COMMON GOALS, YOUR IMPACT

The United Nations Sustainable Development Goals (SDGs) can serve as a framework for measuring impact in environmental, social and governance (ESG)-focused investing.

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For a growing number of investors, financial performance is no longer the sole investment objective. Instead, many are looking to align their financial goals with the ability to influence change.

Yet in fixed income specifically this is no easy task. Traditionally, impact investing has focused on project finance investing, which has clear objectives against which progress can be measured, such as to provide clean water or build a railway. Moving from these types of projects, with well-defined but narrow goals, to establishing objectives for investing in the world's largest and most complex companies is a challenge. And yet solving it is the key to unlocking the wider pools of capital available for this purpose.

The framework for measuring impact needs to be versatile enough to accommodate the diversity of the global bond universe and clear enough to be measurable. The good news is that it already exists.

SUSTAINABLE DEVELOPMENT GOALS (SDGS)

The Sustainable Development Goals are a set of 17 ambitious goals targeting 169 outcomes in the realms of sustainable development, better environmental outcomes and healthier communities.

Some goals are precise enough to be addressed by direct business activities, such as those committing to clean water and sanitation. Others can be addressed through a firm's management of its supply chain and its own governance – for example, a firm can ensure that worker conditions in factories are consistent with the goal of decent work and economic growth. Other goals are more nuanced and require a creative approach, including no poverty. These can be best served through non-business activities, such as establishing a charitable foundation, and through collaborative partnerships.

WHY THE GOALS ARE IMPORTANT

Understanding how a firm's actions align with the SDGs is important for all investors. Consider those that failed to see the sharp shift in regulation in the global banking sector following the financial crisis, or the push to renewables in European utilities in the 2000s. They would have missed important secular shifts impacting long-term financial health.

For a smaller but growing group of investors however, understanding alignment with the goals is not enough. Instead they want to use their capital to help achieve them. For these investors, there are three main levers to pull:

1. Asset Allocation

First, they can decide how and where to deploy capital. Instead of investing in bank equities, which carry exposure to the full range of banking activities, an investor seeking to foster economic growth through housing could invest in covered bonds, which are secured vehicles backed by residential mortgages.

Covered bonds, municipals, mortgages, agencies, supranational and local government debt account for around 23% of the Barclays Global Bond Aggregate Index – investing in them offers extensive opportunities to target different SDGs.

Investing in green bonds or social bonds provides an even more targeted approach. Allocating capital to any of these bonds can be consistent with promoting access to affordable and clean energy, sustainable cities and communities, clean water and sanitation, and industry, innovation and infrastructure, among others.

2. Engagement

Investors seeking positive change can also promote engagement with companies. Engagement is most associated with equity investors but fixed income investors can play just as important a role.

At the heart of engagement is a collaborative relationship between companies and investors. Most companies already report publicly on key ESG indicators, such as gender equality. Investors – both equity and fixed income – can build on what is already publicly available, and engage in a dialogue with firms to deliver greater transparency. Engagement can also serve to raise issues with firms that they may not be currently considering, but which could have a long-term impact on their business.

3. Measuring and Reporting

While engagement may be powerful, transparent measurement and reporting are crucial for investors to see the impact of their capital, and for firms to evaluate their own position.

Yet reporting shouldn't be the sole responsibility of the company. Investors need to provide guidance on information required and work collaboratively with firms to establish key performance indicators (KPIs) given the information available.

South Africa provides a good example of how this can work. Companies there have been mandated to provide integrated reporting since 2011, meaning they must include standardized information on ESG practices alongside financial disclosures. This has allowed ESG-focused investors to set measurable goals for companies and evaluate progress towards meeting them. Adopting this model more broadly, and coalescing behind the SDGs as a means of setting those goals, would be a big step forward in impact investing.

UNLOCKING A MULTI-TRILLION-DOLLAR UNIVERSE

Using the SDGs as a framework for impact investing has the potential to unlock the multi-trillion-dollar universe of fixed income investment for the purpose of change - a much larger pool of capital than currently exists in the mainly equity-focused impact investment world.

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