About those Sustainable Development Goal Funds

This five-minute read sets out five useful tests any investor can apply as a sense-check on whether an SDG fund is worthy of the label. It concludes with how to order and align investment priorities and the SDGs for optimal financial, environmental and social outcomes.

DISCERN sustainability

"Impact Integrity is the foundation stone; above that comes understanding the kind of capital required to make bona fide prospects succeed; and above that, sit the investors whose return expectations and investment horizons are a good match."

Investment minds are throwing themselves into thorough research, literature, and framework building in an effort to bring consistency and shared understanding to the area of impact investing.

For example, the [Impact Management Project] has defined five dimensions of impact: what, how much, who, contribution, and risk and the [World Bank] has now pronounced on Principles for Impact Investment.

The lines between "impact" investing and just plain old investing have started to blur as mainstream investors have started to talk about the positive impacts of their investments.

For some obvious reasons, many of these investors have decided to use the Sustainable Development Goals (SDGs) as a framework for their positive impact that the. But what do SDG-focused funds need to be credible? Are they, in fact, different than traditional impact funds? What are the challenges they face?

DISCERN sustainability

Some of the questions that mainstream funds must address include: "How do you define "contribute?" "Do they negatively impact other SDGs?" "Is the impact "significant?" And "Do you need to contribute to all 17 goals?"

This is to say nothing of the pitfalls of poor measurement. There may also be counter-intuitive results. For instance, beneficiaries who have been poorly understood are liable to behave unpredictably. In the above case, the target population did not, as hoped, buy highly subsidized malaria nets, or use them when they did buy them.

In this respect, SDG and Impact Investment are not immune from the pains of classic development aid, for which the injection of capitalism and enlightened profit was meant to be a remedy.

There is no shortage of superb examples of impact investments making their mark, of course. Perhaps the lesson is that investment from larger pools of capital from somewhat risk-averse clients should only flow to ideas where impact from a project is already demonstrable, not just plausible.

DISCERN sustainability

Back to the world of glass towers. Ernest sustainable investment professionals are as apt as any of their colleagues to over-engineer a product in the quest to cover all possible angles.

Here is something easy to understand but challenging to accomplish: an integrity heuristic to perform before you launch or buy an SDG fund. It includes the following interlocking tests.

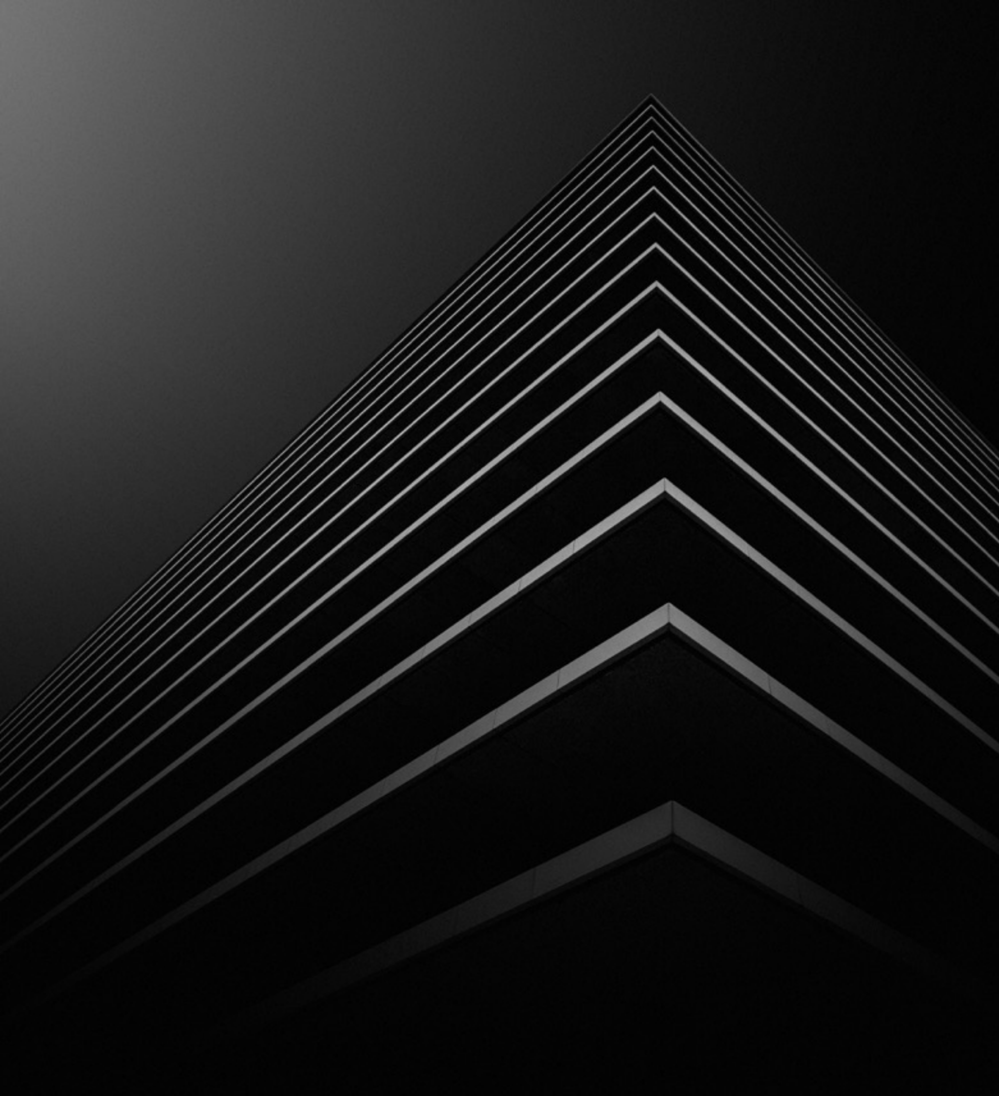
DISCERN sustainability

IMPACT

Does it help people who need help? How do you prove it, not via assumed 'trickle-down effect' but in ways *they* would recognise? To the malaria nets example, are there at least early signs that it is working? Can you be confident that you are offering a leg-up to a badly needed investment that might not happen, without your support? 'Support', here, is not only in the form of capital. All funds should consider what, if anything, they can bring to the table beyond cash, for example: expertise, networks and professionalisation.

DISCERN sustainability

ADDITIONALITY



Can you tie your investment directly to financial, social or environmental outcomes, that are not speculative, transient and do not risk double counting.

Imagine you buy a share in a highly complex MNC, ‘MegaCorp Conglomerates Inc.’ You judge that your equity position of 0.01 per cent entitles you to an equivalent amount of the company’s carbon reduction efforts. Can you sincerely argue that you would not have made that investment anyway, for all the other reasons, be it momentum, income et cetera? Moreover, is it not a racing certainty that some other investor that has never heard of the SDGs would have bought that same 0.01 per cent in far less than the time you can say ‘High Frequency Trading’?

So how does such an investment move the SDG needle? Not through disembodied arguments for helping nudging capital flows in the right direction, though these have their place and are better suited to other fund styles.

DISCERN sustainability

"Can you tie your investment directly to financial, social or environmental outcomes, that are not speculative, transient and do not risk double counting?"

MEASUREMENT

As a corollary of attribution, can you measure it meaningfully, without spurious accuracy or contrived metrics? Spend enough time reviewing 'Impact' and 'SDG funds' and you will find at least a few examples of untenably sketchy assumptions on your travels. If you cannot keep it relatively simple, or at least convincing, it is time to re-evaluate.

COVERAGE

The SDGs come as a package, but they are also, by necessity of tackling interdependent life systems, all-encompassing. One of Europe's largest asset owners, which puts sustainability front-and-centre strove for total coverage. They conceded there were two SDGs, where conventional public equity investment trying to reach them failed the plausibility test.

This is not cause for withdrawal. The SDGs are young, and markets are innovative. New methods and security structures will be invented to satisfy coverage. Until then, if you cannot hit most, let alone all 17 Goals squarely and are not likely to, then this should be clearly explained, until some kind of generally accepted taxonomy and rules are in place.

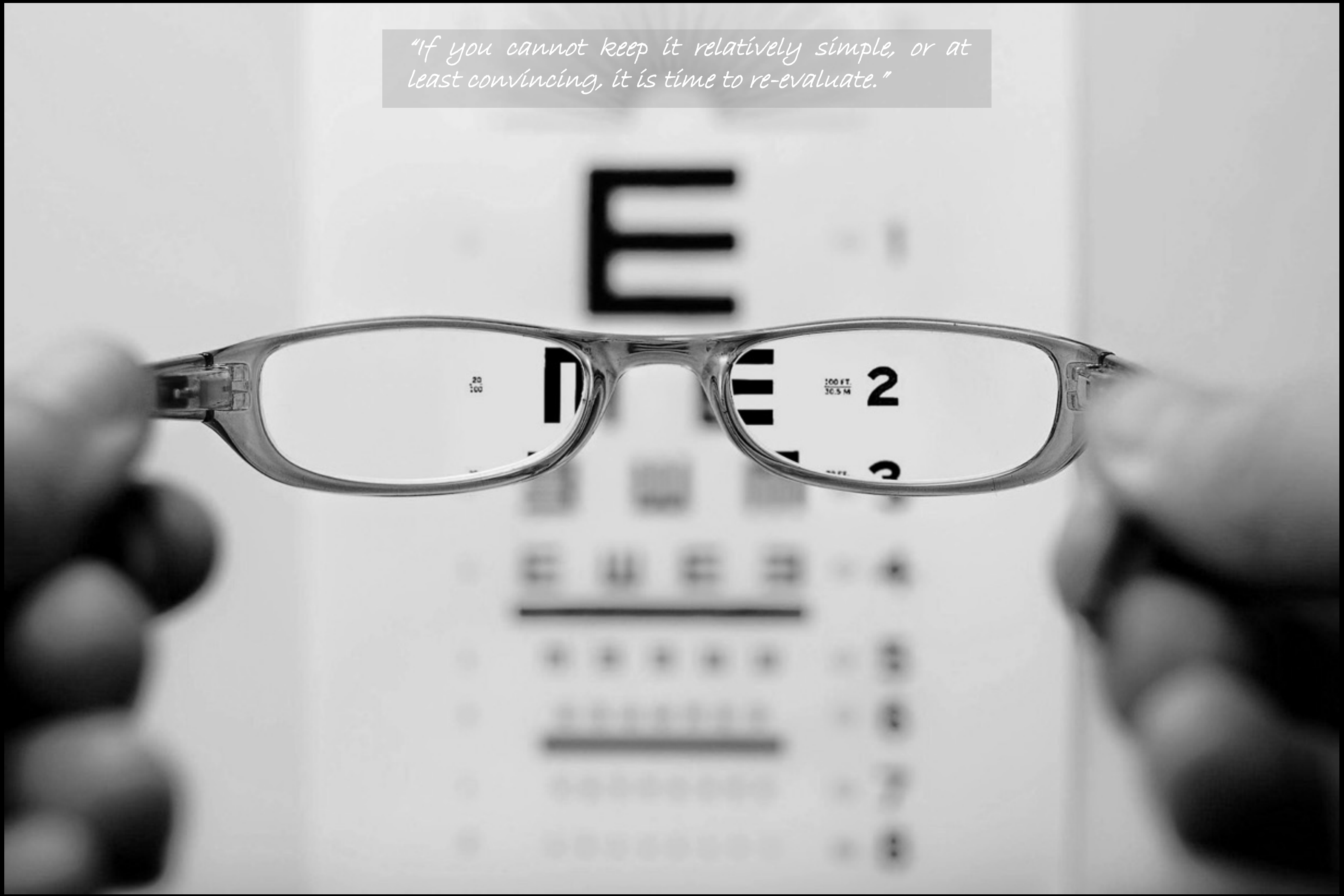
DISCERN sustainability

CLARITY

All of the above lead us to what is the foundation stone. Are you clear about articulating what your SDG fund is and is not about?

That SDG funds should emulate 'impact-like' characteristics does not require them to be interchangeable with 'Impact' funds, in every respect.

You could answer 'no' to all the other tests but clarity would still be left standing, even if the inexorable conclusion is that SDG investment is not for you, for now.



DISCERN sustainability

It bears dwelling on defined purpose. In 2014 Aviva Investors published its "Roadmap for Sustainable Capital Markets: how can the SDGs harness the global capital markets". The authors would, I suspect, agree: we should be vigilant to avoid this chapter playing out as the global capital markets harvesting the SDGs, instead.

This is no injunction against profiting from such investments. For the avoidance of doubt, profit *should* be an aim, or we may as well leave the SDGs to charity and governments; the latter for whom they were principally intended.

The vigilance serves as a reminder that SDG funds should endeavour no less to deliver on the bigger picture: the achievement of the Goals and the funding of the gap between us and them. Ask not what the SDGs can do for you, but what you can do for the SDGs.

The cold calculation of risk and informational advantage through ESG analysis is a legitimate strategy, for many. Though not a panacea, markets would still be more efficient and reduce externalities, if everyone did it well. They have overlap, but ESG integration should not be conflated with SDG investment, or it will not be a happy union.

Established 'impact' investors, too, may have misgivings about SDG funds parking their tanks on their lawn without having endured the same rigour, while diluting rather than galvanising lasting capital flows.

DISCERN sustainability

Asset class fundamentals bring us down to earth. Wendy Abt wrote in the *Financial Times*;

"A clear line between ESG and true impact investing (or "sustainable development goals" investing) is important because products that have direct impact on poverty are rare, plus the investments are usually illiquid, volatile, and require lots of long-term capital. Transaction costs are also high, driven by the need to create, rather than find, the investment projects, secure approvals, and rigorously test impact. ESG investing is important but does not operate under these constraints. SDG impact investors need to understand what they are getting into."

When you match all these characteristics to what is out there in the market presently, impact funds based on the SDGs which target debt and equity in well-defined, small to medium sized enterprises with a scalable business model are most likely to come up to the measure. Other formulations could still work-but we submit that the five tests stand, all the same.

"Investment from larger pools of capital from somewhat risk-averse clients should only flow to ideas where impact from a project is already demonstrable, not just plausible."

DISCERN sustainability

So, if you are a sustainability professional, and you have been having confused thoughts, consider this article permission for saying the following: SDG investment *is* about making a difference. Call it the eighteenth goal.

It is legitimate goal, too, so long as we are transparent about it, and what risk/return an investor can expect. On this measurement, it may be prove better than most assume.

> *"SDG funds should endeavour to deliver on the bigger picture: the achievement of the Goals and the funding of the gap between us and them."*

Conclusion

- We have gone from a problem of a concept starved of sufficient capital to one potentially overwhelmed by demand and undermined by carelessness.
- Impact Integrity is the foundation stone; above that comes understanding the kind of capital required to make bona fide prospects succeed; and above that, sit the investors whose return expectations and investment horizons are a good match.
- These layers in maintained in good order, we can go about engineering the greatest participation and scale this alignment of interests can sustain.

DISCERN sustainability