Time for action?
The role of sustainable investment in bridging the SDG financing gap

July 2023

First Sentier MUFG
Sustainable Investment Institute

About the Institute

The First Sentier MUFG Sustainable Investment Institute (the Institute) provides research on topics that can advance sustainable investing. As investors, both First Sentier Investors and MUFG recognise our collective responsibility to society and that investment decisions should be made with consideration to our communities both now and in the future.

The Institute commissions research on Environmental, Societal and Governance issues, looking in detail at a specific topic from different viewpoints. The Institute recognises that investors are now looking in far greater depth, and with far greater focus, at issues relating to sustainability and sustainable investing. These issues are often complex and require deep analysis to break down the contributing factors. If as investors we can better understand these factors, we will be better placed to consider our investment decisions and use our influence to drive positive change for the benefit of the environment and society.

The Institute is jointly supported by First Sentier Investors (FSI) and Mitsubishi UFJ Trust and Banking Corporation, a consolidated subsidiary of MUFG. Representatives of both organisations will provide input to the activities of the Institute.

An Academic Advisory Board advises the Institute on sustainability and sustainable investment research initiatives. The Academic Advisory Board comprises prominent leaders from academia, industry and nongovernmental organisations in the fields of Responsible Investment, climate science and related ESG endeavours. The Board provides independent oversight to ensure that research output meets the highest standards of academic rigour.

Contact

Institute@firstsentier.com

firstsentier-mufg-sustainability.com

mufg-firstsentier-sustainability.jp

Acknowledgements

The Institute would like to thank Prof Norichika Kanie from Keio University Graduate School and the main contributors to this publication: Arisa Kishigami, Dr Rory Sullivan from Chronos Sustainability, and Elena Zharikova (SII).

About Chronos Sustainability

The Institute commissioned Chronos Sustainability to support the development of this report. Chronos Sustainability was established in 2017 with the objective of delivering transformative, systemic change in the social and environmental performance of key industry sectors through expert analysis of complex systems and effective multi-stakeholder partnerships. Chronos works extensively with global investors and global investor networks to build their understanding of the investment implications of sustainability related issues, developing tools and strategies to enable them to build sustainability into their investment research and engagement. For more information visit chronossustainability.com and @ChronosSustain

About the Institute's sponsors

About First Sentier Investors

First Sentier Investors (formerly First State Investments) is a global asset management group focused on providing high quality, long-term investment capabilities to clients. We bring together independent teams of active, specialist investors who share a common commitment to responsible investment and stewardship principles. These principles are integral to our overall business management and the culture of the firm.

All our investment teams – whether in-house or individually branded – operate with discrete investment autonomy, according to their investment philosophies.

firstsentierinvestors.com

About MUFG

Mitsubishi UFJ Financial Group, Inc. (MUFG) is one of the world's leading financial groups. Headquartered in Tokyo and with over 360 years of history, MUFG has a global network with approximately 2,100 locations in more than 50 countries. The Group has about 160,000 employees and offers services including commercial banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing. The Group aims to "be the world's most trusted financial group" through close collaboration among our operating companies and flexibly respond to all of the financial needs of our customers, serving society, and fostering shared and sustainable growth for a better world. MUFG's shares trade on the Tokyo, Nagoya, and New York stock exchanges.

mufg.jp/english

About the Trust Bank

Mitsubishi UFJ Trust and Banking Corporation, as a core member of MUFG, provides its customers with a wide range of comprehensive financial solutions leveraging unique and highly professional functions as a leading trust bank. Such financial solutions include real estate, stock transfer agency, asset management and investor services, and inheritance related services, in addition to banking operations. We aim to realize our vision to be the trust bank that creates "a safe and affluent society" by always supporting our customers' and society's challenges based on Trust, and thus created a new key concept: "Create a Better Tomorrow". First Sentier Investors was acquired by the Trust Bank in August2019.

tr.mufg.jp/english

Executive Summary

The UN Sustainable Development Goals (the SDGs) are the centrepiece of global efforts to address global developmental challenges and to promote a sustainable future. However, to date the progress on achieving the SDGs has been limited by the availability of capital. While at the time of launch the 2014 World Investment Report estimated that a total annual investment of between US$5 trillion and US$7 trillion was needed to achieve the SDGs, in 2022, the OECD (Organisation for Economic Co-operation and Development) estimated the financing gap was approximately US$3.9 trillion.

As sustainable development becomes more important, awareness of the importance of considering environmental and social factors in investment behaviour has also been growing, and the global assets under management utilizing sustainable investment strategies was estimated to be approximately US$35 trillion in 2020. Whilst these two approaches appear to be correlated at first glance, the potential role of sustainable investment strategies in closing the SDG financing gap has been unclear to date.

This report clarifies the current state of play in efforts made to achieve the SDGs and the existing financing gap, and then reviews the role institutional investors can play. Its main conclusions are that:

The long-term stability and increase in asset value that institutional investors aim for are dependent on elements that are also included in the SDGs, such as access to a healthy and educated workforce by the company or project in which they invest, or a stable climate and high-quality infrastructure that allows for business development. In other words, for institutional investors, contributing to the SDGs may lead to the sustainable growth of their investee companies, as well as leading to higher financial returns on their investments. Therefore, investing in ways to achieve the SDGs is considered to be consistent with the fundamental objectives of institutional investors.

However, there are several challenges for institutional investors to fulfil the role in closing the financing gap to achieve the SDGs. To reduce these challenges, clear and coordinated policy support at the national and regional level is needed. Specifically, this includes de-risking investments into lower-income countries, strengthening the alignment of national and regional sustainable finance policies with the SDGs, integrating the SDGs into national stewardship codes, and promoting ownership of the SDGs in the financial industry. One of the roles institutional investors can play is to engage in dialogue with policy makers to encourage the introduction and development of such policies.

In addition to engaging with policymakers, investors can contribute to achieving the SDGs through their own investment activities. Specifically, after explicitly committing to incorporating the SDGs into their investment strategies, individual or collaborative engagement with investee companies in line with the SDGs, impact investing through private equity and green bonds, and sustainable infrastructure investment are some of the effective methods to consider.

Given the magnitude of the challenges faced in building a sustainable future as represented by the SDGs, and the diversity of investment approaches and assets, it is important for institutional investors to consider a range of actions. The goal of this report is to summarize these potential actions in a "Call for SDG-aligned Investor Action" to help encourage such action.

Introduction

The start of the 21st century saw sustainable social and economic activities (hereafter sustainability) as a rising part of the landscape for public and private stakeholders. The Sustainable Development Goals (the SDGs) were adopted by the UN in 2015 in order to facilitate action on global developmental challenges and promote a sustainable future, building on the progress made towards the Millennium Development Goals in the previous decade. The SDGs recognised the importance of taking effective action to protect the environment and respond to climate change, while also supporting social inclusion (a vision of protecting all people from loneliness, isolation, exclusion and conflict, leading to a healthy and cultured life) and sustainable economic development. In addition to the national governments which led the development of the MDGs, multiple stakeholder groups, including the private sector, were involved in developing the SDGs.[1]

Figure 1.

1 Source: https://sdgs.un.org/goals

In the same period, awareness around the importance of incorporating environmental and social factors into investment activities from a long term perspective has also increased, and "sustainable investment" became a key focus for investment practices. This is evidenced by both the asset allocation and commitments made by institutional investors globally, and the introduction of voluntary and mandatory legal frameworks to support such sustainable investment and lending activities (hereafter, sustainable finance). The World Investment Report 2014 estimated that a total annual investment between US$5 trillion and US$7 trillion was needed to achieve the SDGs, but as of 2022, the OECD estimates the financing gap to be approximately US$3.9 trillion.[2]

Closing this gap is urgently needed in order to achieve the SDGs. At the same time, global assets under management based on a number of sustainable investment strategies were estimated to be around US$35 trillion as of 2020.[3] At first glance, sustainable investment strategies appear to be correlated with achieving the SDG, but despite the growing market share, to date there has been limited evidence of whether this market has or can fill the SDG financing gap.

The contents of the report include:

- **Section 1** - Review of the current status of SDGs delivery and financing gap
- **Section 2** - Review of policy measures needed to address some of the key challenges to mobilising private capital towards SDG achievement
- **Section 3** - Clarifying the position of SDG financing within the broader context of 'sustainable investment'
- **Section 4** - A "Call for Action" which highlights the key steps institutional investors may consider to better align their actions with their commitments to the SDGs

2023, the year of publication of this report, marks the midpoint of the 15 years of efforts being made towards achieving the SDGs. This report reviews the current status and challenges of achieving the SDGs and provides recommendations for specific actions by institutional investors, who are important stakeholders in the road to achieving of the SDGs.

2 UNCTAD (2014), World Investment Report 2014: Investing in the SDGs: An Action Plan and OECD (2022), Global Outlook on Financing for Sustainable Development 2023: No Sustainability Without Equity
3 GSIA (2021), Global Sustainable Investment Review 2020

1. Identifying the SDG Gap

SDG delivery gap

In 2019, the SDG Summit issued a call for a ‘Decade of Action’, aiming to mobilise stakeholders in an effort to overcome the barriers to achieving the SDGs by 2030 deadline.
Four years on, in the wake of the Covid-19 pandemic, and in the face of increasing geopolitical tensions and concerns about global economic growth, the urgency is even greater. The Sustainable Development Report 2022 shows that, for the second year, there was no positive progress towards SDGs, and that progress on some goals such as SDG1 (No Poverty) and SDG8 (Decent Work & Economic Growth) was actually reversed.

One of the key issues is the unequal distribution of capital investment in public services and infrastructure, with most investment occurring in high-income countries but with the greatest needs being in lower-income countries.[4] The UN Sustainable Development 2022 report also highlights how unsustainable trade and supply chains by one market could lead to negative socioeconomic and environmental impacts (known as “spill overs” by the UN) in other markets, and the need for global coordination and cooperation to achieve the goals at a global level.

Another key issue to be aware of is that progressing one aspect of sustainable development can cause negative consequences for another. For example, advancing SDG 1 (No Poverty), SDG 2 (Zero Hunger), or SDG 8 (Decent Work & Economic Growth) can cause increases in GHG emissions coming into conflict with SDG 13 (Climate Action). Consideration of synergies and trade-offs (including the mitigation strategies for addressing unavoidable trade-offs) should form the foundation of SDG-aligned investment and policymaking.

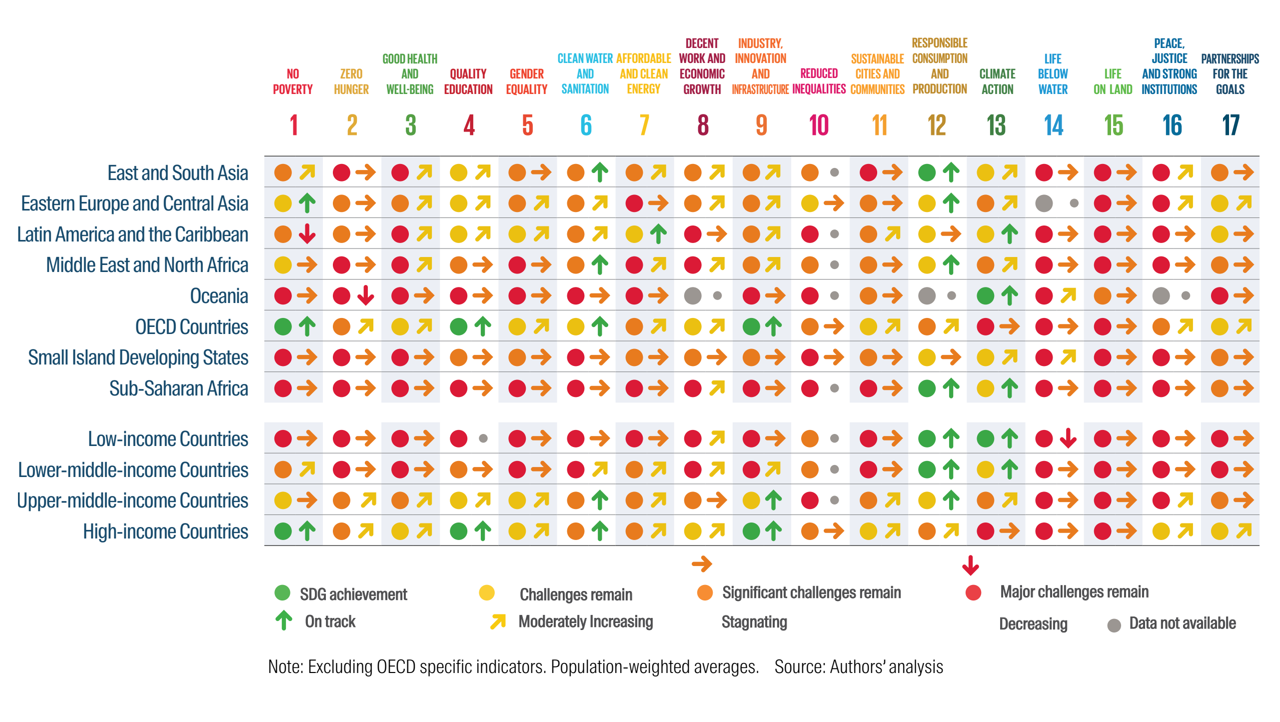
In the investment context, this could be achieved by complimenting the focus on positive contributions to particular Goals with a ‘do no significant harm’ principle covering the remaining SDGs. The approach taken by the EU Taxonomy, or the Sustainable Finance Disclosure Regulation (SFDR) could be referenced. The UNDP SDG Impact Standards[5] is an example of a framework offering a holistic approach to SDG integration which can also be referenced.

4 Sachs et al. (2022), From Crisis to Sustainable Development: the SDGs as Roadmap to 2030 and Beyond. Sustainable Development Report 2022. Cambridge: Cambridge University Press
5 https://sdgimpact.undp.org/practice-standards.html

The graph below (Figure 2) illustrates the progress on SDG achievement across the regions and country income groups as of 2022. Looking at the prevalence of the red dots, representing major challenges to achievement of a particular Goal, it is evident that no group of countries is on track to meet all 17 SDGs. At the same time, the distribution of red is uneven: between the regional groupings, Sub-Saharan Africa, Oceania and Small Island Developing States experience the most challenges. Regarding the income categories, the largest achievement gap lies in low-income and lower-middle income countries.

Next we will outline the financing challenges in more detail, which will provide a background for further discussion of policy measures and the role of sustainable investment in bridging the gaps.

Figure 2. 2022 SDG achievement trends by region and income group



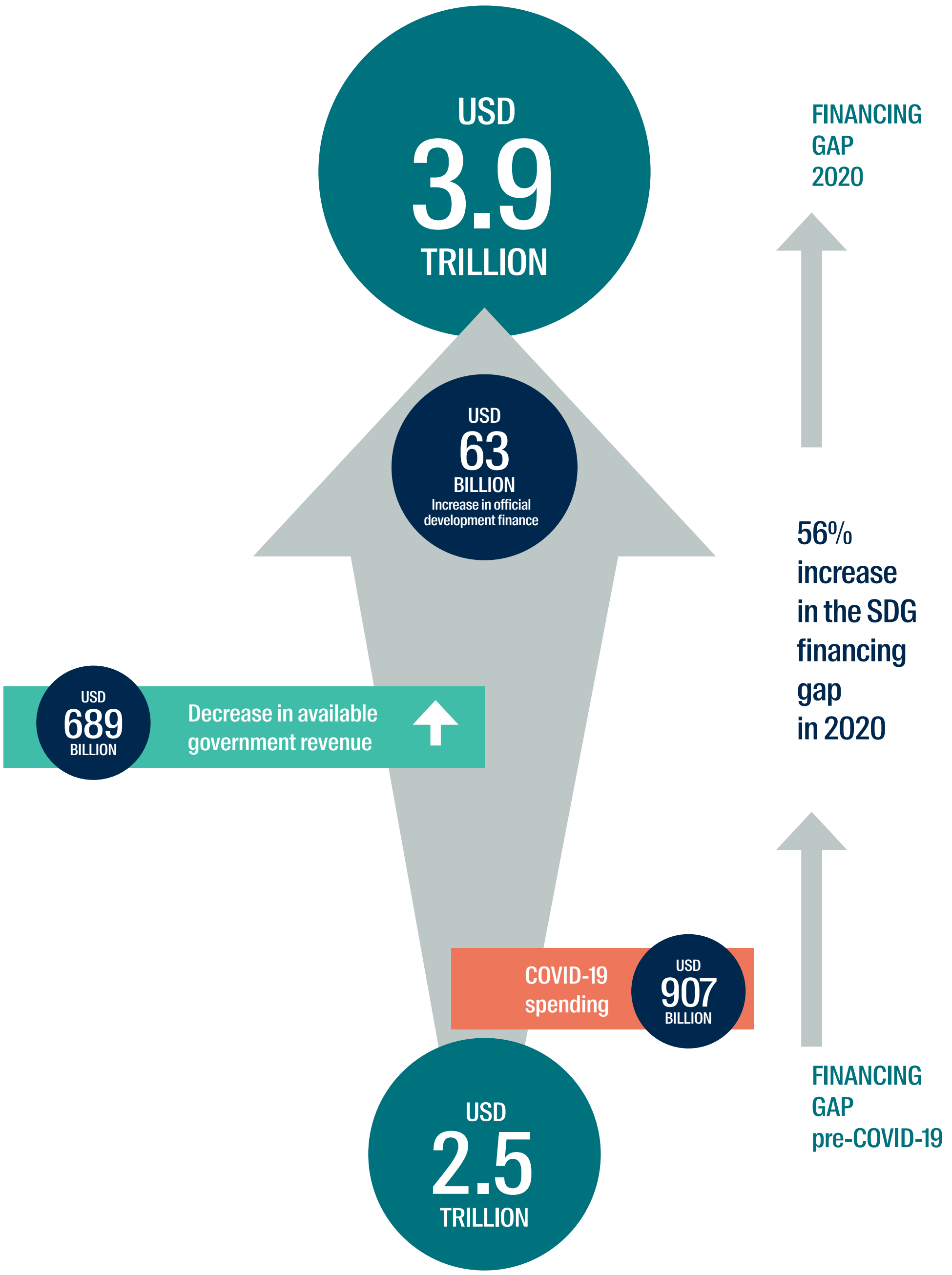
Source: the Sustainable Development Report 2022

Looking at the prevalence of the red dots, representing major challenges to achievement of a particular Goal, it is evident that no group of countries is on track to meet all 17 SDGs

SDG financing gap

As mentioned earlier, when the SDGs were originally being developed, total annual investment needs were estimated at a global level between US$5 and US$7 trillion. In lower-income countries where much of these needs stem, in order to achieve the 2030 target, annual investment needs in SDG-relevant sectors were estimated at between US$3.3 and US$4.5 trillion.[6] Compared with the US$1.4 trillion inflows in these sectors from all investment sources, the remaining annual investment gap was placed at around US$2.5 trillion. While investment in these sectors have increased over time, it has failed to catch up with the projected financing requirements, resulting in the continuously expanding financing gap. In 2022, by OECD estimation, the gap rose to $3.9 trillion.[7]

Figure 3. Growing SDG financing gap



Source: OECD, Global Outlook on Financing for Sustainable Development 2023: No Sustainability Without Equity

6 UNCTAD (2014), World Investment Report 2014: Investing in the SDGs: An Action Plan; according to UNCTAD, the SDG-relevant sectors include power, transport, telecommunications, water and sanitation, food security and agriculture, climate change mitigation, climate change adaptation, eco-systems/biodiversity, health, and education.
7 OECD (2022), Global Outlook on Financing for Sustainable Development 2023: No Sustainability Without Equity

Contribution from all investment sources (public and private, domestic and international) is necessary to close the SDG financing gap. To date, lower-income countries in particular have relied on public funds for much of their financing, however, the limits of these sources of funding are becoming apparent. Low tax revenues and a combination of increasing public debt and debt servicing costs are among the factors restricting the public resources that the lower-income countries can dedicate to achieving the SDGs. Public finance, alongside all other financing sources, was further strained by the effects of the pandemic such as economic decline and the resulting loss of tax revenue.[8]

One way to alleviate the pressure on public financial resources of lower-income countries could be by increasing private sector investment in the key SDG-relevant sectors to closer match the levels shown by high-income countries. The figure below shows the proportion of private sector investments in different markets, to highlight where investments could be raised in lower-income countries to match that in high-income countries.[9]

Figure 4. Private sector investment in SDG-relevant sectors

Sector	Average private sector participation (%)	
	Developing countries	Developed countries
Power	40–50	80–100
Transport	30–40	60–80
Telecommunications	40–80	60–100
Water and sanitation	0–20	20–80
Food security and agriculture	~75	~90
Climate change mitigation	~40	~90
Climate change adaptation	0–20	0–20
Eco-systems/biodiversity	Data not available	
Health	~20	~40
Education	~15	0–20

Source: adapted from UNCTAD, World Investment Report 2014

8 OECD (2020), Global Outlook on Financing for Sustainable Development 2021: A New Way to Invest for People and Planet, OECD Publishing, Paris
9 UNCTAD (2014), World Investment Report 2014: Investing in the SDGs: An Action Plan

The private sector has already been playing a part in SDG financing. According to OECD, almost US$300 billion was mobilised from the private sector over the previous decade (2012-2020). This funding has been shown to mostly contribute to SDG 8 (Decent Work and Economic Growth), SDG 10 (Reduced Inequalities), SDG 13 (Climate Action), SDG 9 (Industry, Innovation, Infrastructure) (order by contribution size).[10] However, there is space for greater contribution. Recent UNCTAD data shows that international private inflows in some of the SDG-relevant sectors have been deteriorating:

Figure 5. SDG investment gaps and directional trends

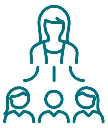
Table V.1. Summary of SDG investment gaps and directional trends

Main investment requirements	Most relevant SDGs	UNCTAD estimated annual investment gaps (Billion of dollars)	Overall SDG investment trends	International private sector investment trends
POWER (excl. renewables) Investment in generation, transmission and distribution of electricity	7 Affordable and clean energy	370–690	→	→
TRANSPORT INFRASTRUCTURE Investment in roads, airports, ports and rail	9 Industry, innovation and infrastructure; 11 Sustainable cities and communities	50–470	↗	↘
TELECOMMUNICATIONS Investment in infrastructure (fixed lines, mobile and internet)	9 Industry, innovation and infrastructure	70–240	↗	↘
WATER, SANITATION AND HYGIENE (WASH) Provision of water and sanitation to industry and households	6 Clean water and sanitation	260	↘	↘
FOOD AND AGRICULTURE Investment in agriculture, research, rural development, etc.	2 Zero hunger	260	↗	↘
CLIMATE CHANGE MITIGATION Investment in relevant infrastructure, renewable energy generation, research and deployment of climate-friendly technologies, etc.	13 Climate action	380–680	↗	→
CLIMATE CHANGE ADAPTATION Investment to cope with impact of climate change in agriculture, infrastructure, water management, coastal zones, etc.	13 Climate action	60–100	→	N.D.
ECOSYSTEMS AND BIODIVERSITY Investment in conservation and safeguarding ecosystems, marine resource management, sustainable forestry, etc.	14 Life below water; 15 Life on land	N.D.	↗	N.D.
HEALTH Investment in infrastructure, e.g. new hospitals, and R&D on vaccines and medicines	3 Good health and well-being	140	↗	↘
EDUCATION Infrastructural investment, e.g. new schools	4 Quality education	250	↘	→

Source: UNCTAD.
Notes: The estimated investment gaps are based on World Investment Report 2014. The overall trend assessments for the SDG investment areas are from UNCTAD's SDG Investment Trends Monitor 2019 and based on available data covering all types of investment and financing, including domestic and cross-border, public and private, and finance mobilization (in addition to capital expenditures). The assessment based on FDI, greenfield and project finance is a specific feature of WIR using the latest data generated for this year's report. For data sources see chapters I and II and the annexes to the report.

Source: UNCTAD, World Investment Report 2020

10 OECD (2023), Private finance mobilised by official development finance interventions, Development Co-operation Directorate, OECD Publishing, Paris



Investors... can encourage investee companies to build their businesses in lower-income markets in line with the greatest social needs

Under these circumstances, investors are stakeholders who have the potential to play a role in filling this financing gap, and a clear interest in seeing progress on the SDGs. The long-term stability and increase in asset value that institutional investors aim for are dependent on elements that are also included in the SDGs, such as access to a healthy and educated workforce by the company or the projects in which they invest, or a stable climate and a high-quality infrastructure that allows for business development. In other words, for institutional investors, contributing to the SDGs may lead to the sustainable growth of their investee companies, as well as leading to higher financial returns on their investments. Therefore, investing in ways to achieve the SDGs is thought to be consistent with the fundamental objectives of institutional investors.

In addition to actual investments, institutional investors can help close the SDG financing gap and accelerate progress towards the SDGs in a variety of ways, including collaboration with policy makers and engagement with portfolio companies.

The following section presents the challenges investors may face and several examples of policy measures that could be implemented in order to help investors to play an effective role.

2. Policy measures to address the SDG financing gaps

Accelerating sustainable development requires strong commitment from the world's governments. At present, most countries have developed national strategies for SDG implementation and monitoring, and many submit voluntary national reviews to report on their progress.

As explained in Section 1, given the SDGs cannot be achieved by the public sector alone, mobilising private sector finance and addressing the financing gaps is an essential pre-requisite to filling in the delivery gaps.

Specifically, the capital held by institutional investors represents a significant resource that could be leveraged in support of SDG achievement. However, the reality is that there are barriers to investment, and policymakers' assistance is required to mitigate those barriers and create an environment where capital can be most effectively deployed.

The levels of SDG integration into public policy are currently inconsistent across jurisdictions and therefore existing efforts are largely unnoticed. This section presents some of the key challenges preventing institutional investors from scaling up their contribution to SDG achievement. It also shares existing examples of action taken at the national and regional level that may help to mitigate these barriers and facilitate the delivery of the SDGs with the aid of institutional investors.[11]

11 Note that the case studies shown below are not necessarily to be considered as best practice, but to offer an insight into the different approaches currently taken by policymakers, which could be further explored when developing future policies and practices.

Challenge 1 - Managing a higher investment risk environment in lower-income countries

Whilst funding is most needed in lower-income countries, the perceived and actual risk of investment in such countries may limit the institutional investors' ability to participate in these markets. Although this is not an issue unique to the SDGs, there is an urgency to address this issue in order to address the SDG financing and delivery gap. Proactive collaboration between governments, international organisations and Development Finance Institutions (DFIs) can be a powerful instrument in addressing these challenges and increasing private capital flows towards the Goals.

Case Study 1.

Collaboration with international stakeholders to address the SDG financing gap

The Accelerating SDG Investment in Indonesia (ASSIST) program has been set up by several UN agencies in collaboration with the Indonesian government, with the expected outcomes of thematic bond issuances, increase in green and SDG-linked loans, and directing impact capital towards SDG-linked sectors. For example, in 2021 Indonesia issued the first sovereign SDG bond issuance in SouthEast Asia.[12]

SDG Indonesia One, a platform to promote infrastructure investment related to the SDGs using blended finance, which combines public and private financing, has been established. The Green Finance Facility (SIO-GFF) is an infrastructure investment platform in collaboration with Asian Development Bank, and offers four solutions; including commercial financing, preferential loans for risk mitigation, project development, and equity funds.13

Challenge 2 - Aligning national & regional sustainable finance policies with SDGs

Despite a rapidly evolving policy-making environment in regard to sustainable finance globally, explicit links with the SDGs have been limited. In many cases, capital allocation commitments related to certain issues such as climate change, and policies addressing human rights and supply chain issues exist, but there is a lack of a holistic integration of sustainable development concerns within sustainable finance and impact finance policy frameworks.

Case Study 2.

Holistic integration of SDGs into public policy

The EU has made the SDGs a priority objective for its internal and external policies, including sustainable finance. A prominent example of this policy commitment is the Green Deal Investment Plan, announced in 2020 as part of the European Green Deal, which aims to mobilise at least EUR 1 trillion of private and public sustainable investment.[14]

Elsewhere in Canada, The Federal Sustainable Development Act, in force since 2008, established a legal framework for developing and implementing the Federal Sustainable Development Strategy. The 2022-2026 Strategy supports Canada's efforts toward SDG achievement. It includes the Private Sector Engagement for Sustainable Development strategy which aims to facilitate private sector support for the SDGs, including addressing the SDG financing gap.[15]

12 United Nations Indonesia (January-April 2022), UN Joint Programme – Accelerating SDGs Investments in Indonesia (ASSIST), Newsletter, 1st edition
13 Asian Development Bank (June 2022), SDG Indonesia One: Green Finance Facility
15 Government of Canada, Feminist International Assistance Policy Guidance Notes, Private Sector Engagement for Sustainable Development

Challenge 3 - Clarifying the scope of Stewardship Codes in relation to SDGs

Institutional investors, who are in a position to be entrusted with assets under management, should fulfil their fiduciary responsibility, or stewardship responsibility from a long-term perspective. This is becoming widely recognized by investment industry participants and national regulators, as evidenced by the introduction of Stewardship Codes in many countries and regions, including the United Kingdom, Japan, and South Africa.

In fulfilling this stewardship responsibility, purposeful dialogue (engagement) with the companies in one's investment portfolio is one important activity. As discussed in Section 3 below, engagement can be one of the effective ways to encourage investee companies to deliver positive impact towards achieving the SDGs impact. However there has been no formalised consensus on this to date.

In recent years, the consideration of environmental and social factors have been recognised as an important aspect of stewardship activities from a long term perspective, and stewardship codes in various countries are being revised with more explicit reference to sustainability. In order to further align investors' stewardship and engagement activities with the SDGs, it would be helpful to clarify the position of the SDGs in these Codes.

Case study 3.

Integrating sustainability into the Stewardship Codes

For example, the UK Stewardship Code, revised in 2020, establishes environmental and social concerns as material for investors and requires the signatories to take ESG (Environmental, Social, Governance) factors into account across their stewardship activities.[16] Building on these, the scope of stewardship practices in relation to the achievement of SDGs could be further clarified in order to facilitate investor adoption.

Challenge 4 - Nurturing ownership towards the SDGs by the finance industry

Whilst policy alignment is key to stimulating private sector investment in the SDGs, this alone will not lead to action. The financial industry can play an important role by taking ownership of the agenda. National regulatory bodies, including financial supervisory authorities, could be in a position to encourage the activities of the financial institutions they supervise, for example by supporting the development of their own SDG initiatives and the issuance of relevant guidance by the respective financial institutions.

Case study 4.

Fostering a culture of bottom-up SDGs related commitments by financial institutions

Japan's Ministry of Foreign Affairs revised its SDGs Implementation Guiding Principle in December 2019, which highlights the role of the growth of ESG finance in mobilisation of private capital towards the SDGs and more specifically towards climate change and decarbonisation efforts.[17] In addition, the Japan Financial Services Agency (JFSA) developed a strategy for SDG integration, aiming to support the private sector stakeholders to implement their own SDG initiatives.[18] This has been led by the respective industry associations such as the Japan Banker's Association,[19] Life Insurance Association of Japan,[20] Japan Securities Dealers Association.[21]

Investor engagement with policymakers

The public policy initiatives described above are expected to help mitigate or avoid challenges to financing the achievement of the SDGs. Further, greater cooperation between policymakers, the investment industry, and development finance bodies is needed to facilitate the creation of innovative financial products which would allow institutional investors to scale their SDG-linked investments.

Engagement by institutional investors with policymakers to encourage the introduction and development of such policies is considered one of the important roles they can play in accelerating investment toward achieving the SDGs, and is summarized in the "Call for Action" in Section 4.

16 Financial Reporting Council (2020), UK Stewardship Code 2020
17 https://www.mofa.go.jp/policy/oda/sdgs/pdf/Revised_implementation_guideline_EN_2.pdf
18 https://www.fsa.go.jp/policy/sdgs/FSAStrategyforSDGs_2020.html
19 https://www.zenginkyo.or.jp/abstract/efforts/contribution/sdgs/
20 https://www.seiho.or.jp/activity/sdgs/content/
21 https://www.jsda.or.jp/sdgs/

3. Sustainable investment and bridging the SDG finance gap

> *Despite the growth of assets managed under sustainable investment strategies, this trend is yet to make a substantial contribution to closing the SDG financing gap. There seem to be two main reasons for this: 1) investors often do not recognise how the SDGs fit into their existing investment strategies and material ESG issues, and 2) that there is limited policy support to address the challenges investors face when considering to finance certain SDGs, such as Climate adaptation and basic infrastructure in emerging markets.*
>
> Professor Norichika Kanie, Keio University

In addition to engaging with policy makers to enhance the investment environment, investors have the potential to contribute to the realisation of the SDGs through their own investment practices. However, without clarity on how the delivery of SDGs fits into the wider landscape of ESG and sustainable investment, it has been difficult for investors to identify how their investments could be leveraged to fill in the SDG financing gap.

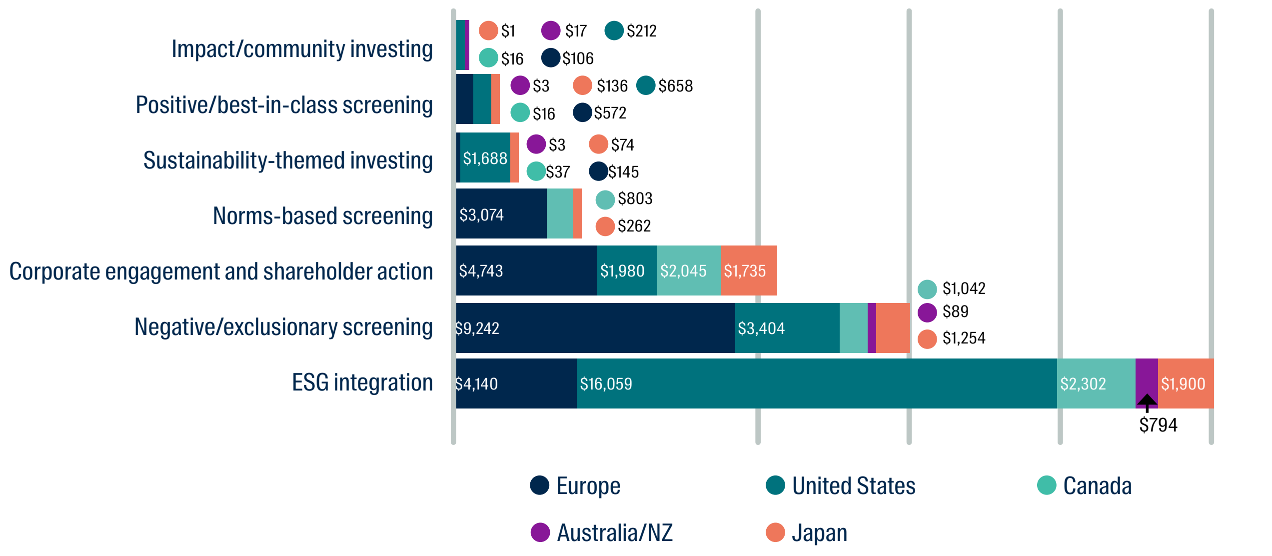
This section briefly reviews the growth in sustainable investment to date, and analyses where the achievement of the SDGs is positioned within this trend and what investment strategies can be utilized. In particular, we focus on corporate engagement, impact and infrastructure investing as strategies where institutional investors could have the most direct and immediate impact.

Sustainable investment – trends and definitions

The definition of sustainable investment is rapidly evolving, moving from being primarily seen as a stand-alone investment strategy in segregated mandates and ethical funds, to being seen as an integral part of the daily investment decision making process.

The definition of sustainable investment has also evolved over time, but to date have been categorised into a number of investment strategies.[22] Specifically, these include ESG integration (where investors consider financially material environmental, social and governance factors in investment analysis, with the aim of managing risks and improving financial returns), negative and/or norm-based screening, corporate engagement and voting, positive and best-in-class screening, and thematic and impact investing. While there are ongoing debates on how to measure the assets under management of sustainable investment strategies, the Global Sustainable Investment Alliance, which categorizes strategies as described above and compiles global statistics on an ongoing basis, estimates the global assets under management to be over US$35 trillion as of 2020 (see Figure 6).[23] As a further update, the report from the Global Impact Investment Network (GIIN) in 2022 estimated that over US$1.1 trillion is invested in impact investment assets.

Figure 6. Sustainable investing assets by strategy & region 2020



Asset values are expressed in billions of US dollars.
Source: GSIA, Global Sustainable Investment Review 2020

Contribution to the SDGs delivery will differ depending on the type of sustainable investment strategy. In addition, the investment strategy that is most appropriate and effective depends on the targeted industry, management approach (passive, active, etc.), and asset class (listed equities, bonds, infrastructure, etc.). Below are the main investment strategies that institutional investors with different characteristics could effectively use to achieve the SDGs.

22 Whilst globally the terminology and positioning of "sustainable investment" is at a transitional stage, this report references the Global Sustainable Investment Alliance for definitions of sustainable investment strategies to date.

23 GSIA (2021), Global Sustainable Investment Review 2020

Strategic positioning of SDG commitment

For many investors, committing to developing a more comprehensive approach to sustainability and moving beyond the currently prevalent focus on climate risk would be important first steps in scaling up their support of the SDGs.

Purposefully committing to integrating SDGs into the investment strategy would lead investors to explicitly consider how they could maximise their positive SDG impact and minimise their negative impact across the full range of activities including portfolio construction, investee, and policymaker engagement.

SDG alignment in both individual and collective engagement

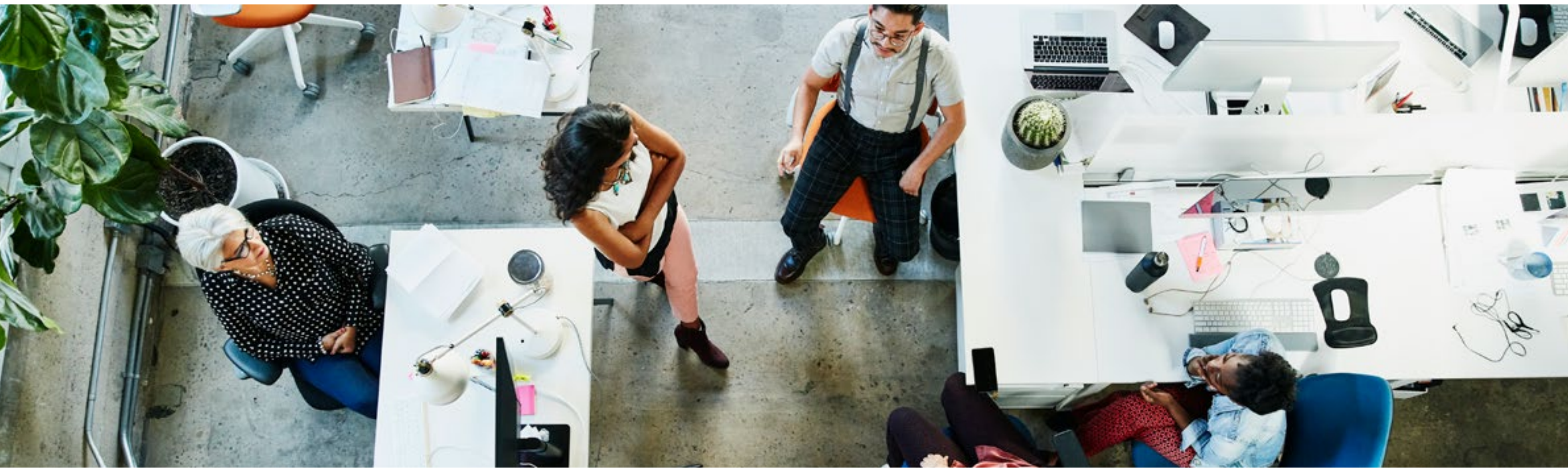
Engaging with investee companies in order to minimise the negative impacts of business activities offers investors an opportunity to accelerate progress on SDGs. This approach may be particularly important when dealing with large businesses with global operational footprints.

By leveraging their influence, investors can encourage their investee businesses to take constructive action to support the SDGs. This can be further enhanced through industry collaboration. This influence can be brought to bear in the primary markets (where companies, national and local authorities etc. raise funds by issuing stocks and bonds) at the point when companies come to market to raise capital or to refinance, or in the listed secondary markets (where investors buy and sell stocks and bonds that have already been issued) through shareholder engagement. As emphasised in the Stewardship Codes mentioned in Section 2, engagement – with individual entities and across investment portfolios is widely recognised as a core component of being responsible stewards of assets, and a key element of the long-term investing approach. Many investors are already taking engagement and voting actions that could be considered to be SDG-aligned – for example, by voting against management and by lodging shareholder resolutions at AGMs on issues such climate change and diversity, equality and inclusion (DEI).[24]

One of the most visible examples of effective collaborative engagement consistent with the achievement of the SDGs is Climate Action 100+. As of April 2023, a total of 700 asset owners and asset managers around the world are participating in this initiative[25], which aims to effectively promote emissions reductions by requiring companies with high greenhouse gas emissions to disclose climate change-related information and address governance issues. Such initiatives have been a very successful means of coordinating and uniting investors on climate action. Building on the successes of CA100+, where progress has been made through collaborative engagement with companies, similar global initiatives focused on issues such as human rights and social issues (e.g. Advance[26]) and biodiversity and nature (e.g. Nature Action 100[27]) are now being set up. This is an encouraging trend, and there is an opportunity for such initiatives to support the achievement of the SDGs. Potential areas of further focus include encouraging improvements in the performance of social factors such as compensation and working conditions, and trade union recognition; encouraging improvements in the performance of environmental factors such as water and energy efficiency; and encouraging companies to support the development of new and existing infrastructure facilities such as transportation and electricity grids with climate action and social inclusion in mind.

Reaching US$15trillion AUM as of 2020[28], the rising growth in passive (index-linked) investment underscores the importance of shareholder engagement in achieving the SDGs. Passive investors seek to replicate the performance of stocks included in a particular Index. Unlike active management, in principle, investors in passive management do not remove specific stocks from their investment universe, making engagement the primary means by which they can influence corporate behaviour.
The development and adoption of an SDG-aligned benchmark which measure the underlying company's contribution to individual SDG indicator delivery and incorporates this into the stock selection and weighting criteria of the benchmark index could help focus engagement efforts by passive investors. Such an index would align investor engagement activities with the benchmark objectives, and may help to steer the growing passively managed assets towards sustainable development.

24 Freshfields (July 2022), Trends and Updates from the 2022 Proxy Season
25 Figures as of 2023.04.27 https://www.climateaction100.org/
26 https://www.unpri.org/investment-tools/stewardship/advance
27 https://www.natureaction100.org/
28 Robin Wigglesworth, Financial Times (10 May 2021), Global passive assets hit $15tn as ETF boom heats up



Impact investing

Among the sustainable investment strategies introduced earlier, perhaps the greatest alignment and potential for direct SDG delivery impact may be found in impact investment strategies. The 2021 report from the Impact Investing Institute highlights the potential of private asset classes and fixed income for shifting institutional capital towards SDG financing.[29] According to a GIIN report, in 2019 most impact capital was deployed through private debt (61%), with substantial allocations to private equity (11%).[30]

In lower-income countries where the SDG financing gap is the greatest, limited opportunities for investments in public equity and debt have led to investors focusing on private markets. As private investors frequently enjoy greater influence as capital providers, this can potentially provide additional leverage for investors seeking to make a meaningful contribution to sustainable development.[31]

As noted earlier, the appetite for impact investment continues to be high, with an estimated US$1.1 trillion in outstanding impact investment as of 2022. Since impact investments are clearly expected to be aligned with the achievement of the SDGs, the growth in this type of investment could play a key role in filling the US$3.9 trillion financing gap.

Where the impact measurement is clear, labelled bonds such as green and social bonds can be recognised as impact investing, and can potentially provide an important channel for delivering the SDG financing gap. In 2021, green bond issuance was estimated to amount to US$578 billion[32], while broader green, social, sustainability, and sustainability-linked (GSSS) bond issuances in 2021 globally amounted to over US$700 billion.[33] Notably, sustainable bonds are increasing in popularity for both corporate and sovereign issuers, with some countries (e.g. Indonesia, Mexico, Uzbekistan) starting to issue SDG-labelled bonds in response to growing investor demand.[34]

According to the ICMA Green Bond Principles, green bonds are defined as "any type of bond instrument where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects"[35], and encourages transparency and measurement of the impact of investments. Where such impacts are aligned with the SDGs, the growth in the labelled bond market could also provide a helpful source of funding.

There are encouraging signs that impact strategies and labelled bond issuance can play a vital role in filling the SDG financing gap. However, as both strategies grow, impact investment and labelled bonds have been questioned on how they define and measure their impacts and performance. An additional challenge is that, most green and social board issuances are currently concentrated in high-income markets.

In order to help scale these investment strategies, investors should engage with the industry, with policymakers and with wider stakeholders to encourage better alignment of impact measurement efforts, and definitions with the delivery of SDGs. In the Financing for Sustainable Development Report 2023, developing common frameworks such as an SDG materiality map has been suggested as a possible step toward building SDG-aligned measurement and accountability structures.[36] Investors should also collaborate with multilateral finance bodies to support local issuances of labelled bonds in lower-income economies.

29 Impact Investing Institute, Impact Taskforce (2021), Mobilising institutional capital towards the SDGs and a Just Transition
30 GIIN (2020), 2020 Annual Impact Investor Survey
31 Impact Investing Institute, Impact Taskforce (2021), Mobilising institutional capital towards the SDGs and a Just Transition, December 2021
32 GIIN (2022), Sizing the impact investing market 2022. Whilst the number is estimated to be slightly lower for 2022 due to geopolitical factors, the long term expectation of growth in this market continues to be positive.
33 OECD (2022), Green, social, sustainability and sustainability-linked bonds in developing countries: How can donors support public sector issuances?, OECD Publishing, Paris.
34 United Nations, Inter-agency Task Force on Financing for Development, Financing for Sustainable Development Report 2023: Financing Sustainable Transformations. (New York: United Nations, 2023), available from: https://developmentfinance.un.org/fsdr2023
35 International Capital Market Association, Green Bond Principles (GBP) June 2021
36 United Nations, Inter-agency Task Force on Financing for Development, Financing for Sustainable Development Report 2023: Financing Sustainable Transformations. (New York: United Nations, 2023), available from: https://developmentfinance.un.org/fsdr2023

Sustainable infrastructure

Sustainable infrastructure stands out as an investment theme of particular significance in terms of SDG achievement. Whilst infrastructure investing in developed markets is clearly important, the largest SDG financing gaps, as shown in Section 1, are in low and middle-income countries, and in key sectors, notably infrastructure (transport, electricity, sanitation), health and education. For example, Asia is estimated to require US$1.7 trillion annually to fulfil its sustainable infrastructure needs.[37] Investment in infrastructure is also important as it has been found to positively influence the achievement of all 17 SDGs such as improving water accessibility, providing renewable energy, and facilitating education.[38]

Closing gaps will require mobilisation of all funding sources. In lower-income countries, where infrastructure projects are primarily publically funded , the availability of finance is constrained by limited resources and post-pandemic economic challenges.[39] At the same time, increasing the contribution of private capital will require concerted stakeholder collaboration between governments, development banks, and domestic and international investors.[40] In particular, for infrastructure projects that require significant upfront investment and have a long capital repayment period, private financial institutions will need to address challenges, including existing political and regulatory risks.[41] Development Finance Institutions (DFIs) leverage their expertise and access to markets to develop and structure projects and transactions suitable for institutional investors worldwide, and are also expected to play a role in infrastructure investment. Even in these DFIs, the incentive structure has historically emphasized earning financial returns. A recent OECD report suggests that policymaker cooperation in incentivising the DFIs in bringing positive impact to sustainable development through investment, would help to mobilise private capital more actively.[42]

Given the critical role played by the infrastructure sector in achieving the SDGs, institutional investors may take several actions to facilitate this. First, investors can work with national policymakers to develop infrastructure strategies aligned with the SDGs, including the development of standards and a common disclosure framework for sustainable infrastructure.[43] In addition, they could contribute to developing incentives and frameworks needed to further facilitate private infrastructure investment in line with the SDGs, especially in lower-income countries. Further, as discussed in Section 2, SDG-aligned infrastructure investment practices could be accelerated by investors and policymakers by collaborating with DFIs and Multilateral Development Banks (MDBs) to devise ever more suitable blended finance mechanisms (combining public funds with private investments, loans, etc. to attract private sector funding).[44]

37 Asian Development Bank (2017), Meeting Asia's Infrastructure Needs
38 Thacker S, Adshead D, Fantini C, Palmer R, Ghosal R, Adeoti T, Morgan G, Stratton-Short S. (2021), Infrastructure for climate action, UNOPS
39 PwC (2020), Global infrastructure trends
40 Bhattacharya, A., Gallagher, K.P., Muñoz Cabré, M., Jeong, M., & Ma, X. (2019,) Aligning G20 Infrastructure Investment with Climate Goals and the 2030 Agenda, Foundations 20 Platform, a report to the G20
41 Daniel Zelikow, Fuat Savas (20 May 2022), Mind the gap: Time to rethink infrastructure finance
42 OECD, PF2SD Perspectives Series, Making private finance work for the SDGs, July 2022
43 PRI (19 April 2022), Policy briefing: sustainable infrastructure
44 Impact Investing Institute, Impact Taskforce (2021), Mobilising institutional capital towards the SDGs and a Just Transition, December 2021

4. Call for action

Closing the SDG financing gap in time to achieve the 2030 target would require an acceleration in concerted effort from all relevant stakeholders. Institutional investors in particular can play a key role to contribute to the much-needed private capital shift towards sustainable development.

In light of the scale of the challenge at hand and the diversity of investment approaches and asset classes, institutional investors may consider several areas of action. Based on the information presented in this report, institutional investors can consider the following actions:

Institutional investors who are committed to the long term sustainability of the environment and society into which they invest in are invited to align their actions to the Sustainable Development Goals through:

Strategic commitments to integrate the SDGs across key firm activities including within:

- investment research and decision-making
- portfolio engagement
- public policy engagement

SDG-linked direct investment and debt financing, including:

- impact investing through private markets
- infrastructure investments

Individual and collective company engagement in alignment with investment purposes. Specifically, engaging with portfolio companies to encourage them to support the achievement of the SDGs and minimise their negative impacts through both operational activities and products and service across their value chain.

Public policy engagement to encourage governments to address key barriers to SDG financing gaps. Specifically, investors should encourage policymakers to:

- Explicitly incorporate the SDG achievement into the goals of domestic fiscal and financial policy. This may include but not limited to:
  - explicit capital commitment to sustainable development, and
  - explicit alignment of sustainable and impact finance regulators and frameworks with the SDGs
- Develop fiscal policy measures and instruments (e.g. first loss instruments, blended finance) that help private investors manage the risks associated with SDG-related investments
- Integrate the SDGs into the scope of investor stewardship responsibilities under the national Stewardship Codes
- Establish SDG delivery plans and strategies which encourage and facilitate ownership of the sustainable development agenda by the financial industry

This report draws on prior literature to identify issues related to the SDGs delivery and financing gap, and calls upon institutional investors for possible actions they can take to achieve the SDGs from a sustainable investment perspective.

This call for action offers multiple options for institutional investors to focus and effectively leverage their influence through the assets they manage and the engagement with both investee companies and policymakers in order to achieve the SDGs. At the same time, it gives each investor the flexibility to choose actions that are appropriate to their expertise, the asset classes in which they invest, and their resources.

We hope that this report will help institutional investors contribute to the achievement of the SDGs as they seek to balance a sustainable environment, society, and economy from a long-term perspective.

Important Information

This material is for general information purposes only. It does not constitute investment or financial advice and does not take into account any specific investment objectives, financial situation or needs. This is not an offer to provide asset management services, is not a recommendation or an offer or solicitation to buy, hold or sell any security or to execute any agreement for portfolio management or investment advisory services and this material has not been prepared in connection with any such offer. Before making any investment decision you should consider, with the assistance of a financial advisor, your individual investment needs, objectives and financial situation.

We have taken reasonable care to ensure that this material is accurate, current, and complete and fit for its intended purpose and audience as at the date of publication. No assurance is given or liability accepted regarding the accuracy, validity or completeness of this material and we do not undertake to update it in future if circumstances change.

To the extent this material contains any expression of opinion or forward-looking statements, such opinions and statements are based on assumptions, matters and sources believed to be true and reliable at the time of publication only. This material reflects the views of the individual writers only. Those views may change, may not prove to be valid and may not reflect the views of everyone at First Sentier Investors.

About First Sentier Investors

References to 'we', 'us' or 'our' are references to First Sentier Investors, a global asset management business which is ultimately owned by Mitsubishi UFJ Financial Group. Certain of our investment teams operate under the trading names FSSA Investment Managers, Stewart Investors, Igneo Infrastructure Partners and Realindex Investments, all of which are part of the First Sentier Investors group.

We communicate and conduct business through different legal entities in different locations. This material is communicated in:

Australia and New Zealand by First Sentier Investors (Australia) IM Limited, authorised and regulated in Australia by the Australian Securities and Investments Commission (AFSL 289017; ABN 89 114 194311)

- **European Economic Area** by First Sentier Investors (Ireland) Limited, authorised and regulated in Ireland by the Central Bank of Ireland (CBI reg no. C182306; reg office 70 Sir John Rogerson's Quay, Dublin 2, Ireland; reg company no. 629188)
- **Hong Kong** by First Sentier Investors (Hong Kong) Limited and has not been reviewed by the Securities & Futures Commission in Hong Kong
- **Singapore** by First Sentier Investors (Singapore) (reg company no. 196900420D) and has not been reviewed by the Monetary Authority of Singapore. First Sentier Investors (registration number 53236800B) is a business division of First Sentier Investors (Singapore).
- **Japan** by First Sentier Investors (Japan) Limited, authorised and regulated by the Financial Service Agency (Director of Kanto Local Finance Bureau (Registered Financial Institutions) No.2611)
- **United Kingdom** by First Sentier Investors (UK) Funds Limited, authorised and regulated by the Financial Conduct Authority (reg. no. 2294743; reg office Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB)
- **United States** by First Sentier Investors (US) LLC, authorised and regulated by the Securities Exchange Commission (RIA 801-93167)
- **Other jurisdictions**, where this document may lawfully be issued, by First Sentier Investors International IM Limited, authorised and regulated in the UK by the Financial Conduct Authority (registration number 122512; registered office 23 St. Andrew Square, Edinburgh, EH2 1BB number SC079063).

To the extent permitted by law, MUFG and its subsidiaries are not liable for any loss or damage as a result of reliance on any statement or information contained in this document. Neither MUFG nor any of its subsidiaries guarantee the performance of any investment products referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of MUFG or its subsidiaries, and are subject to investment risk, including loss of income and capital invested.