclose ESG data points, not only to their investors, the LPs, but also in-line with legislation within the European Union, which the EU Commission launched last year, the SFDR, the Sustainable Finance Disclosure Regulation, which demands investment managers and advisors, in various shapes and guises, to actually disclose ESG data points.

Now, what's really important is the LPs are beginning to scrutinise the funds that they invest in. So they are scrutinising those GPs, not just on the underlying investments that they are putting their money to work in, but it's about how those GPs are actually integrating ESG best practice into the entire lifecycle of their investments. So, what we are seeing the GPs working with their underlying portfolio companies to do is to really showcase how they are making decisions from the pre-investment stage, through the lifecycle of that company and even at the exit stage as well. So we are seeing a lot of requests from GPs to carry out ESG due diligence at that pre-investment stage and then really setting the scene of how they can work with those underlying portfolio companies to really drive positive change through the lifecycle of that investment. We help and support through that ESG due diligence stage and then, through the ongoing lifecycle of that relationship, we work with both the company and the investor to help collect data, so they can really showcase how they are doing, where there are improvements, where there is need for more improvement and then, very importantly, at the end of that investment, when they come to exit, showcase how those companies have actually improved their ESG baseline over the course of that investment for a positive exit.

So, we are certainly seeing GPs and the portfolio companies do a lot more when it comes to integrating ESG and sustainability considerations across the lifecycle of the investment.

Kamar Jaffer

And once they've collected that data, what are you seeing the GPs and the portfolio companies doing to measure the impact of their investments against targets? What are some of the metrics they are using and how are they actually benchmarking?

Andrew Pitts-Tucker

So the first thing really that we advise both the investor and the underlying companies to do, is to understand what are the material ESG data points that they want to collect. So when we start to talk about impact, impact can mean many different things to different people. So what we do is we sit down with the investment manager and we try and get a very clear understanding of what are the specific points that they want to measure their underlying companies against, and this really goes beyond those best-in-class standards and legislation. That's the standard now. Investment managers need to collect what I call those best-in-class standards and legislative data disclosure requirements. That's almost a given. The impact that a company has can be those specific points over and above the standard methodologies which they need to collect and they also need to be able to showcase. That's really important. Once they've thought through what those KPIs are, and once they've collected the data, what's so important then really is to think about putting plans in place to drive change. So, they are improving the metrics. We are seeing an increase around those KPIs that they put in place in the first place and we do that through what we call our gap analysis report. So, we look at the data that is collected by the investment manager on the underlying company. We look at that data, we compare it to those global standards or we look at the KPIs that they have set and then every year, or more regularly, we will collect further data and we'll constantly assess how those companies are doing, which will allow it to benchmark itself, not only to its previous point in time, if it's an annual assessment, but we collect all of that data, we throw it into an anonymous pool so each company can also compare itself to its sector peers to see how it's doing with regards its competition. It's a very powerful and a very useful tool, really towards monitoring and maintaining the ESG status of a company and to see how it's doing compared to its peers, but also, more importantly, so it can see how it is changing over time as well.

Kamar Jaffer

And what are the top three focus areas you are seeing from a GP perspective and how does Apex propose to address them?

Andrew Pitts-Tucker

When we go out to the market, we ask GPs to highlight their areas of concern. There are three fairly classic answers which come back. Number one is ‘can you help us to decide what data to collect?’. Number two is ‘can you work with us on how to collect that data, because with private markets we don’t know where to get the data from?’ and then number three is ‘we are not the ESG experts, so can you help us generate the reports and the positive plans so we can actually work with those companies and use that data?’, and that’s really what we try and do. Those are the areas of concern for the GPs and what Apex has done is really try and solve each one of those areas. So, as mentioned previously, we’ve defined a methodology which is in-line with the best-in-class global standards. It’s also in-line with the rapidly changing legislation and it’s also in-line with innovative projects, such as the data convergence project. So we have created a data set which takes the burden of ‘what data?’ away from the investment manager. We’ve then built that methodology and that data set into a piece of software, it’s a questionnaire built into a web-based tool, which allows the company, the respondent to a questionnaire, to upload and answer the questions about themselves, about the company, in the most simple way possible and that’s really important.

Companies, investment managers, are hugely burdened by the ever-increasing need to provide data, so we’ve tried to make this process as simple as possible and then that third point, what to do with the data, in our view is the most important one, because what we do is we look at that data and we highlight where each company needs to move further in order to align itself with the global standards and we highlight where the biggest gaps are across E, S and G, which provides a roadmap for these companies and allows them to start planning into the future, to really change and put that transition plan in place to become better at ESG, and I don’t like the term “better”, but it’s a sort of an all-encompassing statement. So those are the three primary areas which the GPs are focusing on at the moment and how we can help.

Kamar Jaffer

So shifting gears to the investors’ side, increasingly the investors are adopting a forward-looking methodology that assesses future climate risk and embraces all aspects of sustainability. What is the approach being taken by investors and how is Apex supporting them in their ESG evaluation?

Andrew Pitts-Tucker

Yes, that's a really great question. The fiduciary demand on the investor is different to that of the GP, but what is certainly happening is the requirements are flowing down that financial supply chain and, yet again, the first thing that needs to be done, for any investor, is to really understand the current ESG state of the underlying investments. Now, that's best done through carrying out an assessment, whether it be an ESG assessment, or a carbon footprint assessment, and what this really allows is the investor to understand the baseline ESG matrix of the underlying entities that it is invested in.

Now, it's only once you've done that, really you can get an appreciation of where each company or each underlying investment's gaps are and, again, it's only once you understand where the gaps are that you can really set about putting that long-term strategy in place to close those gaps and improve, and that's where the setting of the KPIs is so important, but there is more than that: what is your vision, where do you want to be within the next two to five years and also, importantly, what's realistic? ESG is not something which you can just change overnight. There are areas which are easier to implement, other areas can take many years, you can't just change the philosophy of a business and so you have to be realistic about what is achievable, but first of all it's about collecting the current state data, carrying out those assessments and then it's about thinking through what your vision is, putting the policies, procedures in place and then it's about execution, what is your transition plan and how are we going to measure and record that.

Apex supports its clients throughout the process. It carries out the assessments, it writes those roadmaps to improvement, even to the extent now that we are working with funds as they are establishing themselves and we are working with them to help make sure that within their DDQ they have got policies, procedures and action plans with regards ESG, and then obviously we are working with those funds at the point where they are starting to think about investments through pre-investment due diligence, and then we can provide that ongoing ESG collection and those report writing initiatives which are so important these days.

Kamar Jaffer

And are there any other areas of focus you are seeing from an investor's perspective, and how does Apex propose to address those?

Andrew Pitts-Tucker

Yes, there are a couple of areas I think which are a struggle for everybody. It's the burden of data collection, it's how do you get that data out of your underlying investors and I think the other thing, as well, which is becoming a real burden is the lack of standardisation. We have a number of examples from GPs who have their view on collecting relevant data from their underlying investments and putting that data to use, but I've got one case, they told me, that they have got over 20 different LPs that are asking them to fill in 20 different ESG reports. Now, a lot of the questions and the data points do overlap, but there are quite a few that don't, and I think one of the issues at the moment is everybody is coming from the same song sheet, but in a slightly different way. There are projects out there which are really focusing on consolidation. I mentioned it earlier, the Data Convergence Project. The burden of how to collect the data and how to put that data to use, it's a tough one and we are a long way from solving it yet. Apex is doing everything it can do to be a sort of single source of data collection and trying to remove the burden of having to go through multiple data collections and then having to go through multiple report generations, but it's very, very tough. So I think the two issues that a lot of people are focusing on really are how can we consolidate and create a standardised ESG data disclosure requirement, and how can we extract that data in the least painful and the least burdensome process. Those are two areas which I think a lot of people are focusing on at the moment.

Kamar Jaffer

So what is your ESG outlook in the Middle East for 2022 and beyond, Andrew?

Andrew Pitts-Tucker

Sure, well I might have hinted at this right at the beginning. I think the Middle East is a really exciting prospect. We've seen huge movement, very rapid move, to not only align with its global counterparts, but to actually overtake and I think even lead the charge and this isn't just about setting standards and policy and process, we are seeing a lot of that, as mentioned, but also when it comes to innovation. The great thing for the Middle East, there isn't a shortage of cash and it's got the ability to really accelerate some of these fantastic new business practices and innovations and, in my view, it's a geography which the rest of the world is going to be watching very, very closely, because I think they are going to be leading the charge a lot quicker than everybody realises. So, we are really excited whenever we get an enquiry out of the Middle East. I am really excited about it, because I know it's generally an organisation that just wants to get on with it and at the moment they are not hampered by significant regulation which is dictating what they should or shouldn't do. They are doing what they feel is right. Going back to what I said at the beginning, morals are driving this to a great extent and that's a fantastic thing. So, it's an area which we are going to continue to watch with great interest and very closely over the next few years.

Kamar Jaffer

Thank you Andrew for sharing your perspectives on ESG in the Middle East with us. For me there are three key takeaways. First, is that the pace of ESG is driven by a moral drive and flow of international money into the region. The second is that collecting data, performing a gap analysis and putting in place a transition plan is key and the focus is where you want to be in three to five years and what is realistic to achieve and thirdly, the Middle East will lead the charge in terms of the initiatives it is looking to put in place. Thank you for listening.

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CA2202036