Implementing and financing the UN Sustainable Development Goals (SDGs)

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"Supporting development is not charity, but is instead one of the smartest investments we can make in our own future[1]" said the President of the United States, Barack Obama, in a 2015 address before the UN General Assembly on the Sustainable Development Goals.

Over the last ten years however, developments in responsible investing have been based on the assumption that investors could be considered responsible provided that they did not finance companies and projects with bad environmental, social and governance behaviours. The objective was to raise investors' awareness and to limit morally reprehensible practices. Although this approach was commendable, it did not question the impact of the financial system as a whole.

Today, responsible investing has to go beyond awareness. It must also consider the role the financial system should play in financing our economies and understand the impact of finance on citizens' everyday lives.

At Mirova, we believe that finance should be considered as a tool: a powerful tool, whose impact is not, and should not be neutral but positive for society. Firstly, finance is not neutral because the way markets invest global capitals impacts the capability to implement investment projects, their cost and their yield. It has therefore a very concrete impact on the course of our lives. Secondly, finance should not be neutral if it is to fulfil its role of serving the needs of our economy.

The legitimacy of the SDGs should pave the road for investors who are ready to commit to sustainable impact investing. Finance could thus be a powerful lever to invest in sustainability. We need to rethink how capital is allocated in order to support employment, poverty eradication, environmental, social and technological innovations, to build new, more sustainable infrastructures and to finance the energy transition. The Mirova asset management company was created on the basis of this assumption, with an ambition to finance sustainable impact projects and companies and to promote sustainable value creation.

Change has already started but the challenge is immense.

Financing the SDGs requires not only money but also new types of research and investment tools which are fully dedicated to sustainability. According

[1] Remarks given by President of the United States Barack Obama on Sustainable Development Goals, General Assembly Hall United Nations, New York, 21 September 2015

to a 2016 survey by Share Action, the lack of data demonstrating how the SDGs are relevant to institutional investors remains a barrier for 66% of them, and the wide-ranging nature of the Goals is seen as an obstacle for 55%.

Research and tools are prerequisites but may not prove sufficient. However innovative the financial tools we develop, however sophisticated our sets of indicators: they will not be used on a sizeable and sufficient scale if we do not collectively work to implement a change of paradigm.

As Bank of England Governor Mark Carney noted, "while they are important catalysts, private niches, like social impact investing, or public sources, like Multilateral Development Banks won't be sufficient. (…) Achieving the SDGs will require mainstream finance. We need to build a new system – one that delivers sustainable investment flows, based on both resilient market-based, and robust bank-based, finance. We need finance for the long term[2]".

Today, responsible investing has to go beyond awareness. It must also consider the role the financial system should play in financing our economies and understand the impact of finance on citizens' everyday lives.

This means promoting a sustainable financial system that reconnects with an investment culture that supports not only the 'real economy' but also the shift towards a sustainable society.

Organisations such as UNEP but also researchers and universities have started to work on 'the financial system we need' and on innovative concepts such as 'shared value'[1], which will progressively help us understand how we can integrate environmental and social needs and externalities back into our economic rationale. We also need a strong and clear definition for responsible investing. Such a definition should privilege impact, rather than only integrating ESG[3] factors. It should be implemented via reformed global sustainable impact financial centres with dedicated asset classes and expertise. Paris could be one of them.

In line with this change of paradigm, we also need to take concrete steps to move this shift forward and start financing the SDGs. Mirova has identified three levers allowing investors and regulators to facilitate this development:

- Firstly, we need a precise understanding of what concrete investments are needed to support each SDG and to identify investment opportunities;
- Secondly, we have to take action, structuring tailored quality financial products that aim for high social and environmental impact;
- Last but not least, sustainable long-term investing should not remain an exception: scaling up and making investments aiming at creating sustainable value mainstream means we need to better align the interests of issuers and investors.

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[2] Remarks given by Mark Carney, Governor of the Bank of England, Chair of the Financial Stability Board, United Nations General Assembly, High-Level Thematic Debate on Achieving the Sustainable Development Goals, New York, 21 April 2016
[3] Harvard Business Review, Michael E. Porter and Mark R. Kramer, *Creating Shared Value*, January-February 2011

Table of contents

UNDERSTANDING the needs & identifying opportunities for SDGs investing

Our observations

Investing in sustainability has proven particularly complex. Surveys demonstrate that insufficient transparency on ESG issues are major barriers to focusing on Sustainable Development Goals for investors and that one of their main reasons for reluctance is the barely quantifiable nature of environmental and social benefits management.

Despite increasing regulations on ESG disclosure for investee companies and projects, most indicators remain focused on risks and processes and do not provide information on the level of opportunity for sustainable investment: does a service, a product, or a project have a positive impact on the SDGs? Sustainability opportunities remain hidden to the financial sector.

Also, financial models have become commonly used management tools (quantitative management, benchmarked management); many investors are still reluctant to change their methods to achieve impacts that are not always entirely quantifiable.

What can investors do?

For Mirova, offering committed investment management begins with dedicated research, based on the following principles:

- **Understanding and analysing the needs for environmental and social impact investments through a thorough review of sustainability issues.**

Mirova's experts analyse the stakes associated with 8 sustainability issues related to the SDGs: combating climate change, pollution control, resource preservation, biodiversity protection, fundamental freedoms, right to health, right to development and responsible governance, so as to understand which type of investment would positively contribute to improving them;

- **Identifying investment opportunities with high levels of sustainability impact**:

Mirova's research team then works to identify sustainable investment opportunities through fundamental analysis (no benchmarked management) within all sectors;

- **Analysing financial and ESG risks**:

investments in a sustainable opportunity are selected and final decisions are made on the basis of a risk analysis that incorporates financial and ESG aspects, to ensure their long-term viability.

How can policy decision makers and stakeholders facilitate understanding and identification of sustainable investment opportunities?

Different paths would help investors to better identify needs and opportunities to support the SDGs:

- **Promoting regulation and initiatives encouraging environmental and social disclosure for companies and projects with investment needs.**

For Mirova, three levels of information are important:

- The company's activities and business model, to be presented through a life-cycle approach,
- The environmental and social impact of products and services, in line with the SDGs,
- The environmental and social impact of production processes.

- **Providing the financial community with more analysis of the investment required to implement the SDGs:**

Regional, national and local public authorities may disclose data and information regarding geographical investment needs for SDGs at the local level. Extra-financial rating agencies could also contribute to link issuers' information and investment needs in reforming their analysis methodologies.

- **Enlarging investor's scope of investment opportunities to support impact investing**

Although some sectors, like renewable energies, have now reached a certain level of maturity, there might not be an abundance of investment opportunities for all SDGs. Supporting the development of projects combining financial, environmental and social return on investment and facilitating access to financial markets for small companies with innovative sustainable impact projects would help to increase the total investments.

In detail: the GRESB infrastructure assessment framework

Assessing the sustainability performance of infrastructures projects is a challenge. In September 2015, a group of institutional investors (AIMCo, AMP Capital, APG, ATP, Aviva Investors, CalPERS, Mirova, Ontario Teachers' Pension Plan, PensionDanmark and PGGM) announced their association with GRESB to develop a global sustainability standard for infrastructures. Within this framework, the objective was to attract more capitals to finance sustainable infrastructures and to improve the environmental and social performance of existing infrastructure funds. GRESB Infrastructure has two components: fund assessment and asset assessment. It provides systematic assessment, objective scoring, and peer benchmarking of the environmental, social, and governance (ESG) performance of infrastructure companies and funds. This standard aims at enabling institutional investors to request standardised ESG reporting from investments and provides tools to analyse critical aspects of management, policy, implementation and performance.

TAKING ACTION - Developing tailored financial products in order to generate social and environmental added value

Our observations

Many investors now have made a commitment to responsible investment. The signatories of the Principles for Responsible Investing (PRI) represent no less than 59 trillion US dollars, roughly 20% of the total volume of the world's capital market (in August 2015). Yet the principle 'incorporate ESG issues into investment analysis and decision making processes' still falls short of the SDG target and has not mobilised sufficient momentum.

The majority of investors committing to the PRIs are acting in good faith, but are encountering difficulties in making the step from intentions to practical applications. We identify two reasons for this:

- The difficulty of combining long-term objectives with the typically short-term management styles that are characteristic of the way financial markets function today;
- The lack of appropriate investment products: most so-called responsible products today focus only on the ESG quality of company processes: although commendable, these types of methodologies are not sufficient to support the implementation of the SDGs.

While the financial performance of funds is readily accessible, their social and environmental impacts remain largely opaque, not only to the public, but to the investment industry itself. Investors have a far more detailed understanding of their returns than of their own 'non-financial' performance. As a result, they have very little to say to beneficiaries about the wider impacts their investments have on society. It would not be an exaggeration to say that in the main, investors do not actually know whether the capital flows they are responsible for benefit or harm society.

What can investors do?

The financial sector has proven capable of developing sophisticated investment products in a wide range of circumstances. With a view to investing to support the SDGs, however, the complex issue is, rather, to develop appropriate tools and products to support long-term sustainable investing. Within Mirova's business model, we strive to develop the following approach:

- **Defining demanding methodologies so as to foster a high-level of environmental and social performance**

Existing market standards are not always satisfactory in terms of supporting long-term sustainable investment that would be in line with the SDGs. Mirova has developed its own methodologies for all asset classes so as to improve the sustainable impact quality of its investments, and to contribute to developing market standards accordingly. In particular, it has developed a carbon assessment methodology in collaboration with Carbon 4 that enables investors to assess induced emissions and avoided emissions, so as to understand the contribution a given asset makes to combating climate change.

- **Developing dedicated thematic impact investment products for all asset classes**

Mirova has developed dedicated thematic funds aimed at delivering sustainable impact, for example a fund dedicated to investing in companies generating employment. Within Fixed Income, Mirova has developed a strong expertise in green bonds. More than a third of the assets managed by the infrastructures branch is dedicated to investments in renewable energies.

- **Implementing engagement strategies to constantly improve ESG and financial added value**

Investing into promising assets may not prove sufficient to ensure the delivery of sustainable impact. Thanks to its engagement strategy and voting policy, Mirova establishes continuous dialogue with investors and thus continuously analyses and contributes to improve their ESG performance.

In detail: THE IMPACT FRAMEWORK

The impact framework has been developed as a cooperation between the Investors Leaders Group and the University of Cambridge Institute for Sustainability Leadership (CISL). The United Nations SDGs are its starting point and reference. Through a considered process, the goals have been converted into a set of six impact metrics for investors – metrics that do not measure intent or process in the asset base, but impacts, both positive and negative, on the critical challenges faced by our generation – poverty, health and wellbeing, job creation, use of resources, protecting ecosystems and stabilising the climate. The framework helps to take a fundamentally different approach to portfolios. Investors may discover some surprising results, and be inspired to tell more compelling stories to their beneficiaries about the value of their work. They may also discover areas where their work is slowing down progress and face difficult decisions about how and where to realign financial, environmental and social interests. The long-term aim of this work is to enable a revolution in 'consumer choice' in financial services, where the social and environmental impact of money is transparent to investment beneficiaries in the same way that it is apparent to food and energy consumers today.

How can policy decision-makers facilitate investors' developing sustainable impact investment products?

Developing investment products is necessary, but it is not sufficient: alleviating the remaining barriers to impact investing is a prerequisite for ensuring that there actually is demand for long-term and sustainable investment products:

- **Defining fiduciary duty**

so as to support long-term sustainable investment and enable investors to take long term risks into account;

- **Encouraging investors to disclose the sustainability performance of investments**

would be a first step to enabling clients and public decision makers to distinguish the type of impact their product will or will not have. Inspirational regulations like the innovative French energy transition law could be adopted in other countries.

- **Supporting the creation of dedicated high-quality standards and labels,**

so as to enable investors to identify impact investment products: one example is the French TEEC label dedicated to financing the energy transition; quality standards will also be important for the green bonds.

SCALING UP sustainable investing, enhancing alignment of interests

Our observations

In order to make responsible investing a mainstream practice, there could be a temptation to enlarge the scope of assets that may be considered as sustainable by watering down the standards of products aiming at improved sustainability performance. This is an ongoing debate for the Green Bonds Market for example.

For Mirova, sustainable impact standards should not be lowered to expand the market: the issue is rather to realign interests. The sustainable impact investment market needs to become much larger if it is to support the SDGs. This, in turn, means that investors and issuers need to share a common interest in delivering sustainable / extra-financial performance.

Issuing bonds or shares that demonstrate a specific environmental or social added value (such as green bonds) may generate additional costs for issuers: providing opportunities for sustainable investing will prove scalable only if it provides issuers with better access and / or cheaper access to capital flows, thus increasing the number of projects than can benefit from investments. On the other hand, investors should also find an interest to allocate their capitals to sustainable projects rather than to other projects.

Many investors may wish to support the SDGs implementation but they need to combine sustainability performance with a financial incentive in order to be able to scale up their approach and ensure their responsible investment commitment is economically viable.

What can investors do?

The financial sector will contribute to mainstream sustainable impact investing by promoting high-quality approaches and developing their products in international distribution networks. However, making sustainable impact investment mainstream will necessarily remain a limited enterprise as long as investors and issuers' interests are not aligned.

- **Developing dedicated thematic impact investment products for all asset classes**

Mirova has developed dedicated thematic funds aimed at delivering sustainable impact, for example a fund dedicated to investing in companies generating employment. Within fixed income, Mirova has developed a strong expertise in green bonds. Half of the infrastructures branch is dedicated to investments in renewable energy.

How can policy decision-makers and stakeholders support scaling up sustainable impact investment?

- **Public investment could be used as a lever and as a security to foster private investment, in the framework of renovated public-private partnerships**

Limited public funds supporting part of the investment risks would help develop sustainable development partnerships.

- **Realigning the interests of investors and issuers to incentivize emission of and investment into high-quality sustainability products** would help to make impact investing a mainstream practice:

– This could be done through adapting prudential regulations that impact the cost of capital, like Basel III and Solvency II which should better balance financial systemic risks and long-term extra-financial risks;

– Adapted subsidies or fiscal incentives could be applied to the projects on the one hand and to investment vehicle on the other hand;

– This type of support should be applied in priority to high-level impact investment products, like the above mentioned labels and high-quality standards, using investment to encourage the creation of more projects and companies that support the implementation of the Sustainable Development Goals.

In detail: LAND DEGRADATION NEUTRALITY (LDN) FUND PROJECT

Achieving LDN is one of the SDGs targets for 2030 (target 15.3). Every year, an area about half the size of the UK is degraded to sustain our global economy. This comes at a huge environmental, social and financial cost. The LDN Fund intends to reward land management practices that help avoid the degradation of productive land. Its goal is to promote switching to sustainable land uses and restoring already degraded land. The operational arm of the United Nations Convention to Combat Desertification (UNCCD), the Global Mechanism, and Mirova have jointly signed an agreement to structure the first global fund dedicated to achieving Land Degradation Neutrality - the LDN Fund. EIB and French Caisse des Depôts are supporting the initiative. The fund should provide a coordination platform for blended finance and is expected to be set up as a Public-Private Partnership among institutional investors, impact investors, development finance institutions and donors committed to supporting LDN. It should be structured as a privately-managed layered fund intending to generate returns for investors in line with their respective risk/ return profiles. The Global Mechanism and Mirova are joining forces to make the project a reality, and to create the conditions that are crucial if this investment vehicle to work. A joint project team has started structuring the fund across six interconnected working groups, including the identification of bankable projects across different sectors and countries.

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