

# SDGs, SUSTAINABLE AND IMPACT INVESTING



ONAFHANKELIJK MAGAZINE OVER VERMOGENSBEHEER EN SECURITIES SERVICES

IN EEN WERELD  
IN VERANDERING,  
**IS HET ZAAK  
HET JUISTE  
PAD TE VOLGEN.**

IS IT A HYPE?

De vermogensbeheerder  
voor een wereld  
in verandering

Andrey Kuleshov, CFA

# THE LANDSCAPE OF PRACTICE

*Triple Bottom Line Investing*  
*Impact Investing*

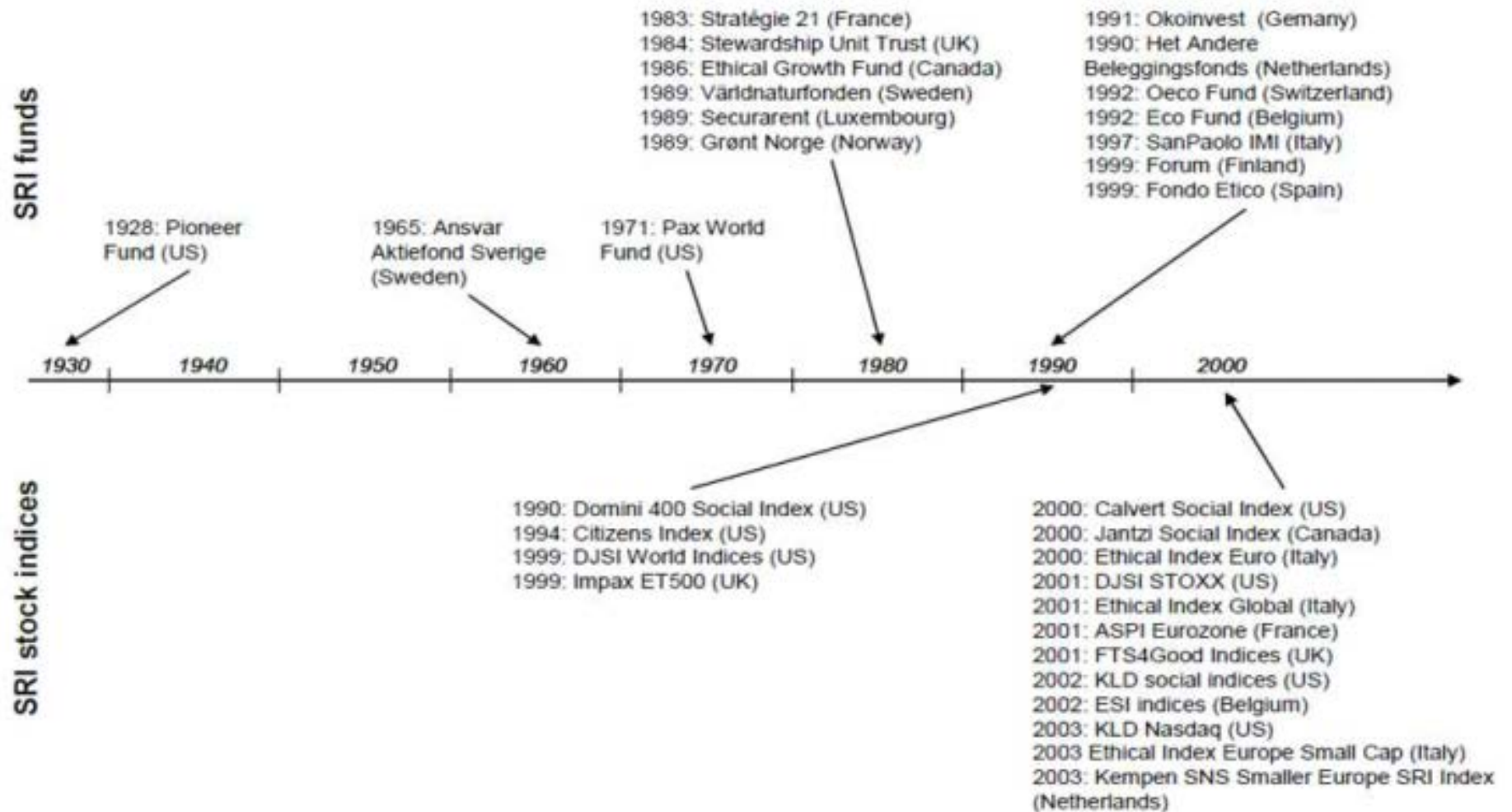
**PRI**

**ESG**

**SRI**

# RESPONSIBLE INVESTING

Recognizing ESG risks



Celine Louche and Steven Lydenberg, "Socially Responsible Investment: Differences between Europe and United States," Vlerick Leuven Gent Management School Working Paper Series 2006-22 (2006).

# ESG FRAMEWORK

- ESG: Issues that are
  - difficult to measure in monetary terms
  - do not form part of traditional financial metrics
  - affect the risk and return of investments (at times, decisively)
- Systematically considering ESG issues will likely lead to more complete analyses and better-informed investment decisions

# ESG EXAMPLES

There is no one exhaustive list of ESG issues. ESG issues are often interlinked, and it can be challenging to classify an ESG issue as only an environmental, social, or governance issue.

ESG issues can often be measured (e.g., what is the employee turnover for a company?), but it can be difficult to assign them a monetary value (e.g., what is the cost of employee turnover for a company?).

## Environmental

- Climate change and carbon emissions
- Air and water pollution
- Biodiversity
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity

## Social

- Customer satisfaction
- Data protection and privacy
- Gender and diversity
- Employee engagement
- Community relations
- Human rights
- Labor standards

## Governance

- Board composition
- Audit committee structure
- Bribery and corruption
- Executive compensation
- Lobbying
- Political contributions
- Whistleblower schemes

# RESPONSIBLE INVESTING

PRI's MISSION:

“We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.”



What? – global financial system:

- Economically efficient
- Sustainable

How? – reward investment which is

- Long term
- Responsible
  - Benefit environment
  - Benefit society as a whole



# PRI'S SIX PRINCIPLES

1. We will incorporate ESG issues into investment analysis and decision-making processes
2. We will be active owners and incorporate ESG issues into our ownership policies and practices
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest
4. We will promote acceptance and implementation of the principles within the investment industry
5. We will work together to enhance our effectiveness in implementing the principles
6. We will each report on our activities and progress towards implementing the principles



# IMPACT INVESTING

Where ethics meets profits

# THE DIFFERENCE

## ESG Investment/PRI based strategy

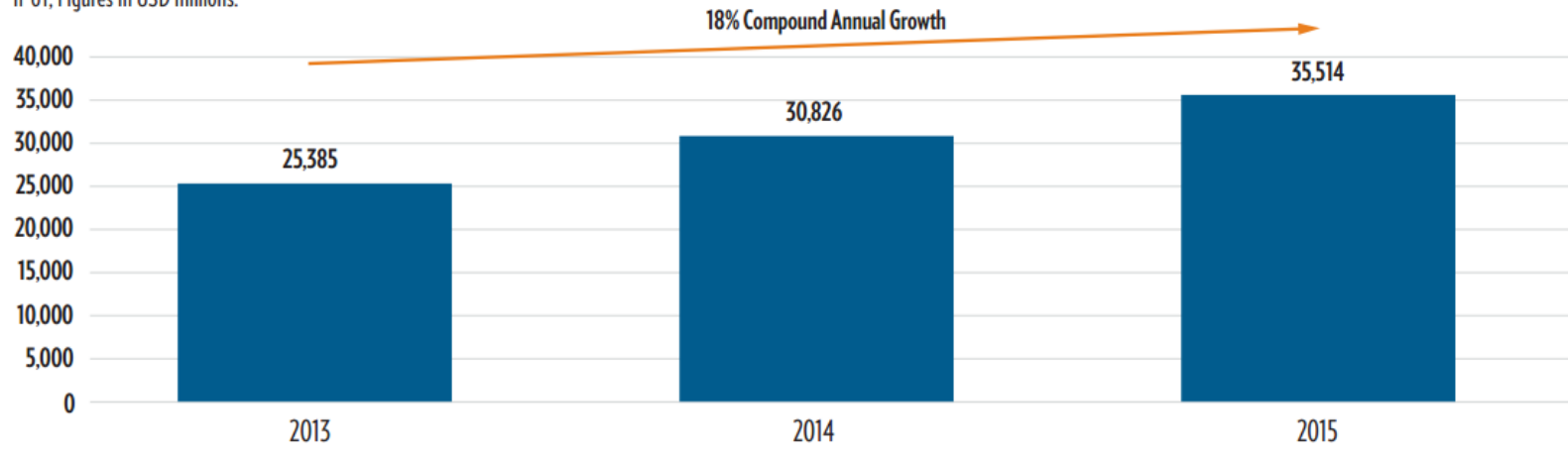
- Can be pursued for financial profit only
- ESG awareness as long term risk mitigation strategy
- Primarily about bringing additional data and analysis into existing approaches

## Impact/Ethical/Green Investment

- Financial and non-financial returns explicitly targeted
- Non-financial returns not monetized but reported to conscious investors

# IMPACT INVESTING GROWTH

n=61; Figures in USD millions.



Source: GIIN

- AUM \$36bn (GIIN, 2015) growth 18%pa
- “The industry is constrained by lack of instruments” (the Economist, 5 Jan 2017)

# INVESTING IN DEVELOPMENT IMPACT

## Responsible

- Market rates of return
- ESG indicators *enhance* the risk profile

## Impact

- Concessional rates, cover losses
- ESG impact indicators supplement financial return

## Non-profit

- Below par rates of return, subsidized
- ESG impact the main indicator

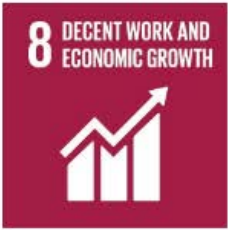
- Development impact funds – from 100% social impact targets towards Triple Bottom Line (TBLI)
- Ambition – to create investable instruments from non-profit activities for private impact investors
- Sustainable Development Goals – common language for coherent collaboration on ESG

# PRACTICING SUSTAINABLE DEVELOPMENT GOALS

The SDGs provide a communications framework regarding impact:

- Mapping impact metrics to the SDGs and underlying targets
- Market impact to investors, clear impact expectations for investee companies, contribute to global image of a stronger impact investing industry

Communication about ESG impact of financial investments brings more capital into impact investing



# SDG 1: NO POVERTY – END POVERTY IN ALL ITS FORMS EVERYWHERE

- Eradicate absolute poverty (1.1)
- Reduce by half relative poverty (1.2)
- Social protection (1.3), access to economic resources (1.4)
- Build resilience, reduce exposure and vulnerability to disasters and shocks (1.5)
- Mobilization of resources (for education, health and social protection)
- Pro-poor policy framework





# SDG 2: ZERO HUNGER, SUSTAINABLE AGRICULTURE

- End hunger (2.1), end malnutrition (2.2)
- Double productivity and income (2.3)
- Sustainable food production systems(2.4)
- Genetic diversity (2.5)

Investment in Rural infrastructure, research

Correct trade distortions

Proper functioning of food commodity markets and their derivatives and facilitate timely access to market information, including on food reserves

2 ZERO  
HUNGER



# SDG 8: DECENT WORK AND ECONOMIC GROWTH

- Per capita growth (8.1)
- Higher productivity (8.2)
- Policies for job creation, entrepreneurship (8.3)
- Decouple growth from environmental degradation
- Full employment, equal pay (8.5, 8.6), Labour rights (8.8), eradicate forced labour (8.7)
- Local financial institutions (8.10)

Aid for trade, trade related TA

Youth employment strategy



# SDG 10: REDUCED INEQUALITIES

- Income growth for the poorest (10.1)
- Economic inclusion (10.2)
- Eliminate discrimination (10.3)
- Fiscal, wage, and social protection policies (10.4)
- Financial market regulation (10.5)
- Voice for developing countries (10.6)
- Orderly migration (10.7)

Special treatment for LDCs

ODA to LDCs, LLDCs, SIDS,

Reduce cost of migrant remittances



# GENDER LENS

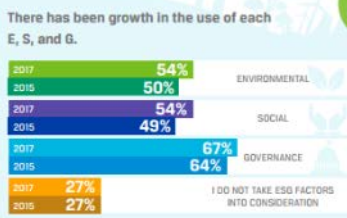


Indicators for all SDGs have gender equality dimension. Time for programs on gender equality in commodities.

# From “Global perceptions of environmental, social, and Governance (ESG) investing, 2017” by CFA Institute

## HOW ESG INFLUENCES THE INVESTMENT PROCESS:

Client demand is the primary driver in ESG investing with most respondents saying they would consider ESG if there was sufficient demand. Although those considering ESG remains the same overall, there has been growth in the use of each component.



Of those that practice ESG integration, it is more commonly done with equities versus fixed income.



While the most common use of ESG in the investment process is still integrating it into the whole investment analysis and decision-making process, there was an uptick in exclusionary screening that was offset by a slight decrease in best-in-class investing since 2015.



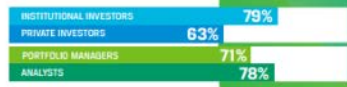
When examining ESG investing practices, the most impactful issues are:



## HOW DIFFERENT TYPES OF INVESTMENT PROFESSIONALS VIEW ESG INVESTING:

While institutional investors are more likely than private investors to take ESG into consideration, the difference between portfolio managers and analysts is less pronounced.

Considers ESG in investment decisions:



## GENERATIONAL DIFFERENCES:

Younger generations are more likely to consider ESG:



## GENDER DIFFERENCES:

Women are more likely than men to include ESG data in their investment process.

**62% of women and 49% of men** systematically consider ESG issues in their investment analysis.

**46% men vs. 18% women** say ESG issues are immaterial or add no value to investment analysis or decisions.



Those who consider ESG in investing put different emphasis on the components.

# THEMED FUNDS, GREEN BONDS, IBs

Tailored products whose remit overlaps with areas responsible investment

Can be part of a responsible investment strategy.

## Environmentally- or socially-themed funds

- Standard management compensation ~ 2%
- Lower hurdle rate of less than 10%
- Obligation to report on impact indicators
- Frequently, specific theme for investment, e.g. African Agriculture, SMEs, EcoEnterprises, Agroforestry

## Green bonds

- Finance for projects consistent with Green Bond Principles
- Top credit quality eg. by WB and IFC
- Fixed income returns
- Commitment to transparency and reporting in the use of proceeds

## Impact bonds

- Transfers the risk of subsidized projects to investors
- Makes social results directly tradeable
- Returns unconnected with financial markets
- Costly verification – directly material
- COMPLEX MULTI-PARTY LEGAL STRUCTURE





HYPE?

We decide



# SO, IS IT A HYPE?

- Responsible Investments: probably will become the “New Normal”
- Impact investments: solid base among ethics-conscious investors, but lack of
  - New instruments
  - Economic mechanisms to make impact measurement material
  - Social investment models which rely on straight/hidden subsidies
- Measurement, Reporting, Transparency, Verification...

# Material Significance of Reported ESG Indicators

# THANK YOU! FOR MORE INFORMATION

- CFA Institute: Environmental, Social and Governance Issues in Investing, a guide for investment professionals
- Global Impact Investing Network (GIIN)
- Toniic Institute
- Global Reporting Initiative (GRI)
- Global Impact Investing Rating Standards (GIIRS)
- Omidyar Network
- KIT's SDG House