Capital Partners
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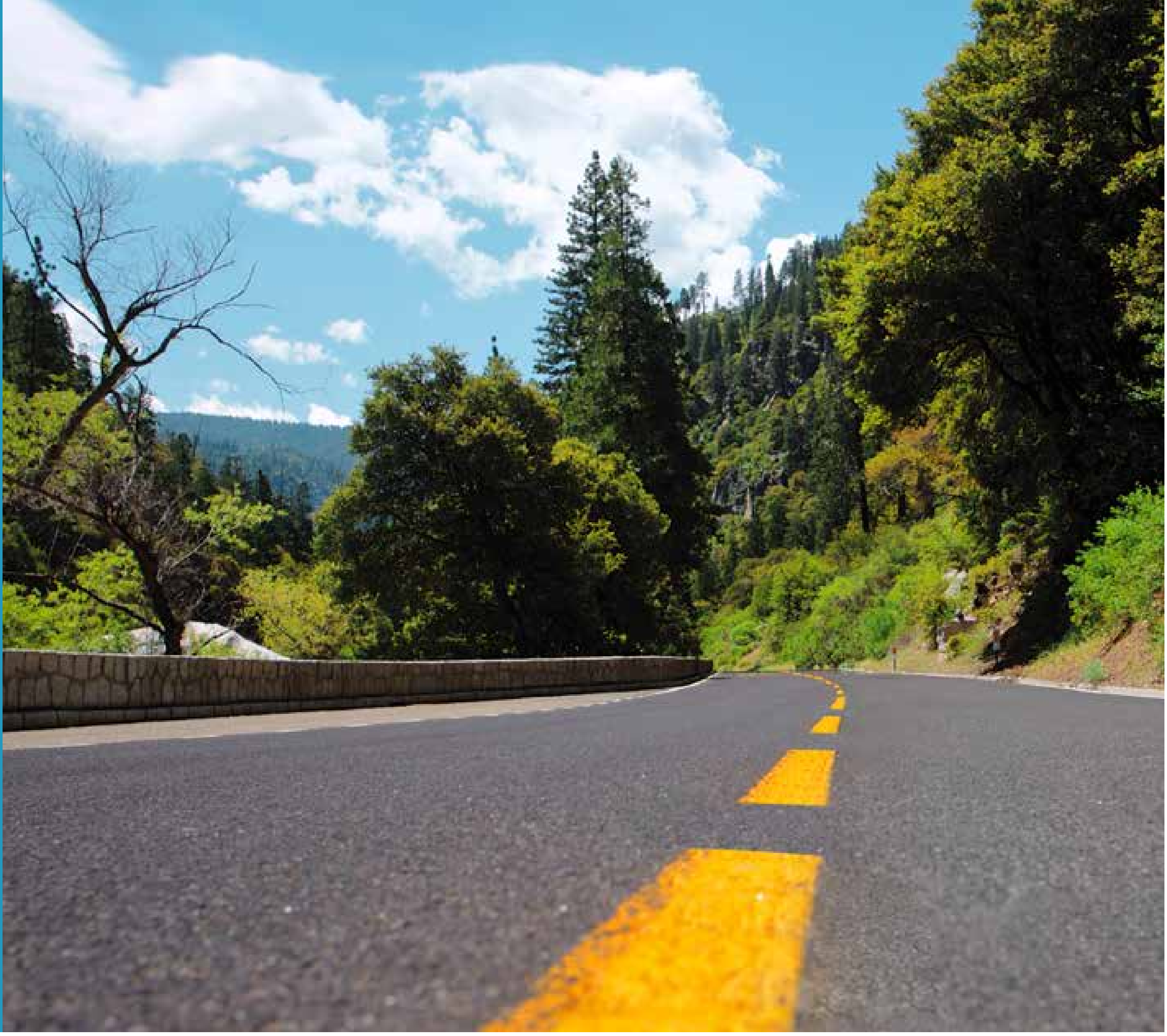
# ESG to SDGs: the road ahead

## A survey of investors in alternatives



"Investors are increasingly turning to the SDGs in order to make their sustainable investment activities more outcome oriented."

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# 1. Introduction and scope of the survey

LGT Capital Partners (LGT CP) has long had an interest in the evolution of environmental, social and governance (ESG) practices in the alternative assets industry. For the past seven years, we have carried out assessments of how the private equity, hedge fund and other asset managers in our portfolios integrate ESG into their investment decision-making. This has given us a rich data set on how ESG practices have evolved over time. As useful as these insights are, however, they do not tell us about the views and expectations of the "end users" of ESG efforts: asset owners and allocators. Our survey of 207 investors from 28 countries – representing pension funds, endowments, insurers, investment managers and others – does just that.

The current study builds on an earlier survey published in 2015, "Global Insights on ESG in Alternative Investing," in which we asked a large, international group of investors about their views on ESG. Since then, the landscape has changed dramatically. ESG has become largely mainstream, as most investment decision-makers today are familiar with ESG as a concept, even if they do not integrate all of its considerations into their investment processes. As a result, the current survey reflects a broader range of views on ESG and provides a snapshot of the current thinking among investors in alternatives.

The investors who responded to our survey shared their views on a wide array of ESG topics, which we hope will help to point the way for the future development of best practices. They told us about the importance of ESG in their day-to-day decision-making, the ESG issues that get most of their attention, their motivations for integrating ESG, as well as what they will focus on in the future. They also shared their expectations for the Sustainable Development Goals as an investment framework, a topic that has been growing in importance in recent years. Beyond this, we were able to look at correlations between various investor responses to identify six different ESG archetypes, from Skeptics to True Believers, who populate the ESG landscape.

Some of the key questions we explore in the survey are:

- What do investors think about the effect of ESG integration on risk-adjusted returns?
- 54% of investors say ESG is relevant to their decision-making, but what does that mean in practice?
- What are the three most important ESG topics to investors?
- What ultimately drives investors to integrate ESG into their decision-making?
- Which areas of ESG do investors want to enhance in the near future?
- Are the SDGs destined to be a niche topic or are they gaining widespread acceptance among investors?

We invite you to read on to learn more about these topics, and we look forward to discussing them in the months to come.

**207**
PARTICIPANTS FROM
28 COUNTRIES

**75%**
INTEGRATE ESG INTO
INVESTMENT DECISIONS

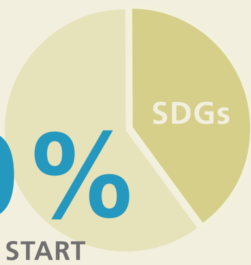
GOALS

**91%** BELIEVE SDGs HELP TO ADDRESS PRESSING “E” AND “S” TOPICS

**!** BETTER DATA SOURCES NEEDED TO DEEPEN ESG

**84%**
BELIEVE THAT ESG HAS A POSITIVE OR
NEUTRAL EFFECT ON RISK-ADJUSTED RETURNS

**6** ESG ARCHETYPES IDENTIFIED




**40%**
PLAN TO START
INTEGRATING SDGs

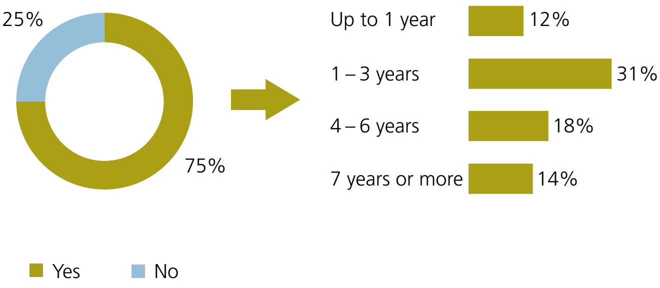
**No.1**
CLIMATE CHANGE IS
THE TOP “E” CONCERN

# 2. Relevance of ESG in alternatives

### Proportion of investors integrating ESG considerations into their investment decisions

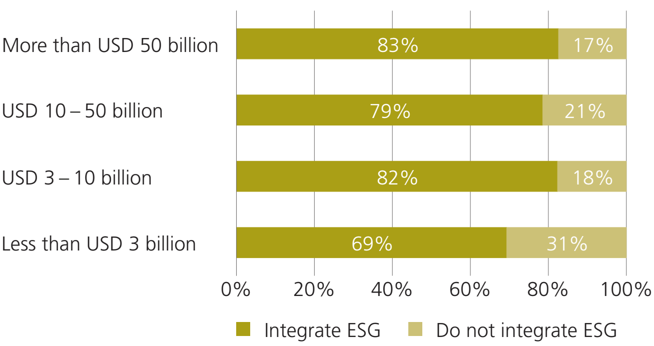
The vast majority of respondents (75%) said they integrate ESG into their investment decisions, with 43% of them having begun within the last three years. The large proportion of investors who are still in the early phases of ESG adoption suggests rising expectations for the managers who invest on their behalf, as investors refine their approach.

**Figure 1: Do you integrate ESG into investment decisions?**




If we break this down by assets under management, we see that smaller investors (less than USD 3 billion in assets under management) are somewhat less likely to integrate ESG factors than their larger peers, with 69% saying they do so, versus 79% to 83% for larger investors. This dovetails with the results of LGT CP's annual ESG assessment of its own underlying private equity and hedge fund managers, which finds that larger managers are somewhat more likely to have institutionalized ESG frameworks in place than smaller ones.[1] It is not to say that size is a barrier to adopting ESG practices, but rather that greater scale facilitates the institutional adoption of ESG.

**Figure 2: Proportion of investors integrating ESG criteria by assets under management**

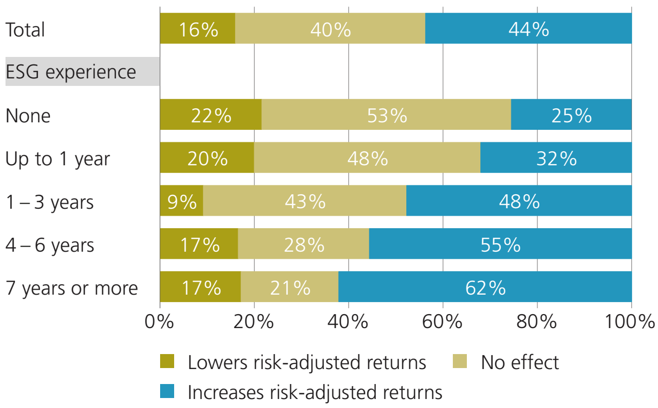



### Investor beliefs on the effect of ESG factors on risk-adjusted returns

The question of ESG and its impact on risk-adjusted returns has long been discussed within the investment community, so we wanted to know what investors in alternatives believe on this topic. While the debate will no doubt continue, we find that 84% of investors believe integrating ESG has either a positive or neutral effect on risk-adjusted returns. Only a small minority (16%) think that ESG entails a sacrifice in risk-adjusted returns. We also see a strong correlation between the length of time investors have been integrating ESG and the likelihood they believe in a benefit to risk-adjusted returns. Investors with seven years or more of ESG experience are largely convinced (62%) that it increases risk-adjusted returns, while those who are new to ESG (up to one year) are less certain (32%). It suggests that experience in ESG integration provides the strongest evidence for a positive benefit to risk-adjusted returns.

> "Experience in ESG integration provides the strongest evidence for a positive benefit to risk-adjusted returns."

**Figure 3: What is the impact of incorporating ESG on risk-adjusted returns?**




[1] LGT CP ESG Report 2018

### Stakeholder concern about ESG integration into investment decision-making

The investors we surveyed typically operate in an environment with multiple stakeholders – whether governing boards, beneficiaries or executive management teams – who hold a range of views on the importance of ESG. Investor perceptions of the relative importance of ESG to stakeholders guides the pace and depth of ESG adoption. Only a small minority of respondents (18%) said their stakeholders are "not concerned at all" about it, while nearly half (44%) said their stakeholders are either "concerned" or "very concerned."

We also see that the longer investors have been integrating ESG into their investment decisions, the more they perceive it as a matter of concern to stakeholders. Nearly two-thirds (65%) of investors with long track records in ESG integration (seven years or more) said their stakeholders are "concerned" or "very concerned" about ESG, while just under half (48%) of recent ESG adopters (up to one year) think the same.

### Relevance of ESG to investment decision-making

While Figure 1 shows that a large majority (75%) of investors integrate ESG into their investment decision-making, it does not tell us how important it is in their process. When asked to rate its relevance (Figure 5), more than half (54%) said it is either "relevant" or "very relevant." We also see that as investors gain experience in ESG integration, its importance in the decision-making process increases. A full 90% of the most experienced ESG investors (seven years or more) said it is "relevant" or "very relevant," while only 44% of investors who have only recently begun their ESG journeys (up to one year) see it that way.

**Figure 4: How concerned are stakeholders about ESG integration?**

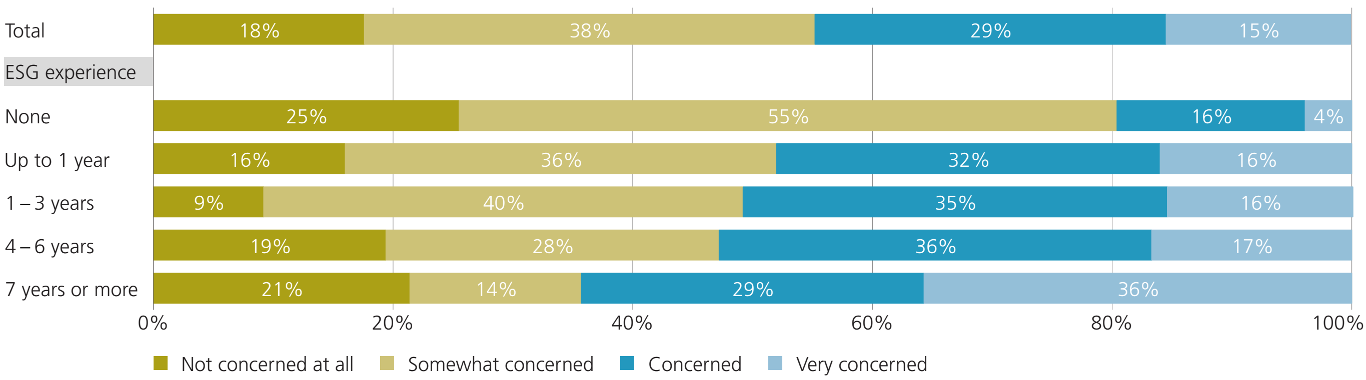
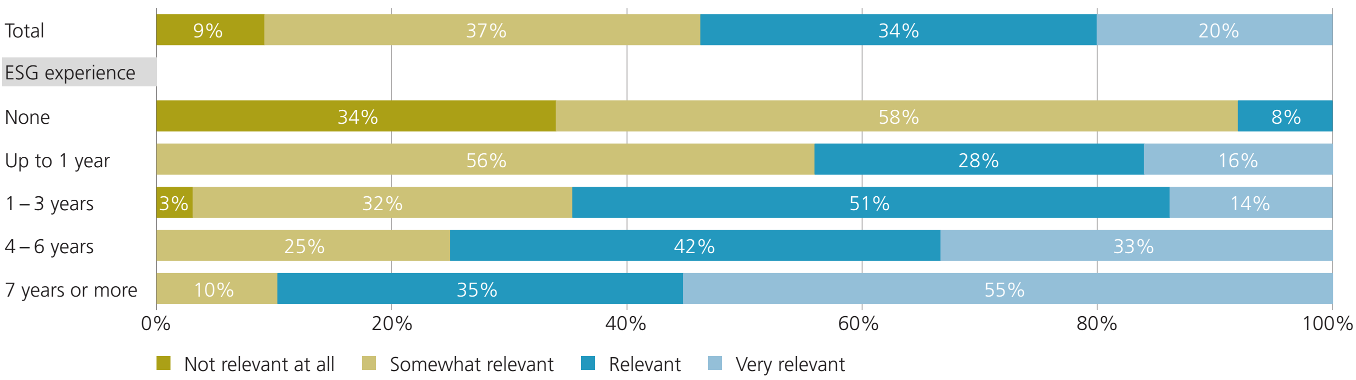



**Figure 5: How relevant is ESG in investment decision-making?**



It is useful to see whether respondents' assessment of ESG relevance matches what they actually do in practice in their investment process. This is why we asked the follow-up question about whether they have ever excluded managers because of ESG concerns. Their willingness to exclude managers shows whether they put their ESG aspirations into action. We find in Figure 6 that just under half (47%) said they have declined to invest with managers over ESG concerns, which is broadly in line with the 54% who say that ESG is "relevant" or "highly relevant."

We also see that investors with significant ESG experience (seven years or more) are much more likely (76%) to have excluded managers because of ESG concerns than those who are new to it (28%). Clearly, investors' ESG actions become much more closely aligned with their ambitions over time.

### ESG conviction and beliefs about risk-adjusted returns

Analysis of ESG relevance (Figure 5) and investors' likelihood to have excluded managers (Figure 6) suggests a way of measuring investors' overall ESG conviction. Those who say that ESG is relevant and have excluded managers on ESG grounds can be said to have "high ESG conviction," whereas those who say that ESG has little or no relevance and do not exclude are said to have "low ESG conviction." In between, are a mix of investors, who either assign low relevance to ESG or do not exclude on ESG grounds, so they are considered to have "medium ESG conviction."

When sorting investors this way, we see that those with high ESG conviction are much more likely (67%) to believe that ESG increases risk-adjusted returns than those with low ESG conviction (27%). While this is not necessarily a surprising result, we should not assume this to be the case. Investors have a variety of reasons for integrating ESG, which we explore in section 4 of the report, so it is telling that conviction on ESG overall and its ability to boost risk-adjusted returns are closely correlated.

**Figure 6: Have you ever excluded managers over ESG concerns?**

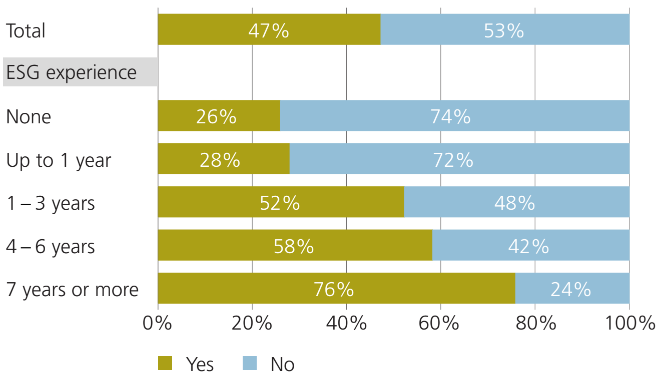
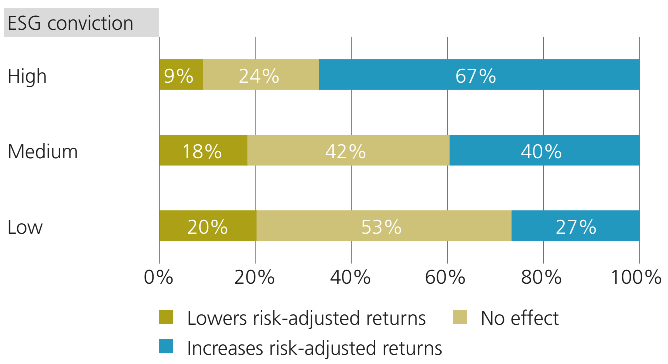



**Figure 7: ESG conviction versus beliefs about risk-adjusted returns**



# The case for ESG and risk-adjusted returns

The debate about ESG integration and investment performance has been a focus of both the academic world and investors ever since sustainable investing emerged as a widely adopted investment practice. We at LGT CP believe that factoring ESG criteria into investment decision-making reduces long-term risks and should ultimately enhance returns. This is because companies that are managed according to ESG criteria should have reduced exposure to ESG risks, and they benefit from cost savings and new market opportunities. These stem from factors like reduced energy usage and waste disposal costs, fewer workplace injuries, higher employee productivity and fewer regulatory and compliance breaches. Such companies are also better placed to profit from positive trends related to sustainability, such as energy transition, social trends and demographic trends.

The theoretical basis for a positive relationship between ESG integration and risk-adjusted returns is supported by extensive academic literature. One of the most persuasive meta studies on the topic was published by researchers at the University of Hamburg, who analyzed the findings of approximately 2,200 individual studies.[2] Researchers looked specifically at the link between ESG and corporate financial performance and observed that 63% of studies found a positive relationship between the two factors, and that this relationship remains stable over time. In other words, the rewards of ESG integration do not seem to diminish even as greater numbers of investors begin to adopt it. Furthermore, roughly 90% of studies found that there was no negative relationship between the two factors.

The findings of academic studies, with their focus on public market data and companies, are also increasingly being reflected in the actions of practitioners in private markets. A PwC survey of private equity firms found "strong evidence of commercial advantage" to integrating ESG factors into their investment decision-making.[3] For example, 40% of the firms surveyed said they would materially mark down or abandon a target company if they discovered it had poor ESG performance. A similar share of private equity managers said they would be willing to pay more for a target with strong ESG performance.

For LGT CP, the debate about ESG and risk-adjusted returns has been settled, and we believe that the preponderance of empirical evidence supports this view.

[2] "ESG and financial performance: aggregated evidence from more than 2000 empirical studies," Journal of Sustainable Finance & Investment, 2015
[3] "Are we nearly there yet? Private equity and the responsible investment journey", PwC, 2016

# 3. The most important ESG issues

Investors looking to build up portfolios that reflect the latest thinking on ESG must consider a wide array of factors. Environmental issues range from well-publicized topics like climate change and pollution to more niche issues like biodiversity and genetically modified organisms. Similarly, for social and governance factors, the breadth of potential topics – from human rights and workforce diversity to board independence and accounting practices – can be a challenge. Investors cannot address all possible topics with equal effort, as they simply would not have the resources to do so. They naturally need to assign priorities, based on what they believe will have the most material impact over the long term, whether in terms of value enhancing potential or risk mitigation effect. In this section, we explore which of these issues is the highest priority for investors.

> "Investors need to assign ESG priorities, based on what will have the most material impact over the long term."

### The most important environmental topics for investors

Climate change and carbon emissions have attracted significant attention in the media, industry forums and the wider public. The topic is also very much in the minds of policymakers, with the 2015 Paris Agreement on climate change and its many follow-on activities, so it is not surprising that it is the area of greatest concern to investors, as shown in Figure 8. Pollution and energy efficiency also rank high among investors' concerns, followed by water scarcity. Other factors, such as waste management, deforestation and biodiversity are much lower priorities for most investors, with the level of concern fairly similar across the three topics.

The strength of investors' concern about climate change and carbon emissions is further illustrated in Figure 9, which shows the proportion of investors ranking each topic as their number one concern. They are roughly six times more likely to say it is their most important environmental topic than either pollution or energy efficiency.

**Figure 8: What are your most important environmental topics?**

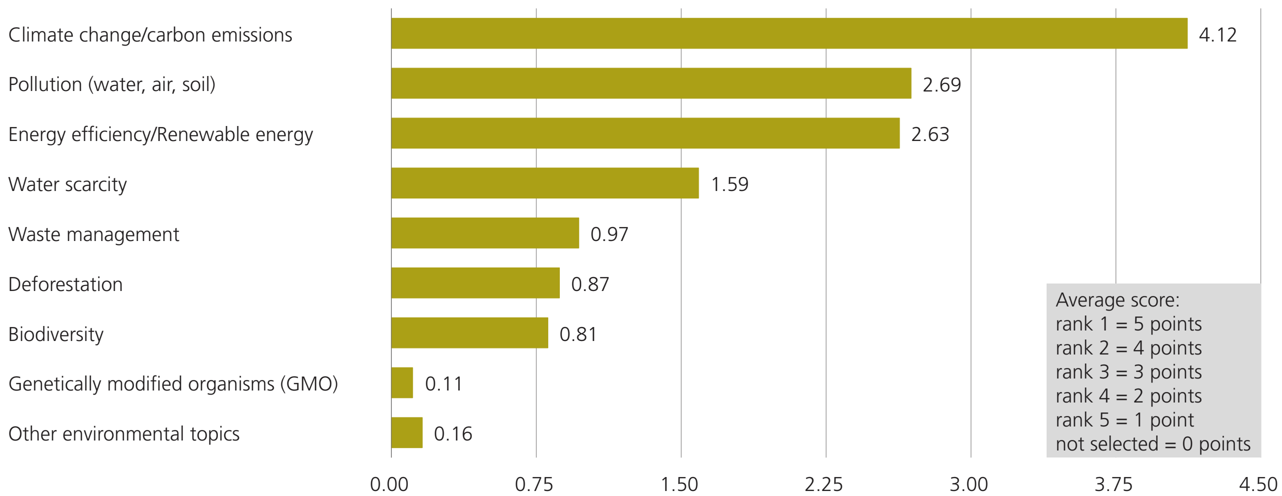
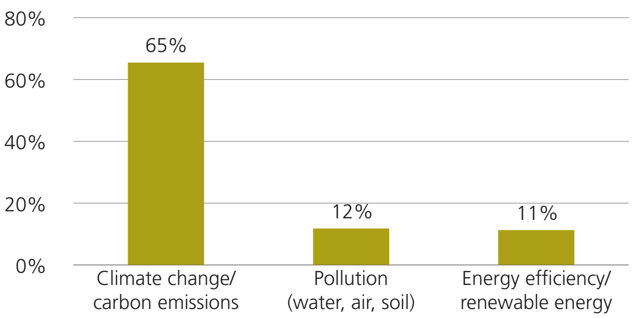



**Figure 9: What is your number one environmental concern?**



## The most important social topics for investors

Investors hold much more diverse views on social topics than they do on environmental ones. While they cluster around climate change when asked about their top environmental concern, three different social topics attract similar levels of support among investors: human rights, controversial weapons and child labor. This is seen in both charts below, whether in the overall rankings of the various social topics (Figure 10) or in the proportion of investors ranking a particular topic as their number one concern (Figure 11). Health, safety, data protection and privacy also rank high among investors' social concerns, in roughly equal proportions. Traditional "sin" activities, such as gambling and adult entertainment, do not attract broad investor concern.

**Figure 10: What are your most important social topics?**

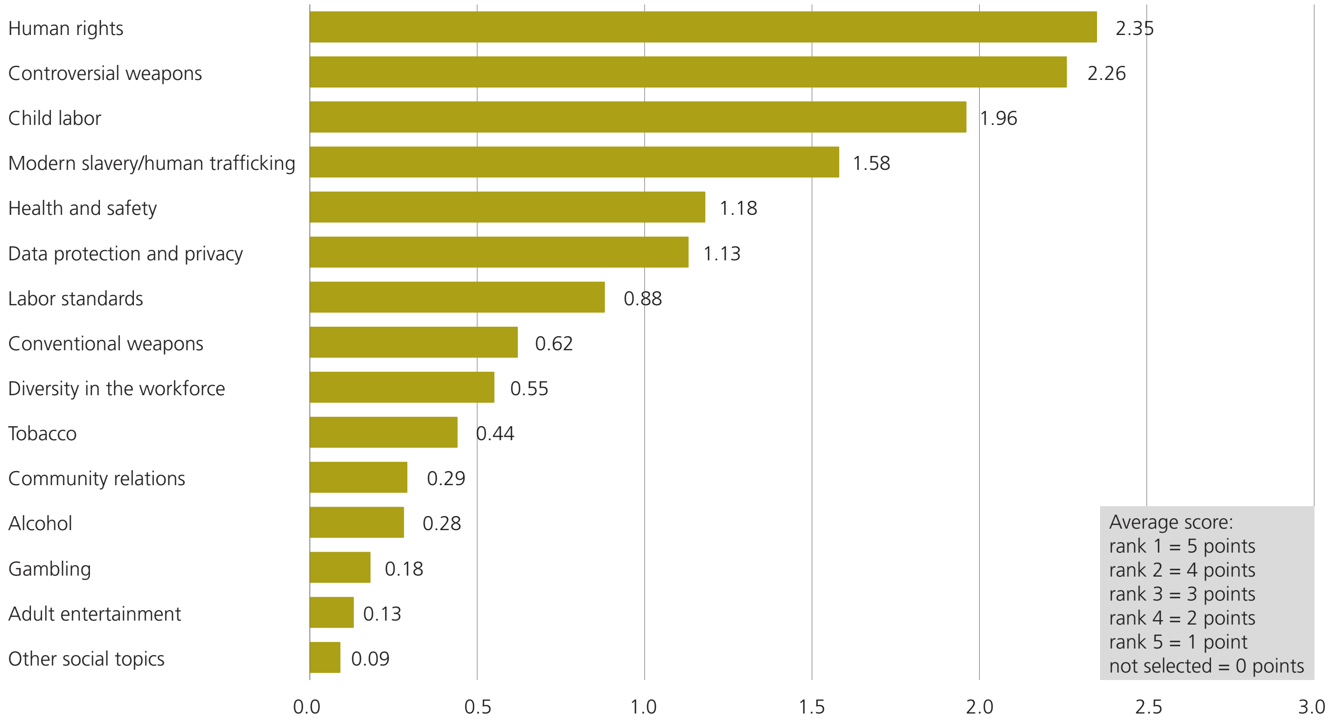
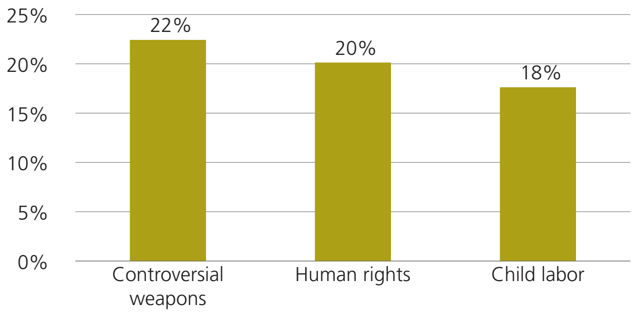



**Figure 11: What is your number one social concern?**



### The most important governance topics for investors

Most investors were integrating governance considerations into their investment decision-making process long before ESG came to prominence. This is because governance topics arguably have the clearest connection to asset value, whether in terms of ownership rights, regulatory and compliance risks or other liabilities. Few can afford to ignore such issues. Among the governance topics that most concern investors, bribery and corruption stand out above all others, whether looking at the overall rankings (Figure 12) or the proportion of investors ranking it as their top concern (Figure 13). This coincides with the growing importance of compliance issues more generally in corporate boardrooms. New or proposed legislation on bribery and corruption has been introduced in a wide range of countries, such as Germany, Spain, Australia and China, to name just a few.[4]

Board independence is the second highest governance priority for investors, followed by shareholder rights. We then see a gradual tapering in the strength of opinion on the various topics, from accounting practices to political contributions. We were somewhat surprised that management/board diversity did not make it into investors' top-five governance concerns, considering the amount of attention it has been given in many corporate boardrooms and the media, particularly in the United States. This could in part be due to the global nature of our study, which includes respondents from 28 different countries, where priorities and views on diversity vary widely.

**Figure 12: What are your most important governance topics?**

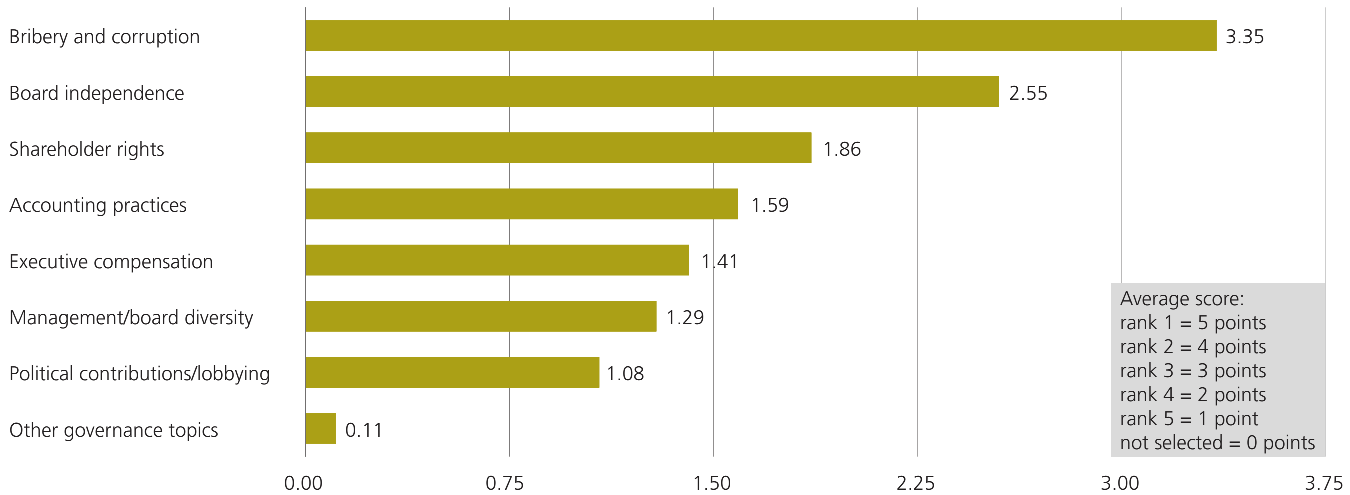
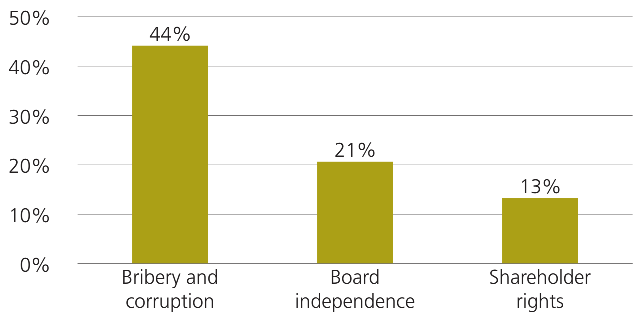



**Figure 13: What is your number one governance concern?**



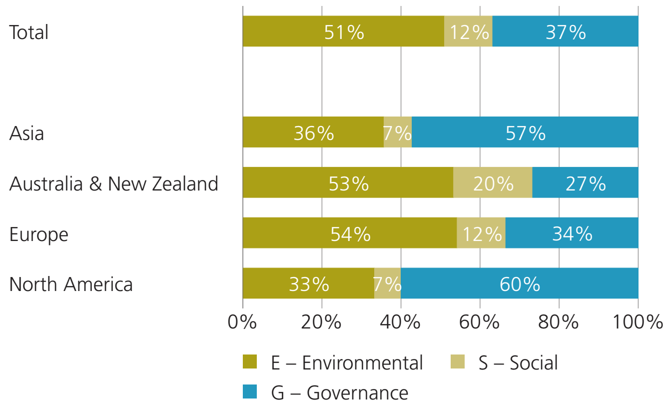

[4] Anti-Bribery and Corruption Review, Clifford Chance, June 2018

### Area of ESG that gets the most investor attention

While it is clear that climate change occupies significant investor attention in ESG discussions, we wanted to get a sense of the relative weightings of E, S and G in investors' minds. Not surprisingly, environmental considerations get the most investor attention, with 51% of respondents (Figure 14) saying it is their most important area of focus. Governance also ranks high, as 37% said they prioritize governance issues. Social topics are often considered to be more amorphous and difficult to measure, which may contribute to the fact that only 12% of investors rate them as their top area of focus.

We see significant difference in the relative weightings of E, S and G across different geographies. Investors in North America (60%) and Asia (57%) report that they prioritize governance topics over both environmental and social. By contrast, investors in Europe, Australia and New Zealand place a greater emphasis on both environmental and social topics.

**Figure 14: What area of ESG gets the most attention?**



# 4. ESG drivers and future development

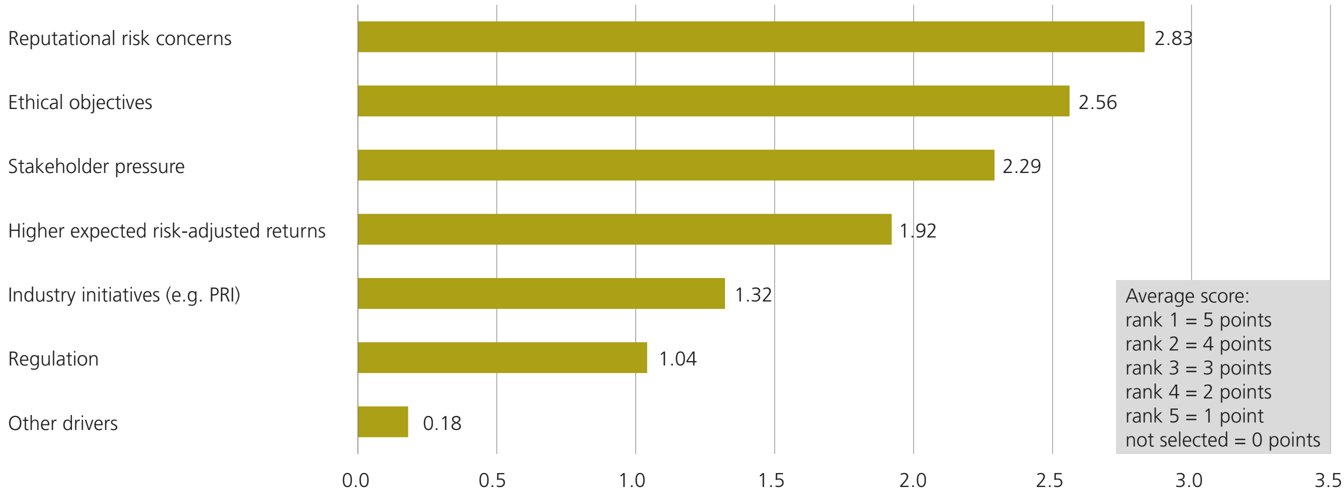
### The most important ESG drivers for investors

Investors face many different drivers leading them to incorporate ESG into their investment decision-making, so we wanted to know which ones were the strongest in their organizations. Reputational risk stands out as the most important one, followed by ethical objectives, stakeholder pressure and higher expected risk-adjusted returns (Figure 15). Undoubtedly, the growing importance of social media and a 24-hour news cycle keep reputational concerns at the forefront of investors' minds.

At the same time, ESG integration provides a comprehensive framework for identifying and mitigating many of the long-term risks that could damage investor and corporate reputations.

The relative strength of ethical objectives as a driver confirms the notion that a large proportion of investors see ESG as an effective way of linking investment decision-making to their values.

**Figure 15: What are the most important drivers of ESG integration?**



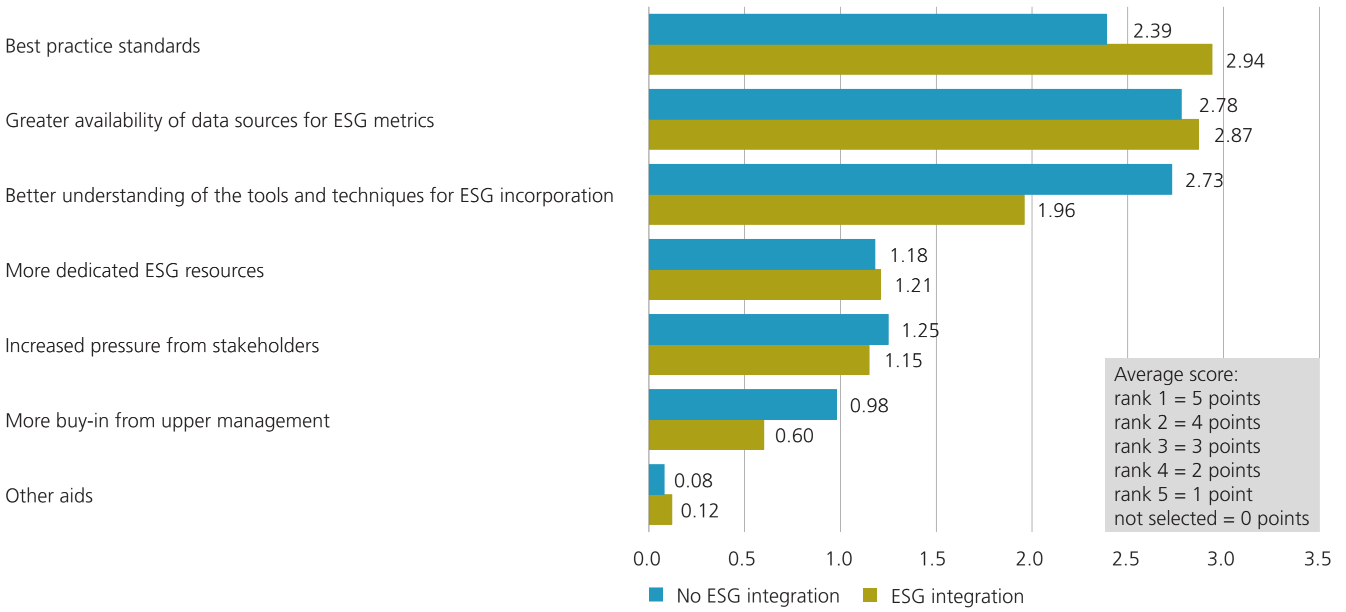
### How to deepen ESG considerations in investment decision-making

When investors think about what would help them most in developing their approaches to ESG, two things stand out: best practice standards and more data sources for measuring ESG (Figure 16). This is true both for those who already integrate ESG and those who may be considering doing so in the future. We hear this echoed in the discussions frequently taking place at ESG industry conferences, where ESG standards and sources of consistent, comparable data are often on the agenda.

Over the last several years, numerous investors and industry bodies have attempted to address both topics through a variety of research reports and guidance documents. One example of this is LGT CP's publication, "A Guide to ESG Implementation in Private Equity," which is a series of 12 case studies illustrating ESG best practice in private equity. Another example is the work that the Principles for Responsible Investment (PRI) has done in trying to address the lack of high-quality ESG data on privately held companies. Its publication, "ESG Monitoring, Reporting and Dialogue in Private Equity" seeks to move the discussion forward among private equity investors.

We see a sharp difference in views between investors who currently integrate ESG, and those who do not, on the subject of ESG tools and techniques. Those who are not yet active in ESG are much more likely to see a need for a greater ESG know-how. First steps for such investors could include exploring the wide array of ESG guidance documents available online from some of the major investor bodies, such as Invest Europe, Institutional Limited Partners Association (ILPA), the PRI and others.

**Figure 16: What would aid in the further integration of ESG into investment decision-making?**

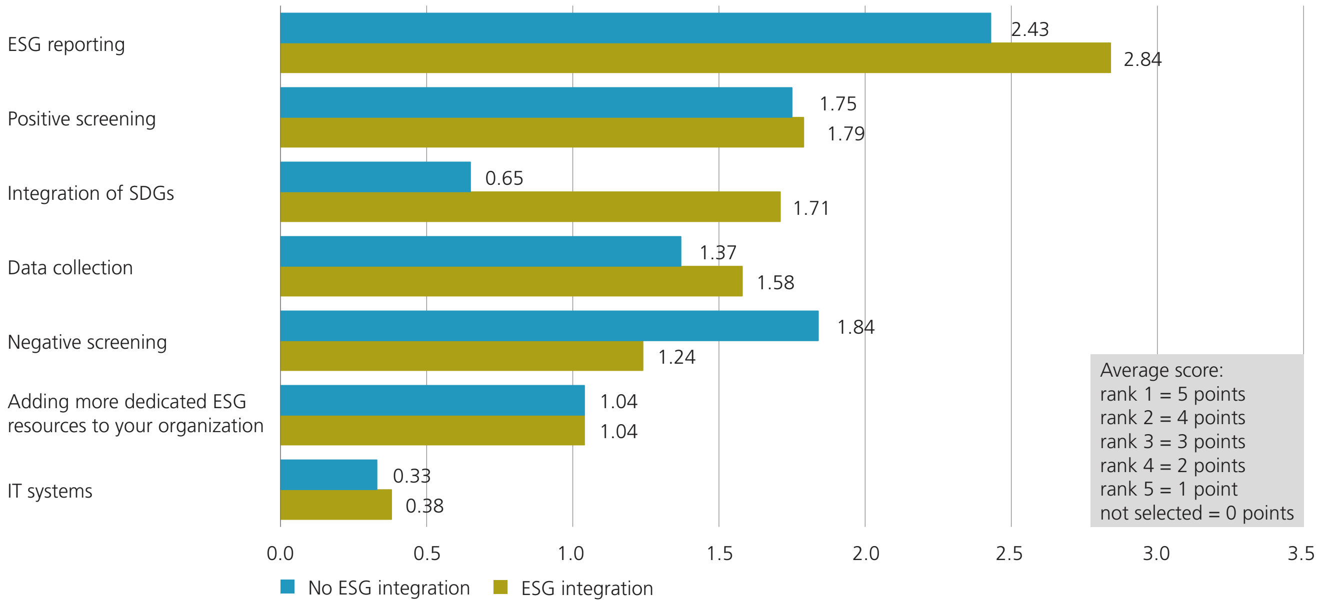


### Where investors are planning to enhance ESG practices

Investors see improving their reporting on ESG (Figure 17) as the top priority, which is no doubt connected to their need identified in Figure 16 for greater availability of ESG data sources. This is consistent with what we have seen in the ESG assessments we carry out each year on the managers who partner with us in private equity and liquid alternatives.[5] They typically begin their ESG journey by integrating ESG into their investment due diligence process and subsequent portfolio management, and they build up their reporting capabilities over time.

Interestingly, investors who do not yet integrate ESG criteria into their portfolios see the introduction of negative screening as one of the top two areas of focus for them, should they get active in ESG. While negative screening is sometimes viewed as "old fashioned" among those who are on the cutting edge of ESG integration, for many it is the logical starting point.

**Figure 17: Where are you planning to enhance ESG practices?**




[5] LGT CP ESG Report 2018

# Monitoring companies for reputational risk issues

Our study finds that investors' top motivation for integrating ESG considerations into their decision-making is the need to manage their reputational risk. High profile examples like Facebook, Uber and Volkswagen illustrate the potential for ESG controversies to cause sudden and dramatic damage to corporate reputations and valuations. Investors may have monitoring systems in place to detect such issues, but in many cases, the information used in these systems is self-reported by companies. Furthermore, in the case of private equity, the information comes with a significant time lag to the LP. For investors concerned about managing their reputational risk, these shortcomings limit the effectiveness of existing systems. The ideal approach would incorporate independent sources of information – especially on privately held companies – that identify emerging issues in real time.

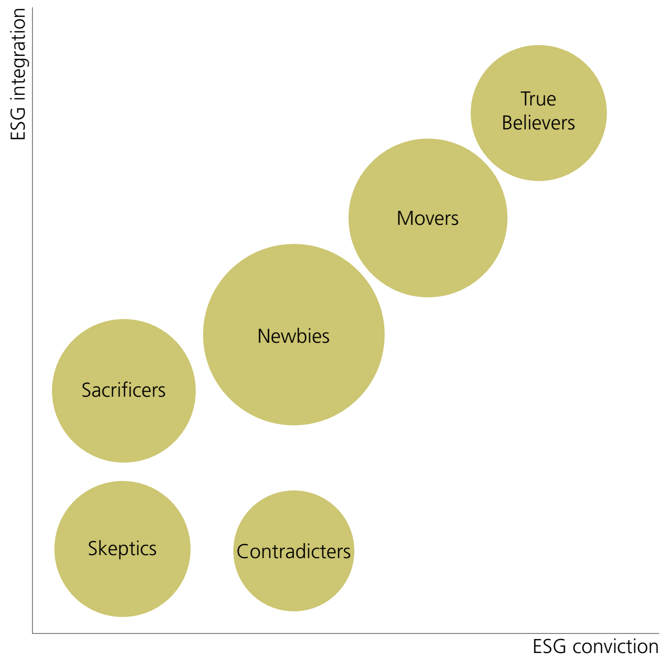
LGT CP addresses this concern by actively monitoring ESG controversies of investments with the help of a partner that has a proprietary solution for tracking more than 80,000 online information sources in 20 languages. It searches for ESG-related controversies documented in news websites, research firms, think tanks, government agencies, NGOs, regulatory agencies and more. Monitoring these sources helps to flag controversial ESG issues, ranging from allegations of environmental or social harm caused by the company to claims of corruption or other governance issues. The information provides timely insights on the ESG controversies that a company may face. It enables us to engage on issues as they emerge in order to minimize the reputational risk to investors.

# 5. ESG archetypes

The responses we have collected from more than 200 investors in 28 countries give us an opportunity to examine more than simply their answers to individual questions. We can also analyze the correlations between answers on various themes – such as ESG integration experience, decision-making relevance, ESG effect on risk-adjusted returns and level of stakeholder concern. Doing so enables us to create groupings of investors with similar views on these four themes, which provide a richer picture of ESG beliefs and practices.

Six different investor archetypes emerge from this analysis, as shown in Figure 18, where they are arranged according to their level of ESG integration and conviction. The size of the bubbles indicates the relative size of the groups, with the Newbies being the most numerous and the Contradicters being the fewest in number. Skeptics score lowest on ESG integration and conviction, while True Believers are the most enthusiastic embracers of the concept. In between the Skeptics and True Believers are four other types who have varying ESG views and practices.

**Figure 18: Six ESG archetypes**




### Key characteristics of the six archetypes

The six ESG archetypes represent a broad range of views and practices, but each one represents a fairly consistent set of thinking and actions on ESG. There are, however, a couple of archetypes with somewhat unusual characteristics, as we lay out below:

- **Skeptics** – As the name suggests, this group has the least engagement with the ESG topic. They have virtually no experience of integrating it into their investment activities, their stakeholders are not interested in it and ESG has little if any relevance to their investment decision-making. They are also convinced that ESG negatively impacts risk-adjusted returns.
- **Contradicters** – This group is similar to the Skeptics in their lack of ESG experience and the fact that they do not consider it in their investment decision-making. Unlike the Skeptics, however, they do register a degree of concern from stakeholders on ESG, but not enough to actually do anything about it. Curiously, they think that ESG has a positive effect on risk-adjusted returns, yet they choose to ignore it their decision-making.
- **Sacrificers** – These investors are almost the exact opposite of the Contradicters. In contrast to them, Sacrificers have some experience with ESG, and they say it is relevant to their decision-making. They are also convinced that ESG has a negative effect on risk-adjusted returns. So while Contradicters are self-consciously "leaving money on the table" by ignoring ESG considerations, Sacrificers are willingly giving up a certain amount of risk-adjusted return for the sake of ESG.
- **Newbies** – These investors have only recently begun integrating ESG into their investment activities, and they say it is relevant to their decision-making. They also have stakeholders who are concerned about it, but they do not think integrating ESG factors has any effect on risk-adjusted returns. It appears to be a group of investors who are taking their first steps on ESG and may not have enough experience to hold strong views on the risk-adjusted return question.

- **Movers** – This group is similar to the Newbies in terms of stakeholder concern and ESG relevance in their decision making, but they have more experience in integrating ESG. They appear to be on their way to becoming True Believers in a few years' time. Perhaps guided by their greater experience, they are convinced that ESG enhances risk-adjusted returns.
- **True Believers** – These investors have unequivocally embraced ESG, as it plays a significant role in their decision-making and they have stakeholders who are very concerned about it. They have significant experience with ESG, and they are convinced of its positive effects on risk-adjusted returns.

People active in ESG – or those considering their first moves – may encounter any number of these six ESG archetypes as they work to achieve their goals. The types can provide insights on the different ways of thinking about ESG, as well as the obstacles that investors may need to overcome to realize their ambitions.

**Figure 19: How the six archetypes compare**

| | ESG experience | Level of stakeholder concern | ESG decision-making relevance | Belief about ESG and risk-adjusted returns |
|---|---|---|---|---|
| Skeptics | None | None | Low | Negative effect |
| Contradicters | None | Medium | Low | Positive effect |
| Sacrificers | Medium | Medium | Medium | Negative effect |
| Newbies | Low | Medium | Medium | No effect |
| Movers | Medium | Medium | Medium | Positive effect |
| True Believers | High | High | High | Positive effect |

# 6. Investor views on the Sustainable Development Goals

The Sustainable Development Goals (SDGs) are a topic that has gained increasing attention in the last several years, with many investors exploring how to embed the goals into their ESG frameworks. The collection of 17 global goals was put forward by the United Nations and approved by 193 countries in September 2015. The SDGs address topics like poverty, hunger, health, education, climate change, gender equality, water, sanitation, energy, environment and social justice. Achieving them is estimated to require investment of USD 5 to 7 trillion per year until 2030.

Investors are increasingly turning to the SDGs in order to make their sustainable investment activities more outcome oriented. Until recently, ESG efforts have focused mainly on establishing policies and processes, as well as providing basic reporting, whether qualitatively or through a selection of ESG-related KPIs. Typically, there has been far less focus on how investment decisions impact the broader environment or society as a whole. Increasingly, investor stakeholders want to see how their capital is being used to affect the bigger picture. The SDGs enable them to do this because the goals allow investors to measure impact towards achieving targets that have been globally agreed and quantitatively defined.

> "Achieving the SDGs is estimated to require investment of USD 5 to 7 trillion per year until 2030."

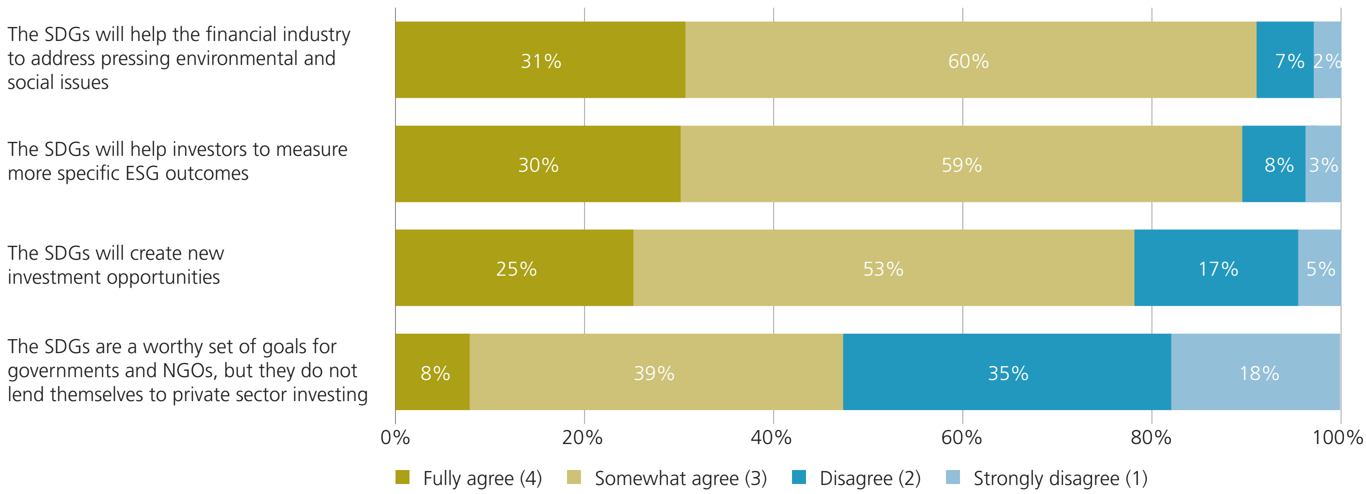
The complication is that the SDGs were never designed as an investment framework, but rather as a set of environmental and social goals defined by governments. Investors have the challenge of translating the goals into investable opportunities that offer the prospect of a financial return, as well as a positive impact on the SDGs. Some investors have already started translating the SDGs into their own investment frameworks, while others have started making SDG-targeted investments. In order to understand where alternative investors stand as a group, we asked survey respondents to tells us what they think about the SDGs and what they are planning to do.

### Expectations for the SDGs within the financial industry

The SDGs have only begun to gain significant traction among investors in the last two years. Our survey shows that most investors have high expectations for the goals, as 91% believe (Figure 20) that the SDGs will help the financial industry to address pressing environmental and social issues. At the same time, 89% think the goals will help investors to measure more specific ESG outcomes. A slightly smaller, but still significant, majority (78%), think the SDGs will create new investment opportunities.

By contrast, only a small minority (8%) strongly believe that the SDGs do not lend themselves to private sector investing, while 39% have some doubts over the usability of the SDGs for private sector investing. The relative pessimism of these latter two groups of investors suggests that there is still much work to do in order to align the goals with the investment industry and its sustainability practices.

**Figure 20: What are your expectations for the SDGs within the financial industry?**



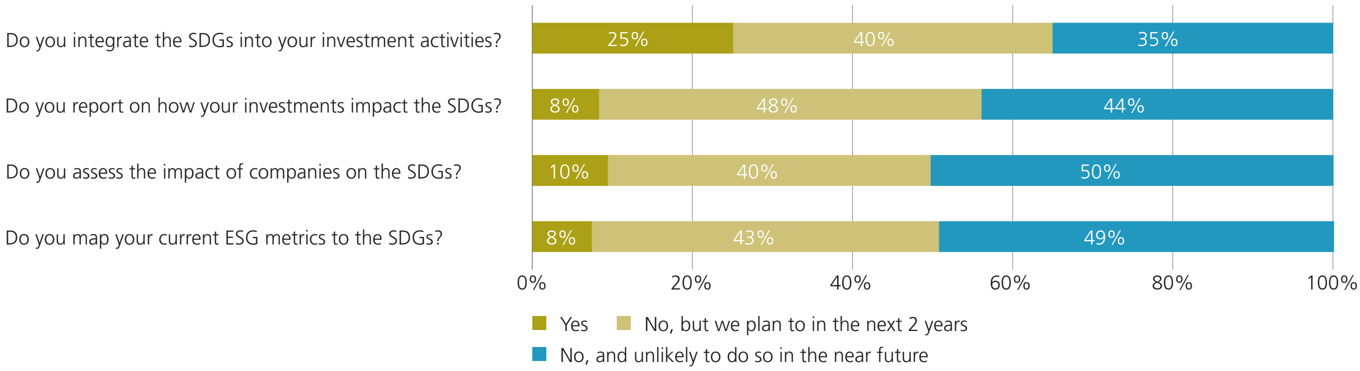
### SDG integration

Many investors have already taken concrete steps to help turn the promise of the SDGs into an investable reality. A quarter of them integrate the goals into their investment activities in some way, as seen in Figure 21, while 8% say they are already reporting on their SDG impact. Even more telling is the large proportion of investors who are planning to start integrating (40%) and reporting (48%) on the SDGs in the next two years. If the investors surveyed in our study realize their ambitions, nearly half of them will be both integrating and reporting on the SDGs within the next two years.

The survey also shows that investors are grappling to find the right approach to incorporating the goals into their investment processes. Only 10% said they assess the impact of investee companies on the SDGs, while even fewer (8%) map their existing ESG metrics to the SDGs. As the two approaches represent basic starting points for SDG integration, it begs the question of exactly how they are doing it. The answer may lie in the 40% or more of investors who say they plan on starting such activities in the next two years. It appears that SDG integration is in its early days and approaches are still being defined.

These numbers are broadly in line with what we at LGT CP have seen in the market, where many investors are talking about the SDGs, and some are defining taxonomies or mapping their existing investments to the goals. This is a start, but it is also clear that investors foresee hurdles to putting significant amounts of capital behind the goals.

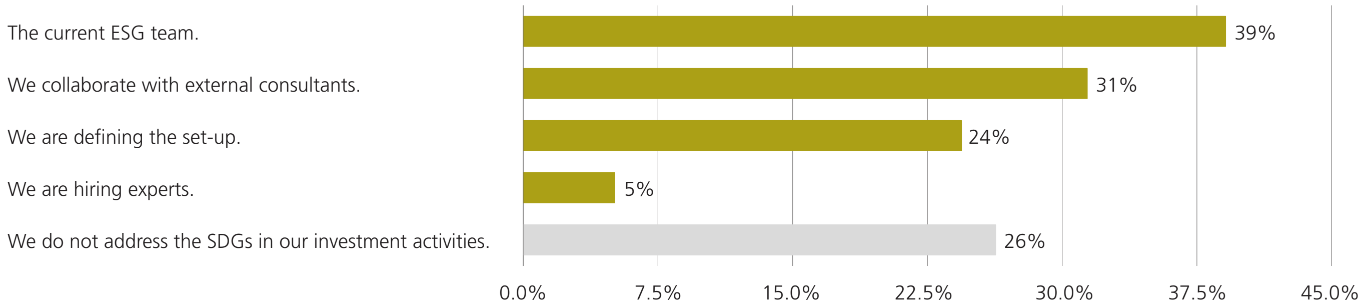
**Figure 21: How are you integrating the SDGs?**



### Resources used to address SDGs

A significant proportion of investors (39%) are using, or planning to use, their current ESG team to address the SDGs (Figure 22), while many others (31%) are collaborating with external consultants. The fact that a quarter of investors said they are still defining the set-up is a further reflection of the reality that many investors are still very early in their engagement on the SDGs. In line with this, data providers like MSCI, ISS Oekom and Refinitiv (formerly Thomson Reuters) have all launched solutions for assessing public companies on their SDG impact.

**Figure 22: What resources do you use to address the SDGs?**



## The most important SDGs for investors

Like we saw in section 2 of this report, where investors have a strong focus on certain environmental topics, they also show distinct preferences for select SDGs. Climate Action (Goal 13) is far and away the single most important SDG for all investors (Figure 23), just as climate change was the most important topic in section 2. This is also reflected in the proportion of investors who ranked Climate Action as their highest priority SDG to address (Figure 24). Closely related to this, they have strong interest in Goal 7, Affordable and Clean Energy, which focuses on solutions related to Climate Action. Goals relating to clean water, health, well-being and education also attract significant interest from investors.

If there is a common denominator in investors views on the SDGs, it is a preference for goals that can be linked to a specific investment thesis or set of opportunities. For example, it is easy to imagine investments in companies or infrastructure projects that will deliver clean energy or water, healthcare solutions, educational opportunities or productions systems with smaller environmental footprints. By contrast, goals such as Peace, Justice and Strong Institutions (Goal 16) are not readily investable, while others, such as Life Below Water (Goal 14) and Life on Land (Goal 15) have a significant focus on conserving and protecting specific types of ecosystems. Investment opportunities related to such activities may be more indirect, making it difficult for investors to incorporate them into their investment decision-making.

**Figure 23: What are the most important SDGs for you?**

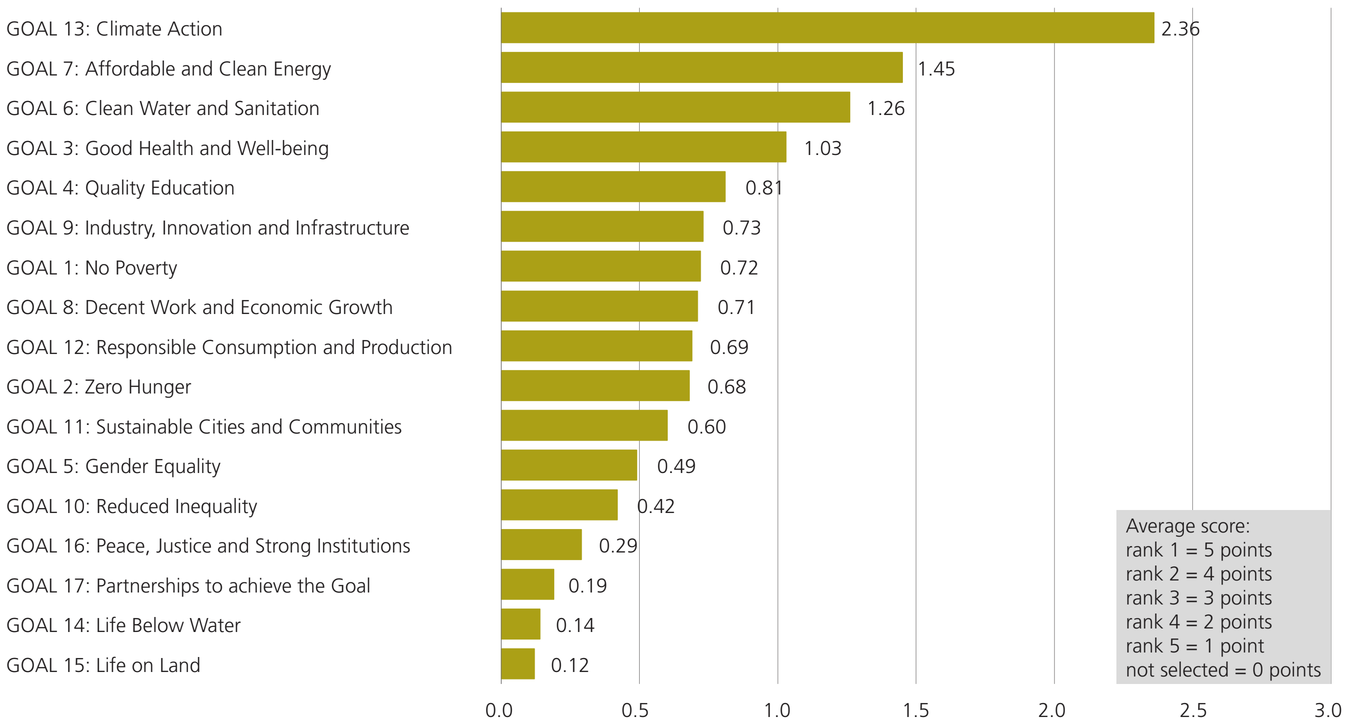
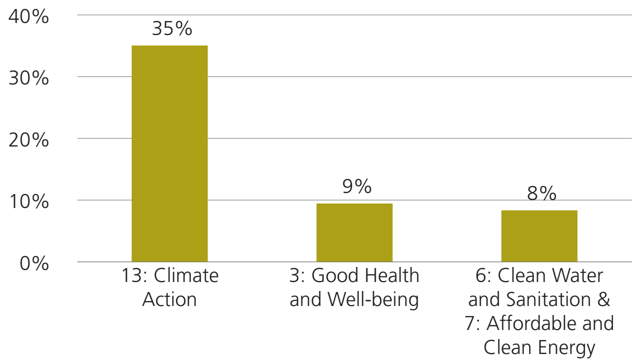



**Figure 24: What is your number one SDG?**



# From SDG ambition to practice

## Hurdles to overcome

Our investor survey shows that 90% of investors think that the SDGs will enable the financial industry to address pressing environmental and social issues, while also helping them to measure more specific ESG outcomes. Nevertheless, few (10%) actually assess the impact of companies on the SDGs and even fewer (8%) report on this impact. It suggests that investors are embracing the SDGs in principle, but in practice, most have done little to integrate them in a meaningful way into investment decision-making.

In our experience, investors face two main hurdles to making the SDGs investable: the complexity of integrating them into their existing investment processes and the lack of accurate and consistent data for measuring impact. One aspect of complexity is the fact that the 17 goals are interrelated, such that positively supporting one SDG can lead to another goal being negatively influenced. For example, an investment that helps to foster Decent Work and Economic Growth (Goal 8) might also result in a new carbon footprint or draw on scarce natural resources, to the detriment of Goal 13 (Climate Action) or Goal 12 (Responsible Consumption and Production).

An investor may also struggle to source accurate and consistent data for assessing even the seemingly most straightforward of metrics, carbon emissions. For example, the investments under consideration might measure carbon emissions over different time periods or may include different scopes (1, 2 or 3) of emissions. Furthermore, some emissions reported may cover all business activities of an investment, while others may include only a selection of activities.

## Overcoming the hurdles

We recognized these challenges when designing an approach for integrating the SDGs into LGT CP's ESG Cockpit, a proprietary system for assessing public companies on their ESG attributes. As we see it, an essential requirement of any solution is the ability to assess both the positive and negative impacts of companies' products and services on the SDGs. Towards this end, we sourced a consistent and comparable set of data from one of the large data providers, and we sorted it into approximately 300 different categories of products and services, covering broadly all of the possible business activities of listed companies.

For each of these 300 categories, we attributed an SDG impact score, on a scale of -10 to +10, based on our assessment of how each product or service impacts each of the 17 SDGs. To use a very simple example, a company that produces renewable energy will have an impact score +10 on Climate Action (Goal 13), whereas coal-fired energy production will have a score of -10. The same company may have different impacts on other SDGs, and these too can be calculated by mapping the various product/service categories to their respective SDG impact.

We can multiply the proportion of revenue that a company generates from each product or service by the corresponding impact score. This results in a weighted average impact score for each company on each SDG. Figure 25 illustrates how to calculate the total SDG impact of our energy company example, based on three energy product categories: renewable, hydro-electric and coal-fired.[6] The resulting weighted average impact score for the company is 1.19, which can be considered its "SDG footprint" on Climate Action. This, in turn, can easily be aggregated to show the impact of an entire portfolio.

The approach described here is a relatively straightforward and simplified example of how an investor can integrate the SDGs into their investment process. Each investor will have their own specific hurdles to overcome, depending on their current investment processes and tools. Whatever their specific challenges, an investor can make a good start by securing a consistent data set, which allows an investor to understand both the positive and negative SDG impacts of their decisions.

**Figure 25: Assessing an energy company's impact on Climate Action (Goal 13)**

| Product category | Impact measure | x | Revenue share (% of revenue) | = | Contribution to total impact |
|---|---|---|---|---|---|
| Energy production (renewable) | 10 | | 32.0% | | 3.20 |
| Energy production (hydro) | 3 | | 13.0% | | 0.39 |
| Coal-fired energy generation | -10 | | 24.0% | | -2.4 |
| | | | | | **1.19** |

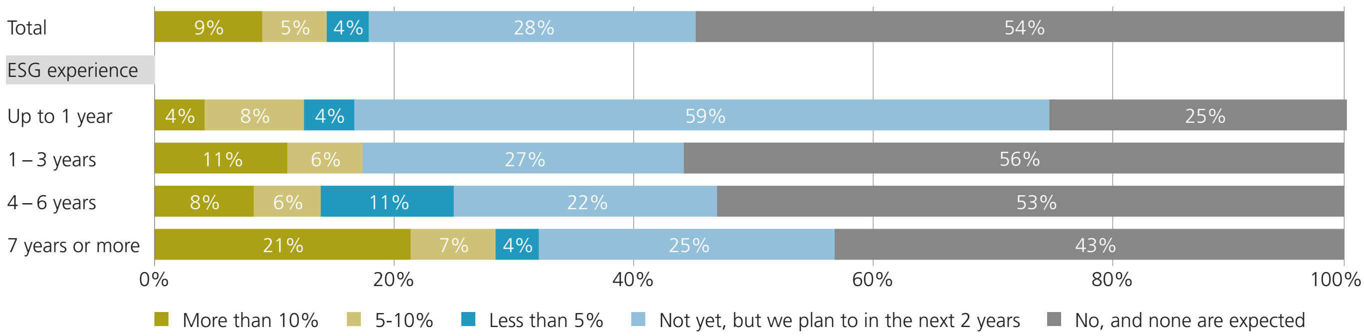
[6] Revenues pertaining to one specific SDG do not comprise 100% of company revenues

## Target allocations for impact or SDG-related investments

Investors can approach the SDGs in different ways, whether by integrating specific SDG targets into existing portfolios, or by earmarking new capital for impact or SDG-related investments. For those wishing to understand the level of commitment to the SDGs, investor allocation intentions can shed light on the matter. As Figure 26 shows, a significant proportion of investors (18%) already have impact or SDG-related allocation targets, and another 28% plan to have them in the next two years. If these plans materialize, it will bring significant new capital to bear on realizing the SDGs.

We also see that the proportion of investors willing to make specific impact or SDG-related allocations increases significantly with experience. The most experienced ESG investors (seven years or more) in our sample are twice as likely, 32% versus 16%, to have such allocations as those who are new to ESG (up to one year).

**Figure 26: Do you have specific target allocations to impact or SDG-related investments?**



# 7. Conclusions

In this study, we have explored the views of 207 investors in alternatives on ESG and the SDGs. We have seen a snapshot of current practices and beliefs and have gotten a glimpse of the road ahead for future developments.

We learned that the vast majority of investors (75%) say they integrate ESG into their investment activities, and just over half say that it is relevant to decision-making. Slightly less than half demonstrate their conviction through a willingness to decline investments in managers over ESG concerns.

Among this global group of investors, views vary on the effect of ESG considerations on risk-adjusted returns. A full 84% of investors believe that integrating ESG has either a positive or neutral effect on risk-adjusted returns, while a small minority (16%) think that ESG entails a sacrifice in risk-adjusted returns.

When integrating ESG factors into their decision-making, investors have to prioritize the ESG topics that are most important to them. Among environmental concerns, climate change stands out as the top issue among investors, by a wide margin. They hold more diverse views on social factors, with human rights, controversial weapons and child labor attracting similar levels of concern. For governance, bribery and corruption is the single most important issue among investors.

When asked about tools or resources that could help to deepen ESG analysis in their investment decisions, respondents cited best practice standards and better data sources as the most important aids. Closely related to this, investors say they will focus on enhancing their reporting practices in the near future, which underscores the need for high-quality sources of ESG data.

As investors increasingly turn to the SDGs to make their sustainable investment activities more outcome oriented, they have high expectations for the goals. A full 91% of investors believe that the SDGs will help the financial industry to address pressing environmental and social issues. At the same time, there is a significant gap between expectations and current practice, as only 10% of investors currently assess the impact of investee companies on the SDGs.

Looking ahead at how investors are likely to adopt the SDGs in their investment practices, it is clear that Goal 13, Climate Action, will be their top priority. This mirrors their priorities for ESG as a whole, where climate change stands out above all others. Overall, we see a preference for individual SDGs that can be linked to a clear investment thesis or opportunity.

We expect investor allocations to impact or SDG-related investments to grow significantly going forward. While 18% of investors currently have such allocations, an additional 28% intend to make them in the next two years.

We at LGT Capital Partners look forward to embracing the opportunities that emerge as ESG and the SDGs continue to evolve. The road ahead points to a challenging but productive journey.

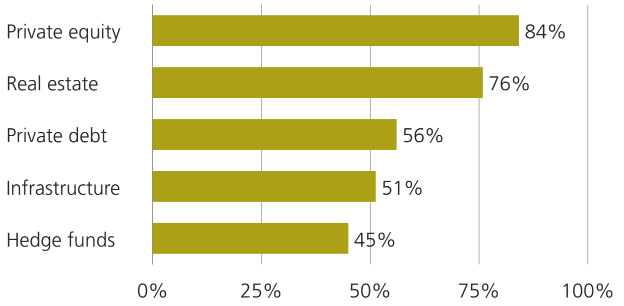
# 8. Survey participation

Our ESG survey of investors in alternatives included 207 participants from 28 countries, who invest in private equity, real estate, private debt, infrastructure and hedge funds. They shared their views on the role of ESG in investment decision-making, the top ESG issues, their motivations for ESG integration and their priorities for the future, including for the SDGs.

**Figure 27: Countries represented**

| | |
|---|---|
| Andorra | Italy |
| Australia | Japan |
| Austria | South Korea |
| Bahrain | Kuwait |
| Belgium | Liechtenstein |
| Brunei | Malaysia |
| Canada | Netherlands |
| Chile | New Zealand |
| Denmark | Norway |
| Finland | Russian Federation |
| France | Sweden |
| Germany | Switzerland |
| Hong Kong | United Kingdom |
| Iceland | United States |

**Figure 28: Percentage of participants investing in various asset classes**



Survey participants represent a wide variety of investor types, including pension funds, endowments, insurers, investment managers, banks and others. They are also largely senior investment decision-makers, with the most numerous being portfolio managers/heads of asset class or CIOs/CEOs.

Participants also represent institutions of all different sizes, ranging from less than USD 3 billion in assets under management to more than USD 50 billion.

**Figure 29: Investor roles**

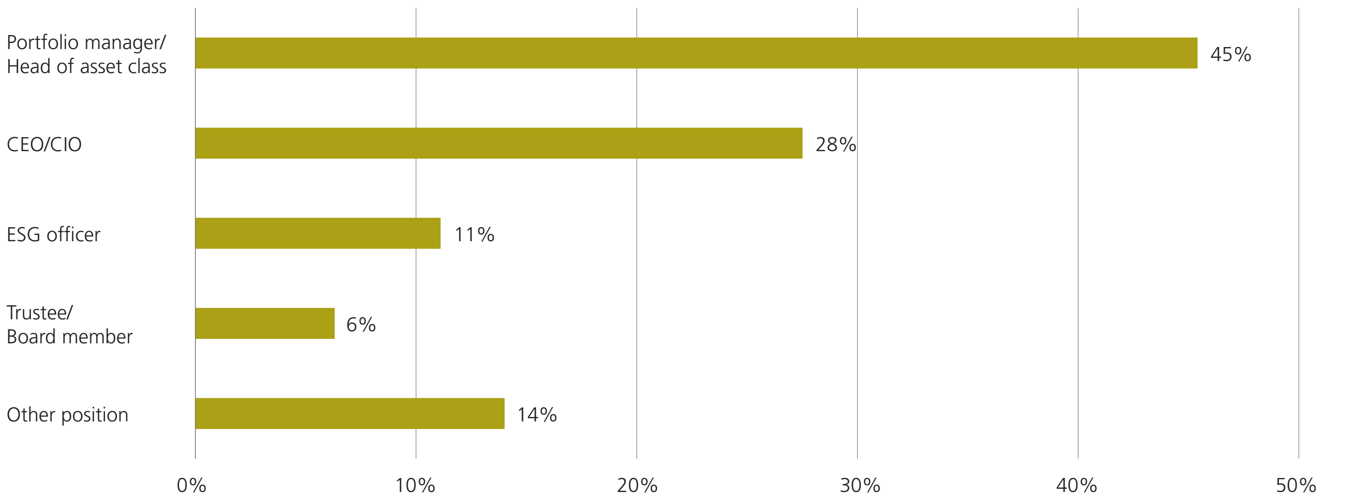



**Figure 30: Investor types**

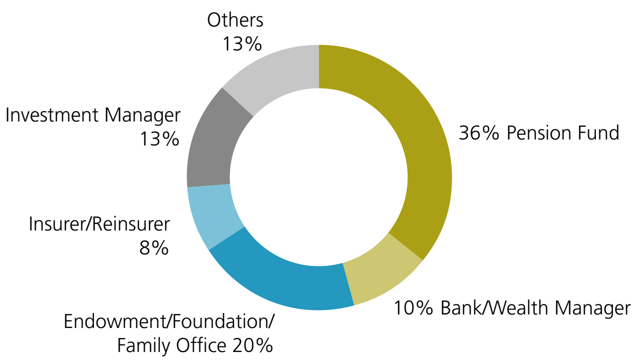
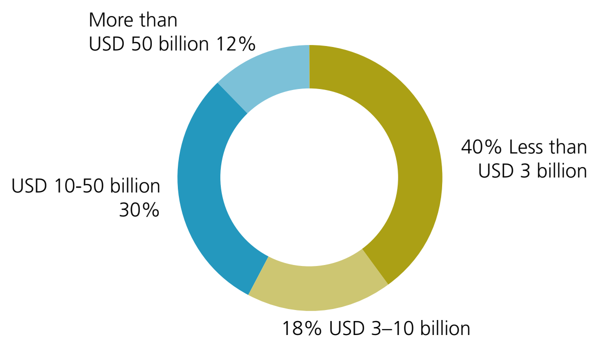



**Figure 31: Assets under management**



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