Profits with principles: SFDR enables a clearer choice on "clean tech"

Pascal Dudle
Head of Listed Impact Equities
Vontobel Asset Management

"We have also learned that money isn't everything – people often want to align their investments to a beneficial environmental or social outcome."

Remember the co-ordinated waves of crowds cheering in sports stadiums? Those days are gone for now, but the sustainable investment industry's own celebratory wave shows no sign of abating – and for good reason. However, new European regulations will start guiding investors towards the strategies that are really worth rooting for.

On 10th March 2021, tight new rules known as Sustainable Finance Disclosure Regulation (SFDR) took effect in the European Union, cementing the region's reputation as a trailblazer (or cheerleader in sporting terms) for sustainable investments. They introduce a uniform requirement of eco-labelling financial products and reporting obligations[1] that will force market participants, advisers and consultants to be much more transparent when presenting financial products as sustainable.

The relevant passages in SFDR regulation are article 8 and 9. The former, which sports a light-green leaf for logo, is given to financial products that promote environmental or social characteristics. The latter, the stricter version that comes with two dark-green leaves, is bestowed on products with a sustainable investment objective. Likewise, investment firms will need to provide details of policies on the integration of sustainability risks and objectives in their investment processes and how their strategies actually meet the ESG claims they make. For example, there will be an evaluation to what degree asset managers' investments live up to the environmental and social standards the company claims to be supporting.

EU Green Deal will spark massive investments

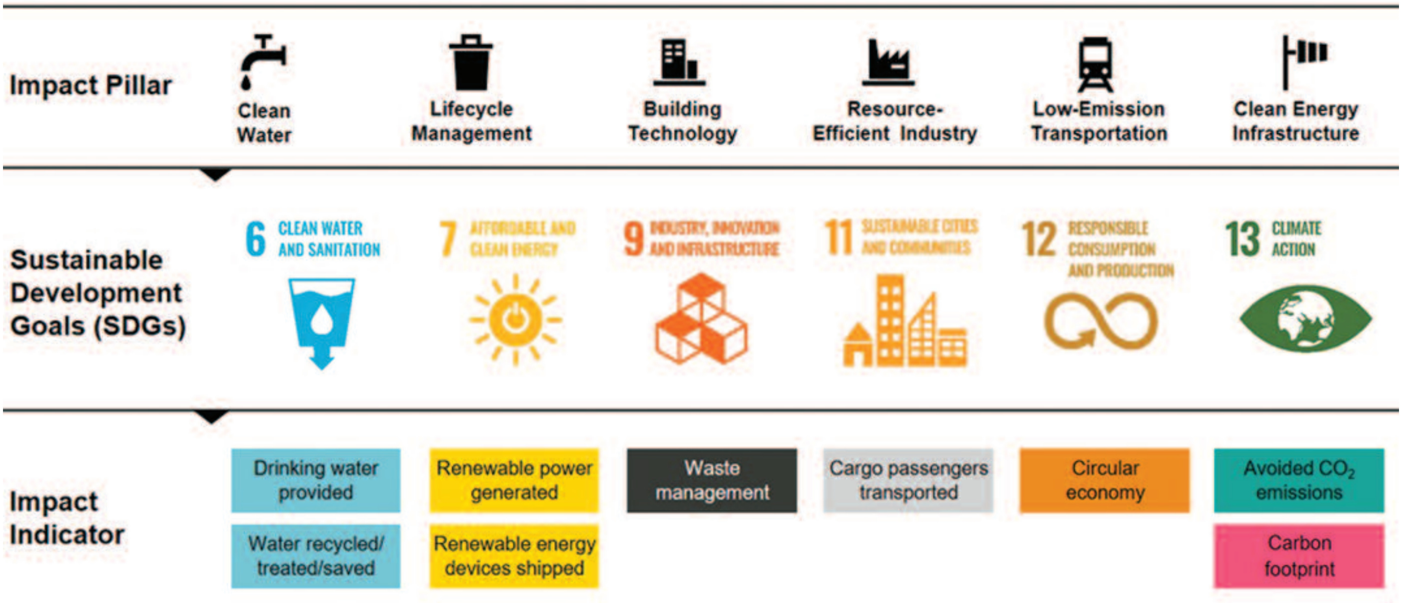
Investors and asset managers with a sustainability focus will welcome this development. On the one hand, the tightening of the regulatory screws will increase competition. On the other hand, the European initiative will not only lead to a "green" classification system for financial products (equity investments as well as standards for green bonds), it also comes with a multi-billion plan to become carbon neutral by 2050. Known as European Green Deal, this push includes the so-called EU Taxonomy, a classification system to distinguish "sustainable" from "non-sustainable" economic activities. The initiative will spark massive investment in the clean tech corporate sector, which will ultimately lead to investment opportunities for the financial industry.

We for our part recognised that the six environmental objectives at the core of the EU Taxonomy (e.g. mitigation of and adaptation to climate change, protection of water resources, the transition to a circular economy) are mostly aligned with the United Nations' Sustainable Development Goals (SDGs)[2]. Established in 2015, the SDGs are a collection of 17 interlinked global goals designed to provide a "blueprint to achieve a better and more sustainable future for all". While not all SDGs are investable, they can provide a valuable framework for investors. Managers may choose to address the SDGs directly or – as we do – develop their own investment framework for addressing the SDGs. Figure 1 shows how our own "impact pillars" are mapped to underlying SDGs that can help improve the daily lives of people, minimise ecological footprint, and offer attractive investment opportunities.

Money matters, but "doing good" too

We are investors, so competitive returns are important. However, we have also learned that money isn't everything – people often want to align their investments to a beneficial environmental or social outcome. Younger generations are portrayed as being more eco-conscious than the more

Figure 1: "Impact Pillars" – how a manager framework can be mapped to the UN Sustainable Development Goals



Source: United Nations, Vontobel Asset Management; for illustrative purposes only.

SDG = The Sustainable Development Goals reflect the megatrends that are shaping the world's future and they are adopted by 193 member states of the United Nations. The agenda contains 17 Goals and 169 targets.

materialistic baby boomers, not the least because of global challenges such as climate change and pollution. Even so, millennials will inherit more than $70 trillion from their parents, one of the greatest wealth transfers ever. The shift in mentalities will increase the flow of money into financial products with green credentials. A growing awareness of global problems is changing the mindset of institutional investors too, who increasingly align their allocation with the UN's Social Development Goals ("SDGs").

We believe it is possible to do good while doing well. Multiple independent studies as well as our own research show that, in the long-term, the performance of impact investing is comparable to traditional investing. Portfolio performance overwhelmingly meets or exceeds investor expectations for environmental impact and financial return.

What gets measured gets done

Measuring the beneficial environmental or social impact of financial products is challenging and complex due to the lack of common standards. But data availability is improving and will continue to do so, not only owing to increased regulatory scrutiny, but also because we and other asset managers continue to nudge companies to improve transparency. The financial industry's measures to assess portfolio companies' sustainability may not be perfect, but not-quite-perfect yardsticks are better than none. With improved company data, investment managers will be able to provide clearer reporting on environmental outcomes from investing, alongside the financial returns, demonstrating the tangible impact clients can have.

Profits with principles

To return to our introductory example, we're definitely cheerleaders for sustainable investments. Whilst SFDR may not be perfect, it is definitely a useful step towards enabling investors to make clear choices about what their money supports – and not just for ethical reasons. With the advent of the EU Green Deal and other similar schemes globally, investors should be able to combine profits with principles.

1. See Vontobel Insights: "EU Sustainable Finance Action Plan – Carbon Neutral by 2050?", June 10, 2020 https://am.vontobel.com/en/insights/eu-sustainable-finance-action-plan-climate-neutral-in-2050 or "The EU action plan – greater transparency in the area of sustainable investments", June 24, 2020 https://am.vontobel.com/en/insights/the-eu-action-plan-greater-transparency-in-the-area-of-sustainable-investments. For background reading, see, for example, "Sustainable finance Disclosure Regulation – is the financial industry ready for the Big One?", Deloitte 2020, https://www2.deloitte.com/lu/en/pages/sustainable-development/articles/sustainable-finance-disclosure-regulation.html or "Sustainable Finance Disclosure Regulation (SFDR), PwC, 2020 https://www.pwc.ch/en/publications/2020/sustainable-finance-disclosure-regulation.pdf

2. The Sustainable Development Goals ("SDGs"), 17 initiatives to improve environmental and social conditions for the world's population, were adopted by 193 countries in 2015. The SDGs, currently the only globally accept sustainability-linked guidelines, are to be achieved globally and by all member states of the United Nations by 2030.