ALIGNING RESPONSIBLE INVESTMENT WITH THE UN SUSTAINABLE DEVELOPMENT GOALS

BY HELPING OUR SIGNATORIES ALIGN THEIR INVESTMENTS WITH THE SDGS, THE PRI WILL HELP DELIVER 'REAL WORLD' IMPACT

Achieving the Sustainable Development Goals (SDGs) is at the core of the responsible investment agenda for the next 10 years.

The PRI Mission states: "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." The preamble to the six PRI Principles states: "We recognise that applying these Principles may better align investors with broader objectives of society."

This makes it clear that the Principles should not be seen in isolation, but as a way to contribute to a sustainable global financial system. A system that will allow investors to achieve long-term value creation, align them with the broader objectives of society, and benefit the environment and society as a whole. The SDGs are welcome guidance as to what the 'broader objectives of society' are. The PRI's strategy for achieving these objectives are discussed in our Blueprint for responsible investment, which sets out our plans for the next ten years and shows how we aim to achieve the PRI Mission.

The SDG challenge

The United Nations Commission on Trade and Development (UNCTAD) has estimated that meeting the SDGs will require US$5-7 trillion in investment each year from 2015 to 2030. Only a relatively small part of that money will come from public funds – an expected ceiling of US$1 trillion annually, leaving a gap of US$6 trillion annually for private capital. It is unclear what percentage of the US$6 trillion can be financed through companies contributing to the SDGs and what percentage will require more direct investments.

The PRI's 1,700 signatories represent around one third of global private capital and to meet the challenge would have to invest US$2 trillion annually in companies and other investments that directly link to positive SDG outcomes. By 2030, the deadline proposed by the UN, that should amount to cumulative 25% of assets under management having a direct positive contribution to the SDGs. This is not something to which institutional investors will commit easily, which highlights why the system and policy settings must be aligned – to ensure that financial returns are also possible. It is likely that if PRI signatories are asked to do this many questions will be raised and will have to be answered adequately. We believe that the PRI is well positioned to translate these globally-agreed goals into investor action. It will be an exciting, but also challenging journey.

The UN Sustainable Development Goals

The global community, represented by the UN, in September 2015 adopted the 17 [Sustainable Development Goals] (which are underpinned by 169 individual targets and includes the Paris COP agreement). UN Secretary General Ban Ki-Moon said at the launch of the SDGs that "at its essence, sustainability means ensuring prosperity and environmental protection without compromising the ability of future generations to meet their needs."

UNCTAD estimates that meeting the SDGs will require US$5-7 trillion in investment each year from 2015 to 2030. While government spending and development assistance will make a contribution to this figure, new flows of private sector capital will be required and crucial to meet some of the global challenges put forward by the SDGs. Being aware that UN and member countries cannot deliver on the SDGs alone, the UN is looking for partnerships in the private sector.

In its mission and preamble to the Principles, the PRI acknowledges the importance of alignment between the Principles, investment policies, investment decisions and active ownership, and broader objectives of society. Many PRI signatories believe that ultimately their investments in companies (and other entities) will only be profitable in the long term if societies and the financial system develop in an equitable and sustainable way. Besides that, beneficiaries increasingly demand that all actors in the investment chain (markets, asset holders and managers) take their long-term broader interests (and those of future generations) into account. To most investors it seems obvious that the SDGs should play an important role in the development of a responsible investment agenda for the 10 years ahead.

How does responsible investment contribute to sustainable outcomes? The current state of play

Ever since the early days of responsible investment, the focus has been on the integration of material environmental, social and governance (ESG) issues into investment policies, decisions and ownership. This has been so successful that we have started to consider responsible investment and ESG integration as equal. The focus of responsible investment has very much been on how ESG factors affect the risk-return profile of investment portfolios and specific investments, but not the other way around i.e. how responsible investment practices support broader objectives of society. In other words, how they contribute to the UN SDGs.

The PRI Principles

The assumption behind Principle 1, incorporation of ESG issues in investment policy and decisions, is that it will ultimately affect the cost of capital, lowering the costs of capital for sustainable businesses and increasing the costs for non-sustainable businesses. As a result of the lower costs of capital, sustainable businesses will gain competitive advantage over non-sustainable businesses. There is clear evidence that sustainable business practices lead to lower cost of capital and equal or even better financial performance. The assumption of crowding out companies with unsustainable business practices has yet to meet the test of empirical research.

The assumption behind Principle 2, ESG integration in active ownership, is that engagement with investee companies will highlight the materiality of ESG issues, convincing businesses to adopt more sustainable products, services and processes. This should improve the risk-return profile of the businesses. Academic research has provided some insight into the positive impact of active ownership on company ESG practices and financial performance. However, the contribution of ESG incorporation in active ownership/engagement is indirect because it often focuses on processes instead of outcomes. It is therefore several steps removed from the desired SDG outcomes.

The third way that responsible investment contributes to the SDGs is the allocation of capital to thematic, environmental and social themed or impact investments. After all, the total required investments to achieve the SDGs is estimated at approximately US$75-100 trillion. Currently 17% of PRI signatories report approximately US$2 trillion in total allocated to environmental and social themed investments (inclusive finance, renewable energy, clean tech, affordable housing, etc.). These investments are made under the assumption they will provide market rate returns, as well as positive outcomes to society. It is clear that the total of US$2 trillion is not yet anywhere near the level required for the next 12 years of the SDG agenda.

The preliminary conclusion is rather ambiguous. Better CSR practices lead to lower cost of capital but not necessarily to a process of gaining competitive advantage over unsustainable businesses. Engagement on CSR/ESG issues may, if successful, have a positive impact on financial returns, but it remains unclear how broad CSR/ESG-oriented engagement is used and if it matches or even surpasses more traditional forms of engagement focusing on short-term gains, and it remains unclear if companies step up their efforts on the SDGs as a result of investor engagement. There is some allocation to environmental and social themed investments, but is still quite limited and outcomes to society are not generally measured.

Translate Mission and preamble into practice

The global UN agenda for the SDGs requires that the PRI and PRI signatories revitalise responsible investment beyond a mere process-based approach of material ESG integration, towards an outcome-based approach that, within the constraints of a modernised concept of fiduciary duty and within the constraints of the need to achieve a reasonable or market rate return on investment (ROI), explicitly aims to contribute to the sustainability challenges put forward by the SDGs. The six PRI Principles should be seen as a way to achieve the PRI Mission and preamble. This means that we should think about how the application of the Principles and incorporation of ESG issues can and should contribute to a more sustainable economy. An advisory committee to develop the SDG investment case and further guidance has already been established.

Responsible investment blueprint

The PRI's Blueprint, published in 2017, sets out the PRI's high-level agenda for the next ten years, which focuses on real-world influence and sustainable outcomes. This Blueprint is the outcome of the consultation process that the PRI went through as part of its 10 year anniversary, including more than 25 meetings around the world. The Blueprint clearly makes the case for aligning responsible investment with the broader objectives of society and the SDGs. If this work is successful, by 2030 PRI signatories will have allocated 25% (cumulative, in total) of their AUM to investments with a direct link to positive SDG contributions.

From ESG processes to SDG outcomes

Some institutional investors have reached the conclusion that aligning their investments with the broader objectives of society requires a shift in focus from processes to outcomes. They have already agreed on a strategy of explicitly decreasing their carbon or even wider environmental footprint and structuring their portfolios to create a positive ESG or even SDG impact. There are also relatively new initiatives like the Montreal Carbon Pledge (public disclosure of the carbon footprint) and the Portfolio Decarbonisation Coalition (measure, disclose and reduce carbon footprints). This underlines how responsible investors have moved from an emphasis on processes to outcomes and impact, decreasing their negative environmental and social impacts and setting targets for positive ESG/SDG impact.

The investment case: aligning responsible investment with the SDGs

It is clear that, to meet the challenges of the SDGs, responsible investment should not just look at how ESG risks and opportunities affect the risk-return profile of an investment portfolio, but also how a responsible investment portfolio affects the broader objectives of society, or the SDGs. Achieving the SDGs is in the ultimate interest of beneficiaries, clients and future generations. Fiduciaries' duties and other investor responsibilities may often be interpreted as including this type of beneficiary interests. But there are at least four more 'financial' reasons for investors to align responsible investment with the SDGs.

With governments introducing regulation and incentives to promote the SDGs, and companies globally moving towards more sustainable business practices and innovation in sustainable products and services, investors who integrate the SDGs in their investment strategies and decisions are likely to be cutting edge and will potentially stay ahead of the curve, which makes perfect sense from a risk-return perspective. The global journey towards achieving the SDGs provides investment opportunities many investors are keen to grasp. Although some investors have already adopted strategies to capture the benefits of this journey towards sustainability, many are still seeking answers to the question about how the SDGs will affect their investment strategy and decisions. This requires the development of a clear SDG investment case.

The SDG investment case

	Macro	Micro
Risks	For asset owners who, based on Modern Portfolio Theory, choose to spread risks along a wide range of asset classes and geographies, failing to achieve the SDGs will put 'value at risk'. This has also been framed as the concept of universal ownership.	The challenges put forward by the SDGs reflect that there are very specific risks for specific industries, companies, geographies and countries. These risks may be regulatory, ethical or operational and are often also financially material. Integrating the SDG risk framework into investment decision-making processes is therefore crucial for any responsible investor.
Opportunities	Any investor with long-term liabilities will acknowledge that global GDP growth ultimately is the main (if not the only) structural source of financial return. Achieving the SDGs will be a key driver of global GDP growth over the next 15 years to 2030.	Companies globally moving towards more sustainable business practices, products and services, provide clear investment opportunities. Investors will have an interest to position themselves ahead of the curve.

The reasons mentioned for investors to consider the SDGs in their investment strategies, policies and decisions have to be further developed into a clear investment case. It is the first PRI SDG work programme priority.

Further guidance

Based on the SDG investment case, the PRI will develop a programme that helps signatories to align their responsible investment practices with the broader sustainable objectives of society, as currently best defined by the UN SDGs, providing information, research and education, facilitating collaboration, integrating SDGs in the work on public policy, investment practices (investment strategy, asset allocation, manager selection, incorporation in asset classes), engagement and in the PRI's Reporting Framework.

While the scale and scope of the SDGs is unprecedented, the fundamental ways that investors can contribute are rooted in existing practices. The six Principles offer a foundation for action on ESG issues. Many of the SDGs can be enhanced through improved ESG outcomes. For example, climate change, water quality and availability, gender equality, ESG disclosure and sustainable cities are areas to which investors and the PRI are already making a contribution. Additionally, the PRI and signatories have been active in promoting government policies that are favourable to responsible investment, the development of industry standards, the Sustainable Stock Exchanges initiative and institutional capacity building. There is an opportunity for institutional investors to contribute to the SDGs through both asset allocation, investment decisions and company engagement as well as the development of new financial tools and products.

Define the PRI position in the SDG landscape and collaborate with relevant organisations

Many international, national and industry organisations are currently adapting their products, services and activities to the UN SDG agenda. There is no need to create a new institutional infrastructure for the SDGs. However, there is a need to map the landscape of SDG initiatives, to prevent overlap with other initiatives and avoid a situation in which the PRI would have to move into areas and activities that are not the PRI's core competence. On the one hand this means the need to develop partnerships and define clearly who does what and on the other hand stay close to the Principles and integrate the SDGs into the PRI's regular work. Still, there may be occasional gaps that need to be addressed and there is a need to set priorities. The PRI will seek to collaborate with other relevant organisations to create a system that will allow investors to deliver on their contribution to the SDGs. This includes:

- preparing a "landscape map" covering the various initiatives and developments in the SDGs space that are relevant to investors – this can be updated regularly and published on the PRI website;
- working closely with the PRI's UN partners, UNEP FI and UN Global Compact;
- participating in the UN Inter Agency Task Force Financing for Development;
- collaborating with UN agencies and Bretton Woods organisations and others on bridging the gap between the SDG agenda and the investment case;
- contributing to initiatives that will improve reporting on the SDGs by companies and other invested entities (UN Global Compact, GRI, SASB, IIRC and others);
- continuing to collaborate with the Sustainable Stock Exchange initiative;
- developing a market map of environmental and social-themed investments that could potentially be further developed in collaboration with other institutions (UNEP FI, etc.);
- being a catalyst for better transparency of the market of investments that could contribute to the SDGs.

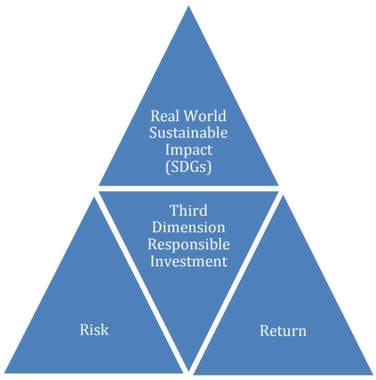
SDGs and the sustainable financial system

The PRI has developed a programme to contribute to a more sustainable financial system. The creation and establishment of a sustainable financial system is not just a goal in itself, but also an incentive for investors to allocate capital to the SDGs. To fulfil that purpose the financial system must not just be resilient, but the architecture of economic and financial markets should also provide the necessary incentives to ensure the allocation of capital to SDG-related investments. The SDGs provide a clear political roadmap, but do not always provide the right incentives for companies and investors to move along that preferred road. The existing incentive structure of markets may direct companies and their investors in directions that are not addressing or may even be detrimental to the SDGs. Internalising externalities in financial and economic markets will create a situation where markets will serve as a catalyst for sustainable development. Besides working on a sustainable financial system, the PRI will:

- Promote public policy coherence. Heighten the awareness of, and potentially directly address, gaps within regulatory frameworks that undermine the ambition of attracting capital to the SDGs.
- As part of the PRI work on a sustainable financial system, develop a clear policy approach for externalities, making sure that negative externalities of the system are adequately addressed through regulation and/or market-based incentives.
- Potentially follow up with guidance to governments on their national plans for the SDGs and how they can help make them investable.

Provide investment practice guidance on how to integrate the SDGs in investment strategies, policies and investment decisions (Principle 1)

The recently-published PRI discussion paper on investment strategy has already introduced a shift towards a new approach. It introduces a third dimension besides risk and return and real world sustainable impact and focusses on how to make sure that ESG issues and real world influence (outcomes) are integrated into the 'regular' development of an investment strategy.



To advance this agenda of incorporating the SDGs in investment practices we will:

- provide guidance on the integration of the SDGs in investment strategy, policy and asset allocation;
- provide guidance on how asset owners can integrate the SDGs in mandate development, selection, appointment and monitoring of investment managers
- focus the PRI's work on investment practices in diverse asset classes, providing guidance on how responsible investment and the incorporation of ESG issues can contribute to the SDGs.
- Develop tools that help investors to allocate capital towards the SDGs through areas such as blended capital, SPVs, PPPs or innovative products.

Integrate the SDGs in active ownership and engagement (Principle 2)

The key challenge is to make sure that ESG factors and the SDGs are fully integrated into all dialogues between investors and companies (and other invested entities). Too often there is a lack of alignment between the engagement by responsible investment/ESG professionals and analysts and portfolio managers. Improving these practices is of the utmost importance, in general and also specifically for SDG engagements. This will require:

- general guidance from the PRI on key expectations with regards to active ownership (guidance on Principle 2 is currently under development) and provide guidance on how Principle 2 (ESG integration in active ownership) could operate as a delivery mechanism for the SDGs;
- prioritise SDG themes for engagement activities and develop the PRI SDG engagement agenda;
- use the Collaboration Platform to facilitate investor collaboration on SDG-related engagements;
- define and measure the impact of current and future PRI and (collaborative) investor engagement activities in support of the SDGs.

Promote improved disclosure on ESG factors and the SDGs by companies and other entities (Principle 3)

Transparency is key. There are almost always one or more chains between the investor and the economic activities that may support the SDGs. Without transparency by invested entities on their SDG performance, it will be very hard for investors (asset owners and investment managers) to allocate, invest or engage on the SDGs effectively. Therefore it is necessary to:

- Promote improved ESG and SDG disclosure by companies. This includes the PRI's work in collaboration with other global investor organisations to provide a more unified view on corporate reporting standards.
- Collaborate with the SSE initiative on improving ESG/SDG reporting by companies.
- Collaborate with UN Global Compact, GRI, SASB and other reporting initiatives to make sure the SDGs get integrated into corporate reporting.
- Promote reporting of SDG performance data by non-corporate investment entities (sovereign bonds, real estate, etc.)
- Promote improved ESG/SDG disclosure from investors. Update the Reporting Framework with a view on 'outcome/impact' and mainstream RI/ESG reporting.

Provide information on the SDGs to create awareness, education and promote research (Principle 4)

The 10-year consultation process undertaken in 2016 showed that approximately 50% of asset owners and investment managers consider the SDGs to be relevant for investors. Meanwhile there are signals that this percentage has increased. But for many investors the SDGs are relatively 'unknown territory' and for even more investors it is not clear how they should respond. This requires a process of awareness raising, education and research, including:

- Campaigns to inform signatories of the existence of the SDGs and the UN's search for partnerships.
- Academic research to answer the question about if and how responsible investment along the PRI Principles contributes to the SDGs. Work with partners to commission

research that shows positive financial and economic impact related to advancing the SDGs.
- Encourage service providers and/or researchers to cover the SDGs in their research explicitly. The PRI could create a working group of service providers/rating agencies to evaluate how the SDGs can be further integrated into investment practices.

Promote collaboration of investors on the SDGs (Principle 5)

Collaboration is needed by the PRI, signatories and other organisations in the industry, etc. Therefore the PRI will facilitate collaboration on SDG-related activities between investors through the PRI Collaboration Platform. The PRI will further develop the current Collaboration Platform to provide a truly global Collaboration Platform for all activities/initiatives on investments targeting the SDGs, not just the PRI's.

Define and measure the impact of current PRI and investor activities in support of the SDGs and communicate publicly about the ways in which the PRI's current activities support the SDGs (Principle 6)

Transparency, measurement and monitoring progress all play a key role in advancing the SDG agenda. There is also a clear need for increased transparency on SDG performance by investors themselves. The PRI should stimulate investor reporting on 'outcome/impact' (and shift from reporting on processes, also in the PRI's Reporting Framework). The PRI will update the Reporting Framework to reflect the outcomes/impacts on the SDGs and promote improved ESG/SDG disclosure from investors through mainstreaming responsible investment/ESG-reporting by all financial institutions. The PRI, in collaboration with others, will:

- Stimulate investor reporting on the outcomes/impacts of an investment and shift away from reporting on processes, and ultimately to reflect this in the PRI's Reporting Framework.
- Update the Reporting Framework to reflect outcomes/impacts of the SDGs and gradually introduce reporting on outcomes in the PRI's reporting, assessment and accountability framework, starting with thematic investments and climate change.
- Implement the FSB Task Force on Climate-related Financial Disclosure recommendations in the R&A Framework.
- Promote improved ESG/SDG disclosure from investors through mainstreaming responsible investment/ESG reporting by all financial institutions.
- Define and measure the impact of current PRI and investor activities in support of the SDGs and communicate publicly about the ways in which the PRI's current activities support the SDGs.

Aligning responsible investment with the SDGs: a work programme

To be able to address all the challenges of the SDG agenda, the PRI will undertake several activities in the next couple of years. The PRI SDG work programme includes:

- The SDGs will be a key aspect of the PRI Blueprint and (together with the work on a sustainable financial system) will be part of the PRI board and Policy Committee agenda;

- The PRI work on the SDGs will be supported by an SDG advisory committee (made up of approximately 20 members). The SDG Advisory Committee will advise the executive and the board on the PRI's work on the SDGs, taking normal decision-making procedures into account. With the support of the SDG Advisory Committee there will be five major areas of work; one that will be the main responsibility of the PRI executive and four that will be prepared by SDG working groups. The working groups will each get specific items they are asked to address, including the development of a refined roadmap for their part in the SDG work. Members of the working groups can also be recruited form outside the SDG Advisory Committee. Working groups will start ASAP. All working groups report to the SDG Advisory Committee.

- The PRI will create a landscape map of current SDG initiatives, including work done by the UN, UN Finance for Development, UNEP FI, UNGC, SASB, GRI, IIRC, etc., as well as some major national initiatives. Part of this is to collaborate with some of these institutions or contribute to their work to make sure they assist investors engaging on the SDGs.

- A first PRI working group will develop the SDG investment case as the number one priority. It should discuss why the SDGs are relevant for investors. It should serve as an informative and convincing investment case to inform investors about the SDGs and bring a larger group of investors on board to adopt the SDGs as an issue that is relevant for them.

- A second PRI working group will be set up looking at the allocation of capital to the SDGs. It will focus on how to incorporate the SDGs into asset allocation, risk/return expectations, mandates for different asset classes, how to select and monitor SDG-relevant investments, etc. It will address what the investment case for the SDGs means for Principle 1 (incorporation of ESG/SDG in investment decisions). Activities that will be under this working group include:

P1: Provide guidance on the integration of the SDGs in investment strategy, policy and asset allocation
P1: Provide guidance on the integration of the SDGs in mandate development, selection, appointment and monitoring of investment managers
P1: Focus the PRI's work on investment practices in diverse asset classes on how RI and incorporation of ESG issues can contribute to SDGs
P1: Develop tools that help investors to allocate capital to the SDGs (blended capital, SPVs, PPPs or innovative products)
P1: On a continuous basis, collect, publish and promote 'best practices' on SDG integration by signatories (and others)

- A third working group will work on the development of an SDG engagement agenda. It will address what the investment case for the SDGs means for 'Principle 2', incorporation of ESG/SDGs in active ownership and engagement. It will consider what a transition from ESG engagement to SDG engagement means, what active owners can do, how they can select priorities, collaborate, etc. Activities that will be under this working group include:

P2: Provide guidance on how Principle 2 (ESG integration in active ownership) could operate as a delivery mechanism for the SDGs
P2: Prioritise SDG themes for engagement activities and develop the PRI SDG engagement agenda
P2: Measure SDG impact of current and future PRI and (collaborative) investor engagement activities

- The fourth working group will be on measurement and reporting. Activities will focus on tools that will help investors monitor progress on the SDGs, report on their SDG-related activities and will also look at adapting the PRI Reporting & Assessment Framework to shift gradually from process-based reporting to outcome-based reporting. Activities of this working group include:

P3: Promote SDG disclosure by companies (collaborations with UN Global Compact, SSE, GRI, SASB, IIRC)
P3: Promote SDG reporting by non-corporate investment entities
P3: SDG performance disclosure by investors
P6: Stimulate investor reporting on 'outcome/impact' and update the Reporting Framework with a view on ‘outcome/impact’ on the SDGs
P6: Implement the FSB Task Force on Climate Disclosure recommendations in the R&A Framework
P6: Promote improved ESG/SDG disclosure from investors through mainstreaming RI/ESG/SDG-reporting by all financial institutions
P6: Define and measure the impact of the PRI and investor activities in support of the SDGs and communicate about support of the SDGs

- On an annual basis the PRI will report on its own and its signatories’ progress aligning investment with the SDGs.

- How else can the PRI help? To better understand investors’ needs, interests and opportunities the PRI needs to hear from signatories. Please share your ideas, plans and feedback with kris.douma@unpri.org.