EDENTREE RI EXPERT BRIEFING | JUNE 2018

THE SUSTAINABLE DEVELOPMENT GOALS

SCOPING THE ISSUE

We are seeing market excitement and some interest from clients around the concept of integrating the UN Sustainable Development Goals (SDGs) into portfolio construction as a framework for assessing 'impact'. This Expert Briefing responds to client interest, explores the issue more deeply, and sets out our response and current position.

WHAT ARE THE SDGs?

The 17 Sustainable Development Goals, the successor to the Millennium Development Goals, were devised by the UN, and agreed in 2015. The Goals are underpinned by 169 targets and are an agenda for the world up to the year 2030. These Goals apply universally to all nations to mobilize efforts to end poverty, fight inequality and tackle climate change.The Goals require a revitalised partnership between agencies and Government for '*people, planet and prosperity',* but are *not* primarily built for business or investors.

WHY IS THERE INTEREST IN THE SDGs?

The responsible investment market is vibrant and changing. Products now encompass multiple strategies from 'ethical' to ESG (environment, social and governance) risk integration. Thematic funds seek to specialise in 'solutions' based stock picking, focused, typically, on water, energy and waste. Another approach that is receiving considerable attention is 'sustainability'. Definitions vary, but this approach typically looks at solutions based approaches that are utilising the SDGs. Various new product launches in the UK and Europe claim to 'integrate' the SDGs to make investments contribute positively to selected SDGs via the goods and services they produce. Some go further by attempting to measure 'impact'.

WHAT HAS BEEN EDENTREE'S RESPONSE?

Our entire responsible investment offer to clients is built on trust and integrity. For 30 years, we have sought fully to integrate ethical and responsible business practices into stock selection to deliver 'Profit with Principles'. Our response has been to conduct intense due diligence to look at the viability of 'SDG integration' and the concept of 'impact'.

WHAT HAS THIS ENTAILED?

We scoped five service providers that have developed tools for investors to integrate or map the SDGs across portfolios. These models are in various stages of development but they currently share some similar drawbacks.

- There is little consistent reporting by companies to allow an informed SDG integration process to take place;
- The tools we have seen are modelled largely on assumptions rather than quantified, published data;
- All tools apply different methodologies and come to different conclusions which may compromise the integrity of outcomes.

TO WHAT EXTENT IS CORPORATE DATA THE PROBLEM?

Despite investor appetite, companies are not required to report against the SDGs, and the state of current reporting is variable. The UN has not provided guidance to business on their adoption, which is something of a missed opportunity preventing their mass take-up by companies. Only 40% of the world's largest companies discuss the SDGs in corporate reporting, and fewer than 10% report on the business case for their integration. We have been told that many companies find it challenging to translate support for the SDGs into business specific, measurable targets. Very few companies have gone further than look at the 17 overarching goals by considering the underlying 169 targets.

Almost no companies discuss any negative or detrimental impact on the SDGs; however, we believe comprehensive integration requires a balanced score card of both positive and negative analysis.

WHAT IS THE PRI's VIEW?

The PRI (Principles for Responsible Investment) have issued guidance on integrating the SDG's, however this applies only to asset owners. They take the view that the SDGs form part of investor fiduciary duty and are an articulation of the issues investors should be integrating into their investment process as a risk assessment frame-work. They see three ways in which the Goals can be used:

- Integration into portfolio construction

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- Part of active ownership
- As part of thematic asset allocation

The PRI introduces new obligations that go well beyond its six Principles and, in our view, what is reasonably understood to be an investor's Fiduciary Duty.

WHAT IS EDENTREE'S CONCLUSION?

We have concluded as a result of our extensive due diligence that integrating the SDGs into portfolio construction is still novel with no standardised methodology in place. Providers are experimenting using assumptions with outputs varying widely between competing, untested models. Outcomes may lack integrity given the absence of corporate data. We do not currently feel there is a way to do this that is satisfactorily robust or has sufficient integrity.

WHAT WERE THE VIEWS OF THE AMITY PANEL?

The Amity Panel, which has independent oversight of the Amity process, has provided advice on our findings, and agrees that, at least at present, using an experimental model to integrate the SDGs would not add value for clients. They pointed to our screening process as robust and transparent, and which correlate well to the SDGs.

IS EDENTREE'S SCREENED PROCESS A REASONABLE SDG PROXY?

Yes. Our screening process which comprise six ESG risks and four themes was extensively refreshed in 2019. The ESG or Responsibility screens comprise business ethics, community, corporate governance, employment & labour, environmental management and human rights. Our original three themes (education, health & wellbeing and social infrastructure) have been joined by a fourth: sustainable solutions. The areas we look for in screening companies proactively into the Amity Funds encompass many, if not all, of the SDGs appropriate to the investor. For instance, SDG8 (Good Work) correlates indirectly with our Employment & Labour pillar; SDG3 (Good Health) with our Health & Wellbeing pillar. Our process serves positively to commend stocks into the screened funds, and in this way, we believe these companies are contributing to the spirit of the SDGs. However it is for companies themselves to articulate how they are contributing to meeting the Goals, and few, as we have seen, are yet reporting the direct contribution they are making to the underlying 169 targets.

WHAT IS THE DEFINITION OF 'IMPACT INVESTING'?

The market is currently alive with interest in measuring 'impact' with considerable client expectation around the 'value add' of measuring the social and environmental impact of a portfolio. Originally, this related to mission-led investors able to sacrifice an element of market return so as to deliver a measurable element of social impact. This is now changing to *suggest* a range of returns from below market to market rate in order to address the world's most pressing needs in sectors such as agriculture, renewable energy, healthcare and education. There is consensus that the core elements of impact investing are:

- Stating social & environmental objectives
- Setting performance metrics
- Monitoring performance against these targets
- Reporting on the social & environmental performance

Thus a hallmark of 'impact investing' is the presumed ability to *measure* and *report* the stated impact, however, we believe it is not a model that lends itself well to public equity markets.

WHAT IS THE CHALLENGE THEN IN MEASURING IMPACT?

In our view, any meaningful measurement of 'impact' does not easily translate to mainstream equity markets – EdenTree's core investment universe. Fund performance is subject to standardised benchmark comparison; social & environmental impact is not. A recent report into the burgeoning 'impact' market[1] highlights some of these challenges, with 66% of the survey's respondents seeking standard risk-adjusted market rate returns. Given the way capital markets operate, it is particularly challenging for listed equity to deliver an additional element of quantified impact. As we have seen, any measurement of impact will rely heavily on assumptions rather than hard data. We do not believe this is satisfactorily robust enough at present to be meaningful.

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Impact is easier to measure in the Fixed Interest market, for instance in the issuance of social and green bonds. These instruments often link the proceeds directly to environmental or social outcomes that are measurable. It is notable that of 'impact' Funds in the market, the majority are in fixed interest, private equity or venture capital, with only 2% of products stated as being in publicly quoted or mainstream equity.

Where we do have exposure to 'impact' type instruments, these are prominent in our Amity Sterling Bond and Amity Short Dated Bond Funds particularly in the renewable energy and social housing sectors.

WHAT OTHER MODELS ARE AVAILABLE?

Although the SDGs provide a comprehensive framework that has achieved significant consensus, as we have seen, the SDGs are not principally modelled for business or investors. Data affording easy integration is largely absent. Progressive companies are experimenting with other models in which the SDGs may be referenced, but are not the driving factor. Examples include Nestlé's *'Shared Value'* model, Mondelēz International's *'Impact for Growth'* model, and resource intense circular economy models in which companies avoid a 'take, make and dispose' business strategy in favour of one that designs waste out.

WHAT IS EDENTREE'S APPROACH?

We understand the interest from clients in seeking to measure impact via integrating the SDGs. However we currently believe this is not possible under current reporting regimes. We will monitor developments and continue to engage with service providers as tools mature and data allows the reliance on assumptions to be reduced.

We will begin to reference the SDGs in our Amity Insights and in our thought leadership. For instance our Insight 'Hungry Planet Revisited' is a thematic response to SDG2 (No Hunger), our Insight, 'Sustainable Cities' a response to SDG11 (Sustainable Cities and Communities), and Thirsty Planet Revisited, a response to SDG6 (Clean Water and Sanitation). Our Expert Briefs that look at particular stocks will increasingly reference their reported contribution to meeting the SDGs, where appropriate.

In June 2019 we will publish our Insight 'Sustainability: Fad, Fashion, The Future of Investment?', which sets out our House definition of sustainable investing and maps for the first time our screening process to the 17 SDGs

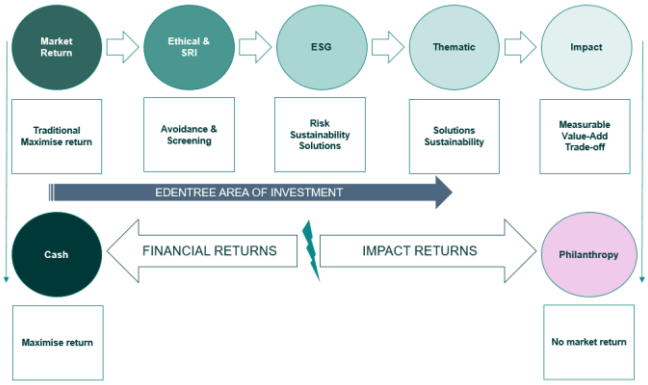
Our quarterly Global Corporate Governance reports reference SDG16, Peace, Justice and Strong Institutions, which is a commitment to '*develop effective, accountable and transparent institutions at all levels'*. We believe that our Stewardship on behalf of clients is a contribution towards strong institutions.

For 30 years our robust process has sought to offer clients *Profits with Principles*. We strive to integrate the principles of ethical and responsible investment in a way that has deep integrity. We are not the followers of fashion, but leaders striving constantly to innovate. In many ways the 17 SDGs are an eloquent articulation of the issues we look at and the concerns we have followed for many years. The way we manage Funds and communicate to clients place the priorities of the SDGs at the very heart of what we do.

CONCLUSION

The Amity range of ethically screened Funds invests principally in listed equity and fixed-interest instruments, and are subject to our robust negative and positive screens.

The wider values-led investment market is vibrant with models that now encompass ethical, ESG, sustainability, thematic and impact. We are not principally thematic or sustainability fund managers, although elements of our Funds' portfolios have strong exposure to instruments that may be defined as either 'sustainable' or 'thematic'. The broad canvass of potential investment is shown below, in which cash, the most vanilla and mainstream product bearing market returns with no ethical or responsible overlay is at the opposite end to philanthropy where there is no market return at all.



[1] Global Impact investing Network www.thegiin.org

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We have a specialist in-house Responsible Investment (RI) team who carry out thematic and stock-specific research to identify ethically responsible investment ideas for our range of Amity funds. Headed up by Neville White, Head of RI Policy & Research, and supported by Responsible Investment Analysts Esmé van Herwijnen and Jon Mowll, the team is also responsible for creating an on-going dialogue with companies, allowing us to engage on a wide variety of ethical and socially responsible investment concerns. Our ethical and responsible investment process is overseen by an independent Amity Panel that meets three times a year, and comprises industry and business experts, appointed for their specialist knowledge.

We hope you enjoy this RI Expert Briefing and find it useful and informative. For any further information please contact us on 0800 011 3821 or at ifa@edentreeim.com