FOR PROFESSIONAL INVESTORS

# An introductory guide to SDG Credits

SEPTEMBER 2021

Sustainable Investing Expertise by ROBECOSAM

# Introduction

**Although investors are increasingly embracing sustainable investing, there is no one-size-fits-all approach. Sustainable investing means different things to different people, and their investment goals can vary considerably. While it is easy for asset managers to talk about sustainability, it is much more challenging for them to implement it. Compounding the lack of a clear definition is the challenge of measuring the impact sustainable investors make. Nevertheless, there have been some very interesting developments in this ever-evolving investment field.**

Launched in 2015 the UN Sustainable Development Goals (SDGs) take the quest for sustainability to the next level by making integration tangible and measurable. Investors are becoming increasingly interested in investment products that contribute to the realization of these goals and at the same time offer attractive returns. Building on the success of the Millennium Development Goals and adopted as part of the 2030 Agenda for Sustainable Development, which was signed by 193 countries, the SDGs are a vast agenda of 17 goals and 169 targets such as the elimination of poverty and hunger, decent work and growth, sustainable cities and communities.

The UN Commission on Trade and Development (UNCTAD) estimates that between USD 5 and 7 trillion per year will be needed to achieve these goals within this timescale. As governments alone are unlikely to be able find such huge sums of money, the UN has explicitly asked the private sector, including asset owners, to contribute as well. According to a survey among Dutch institutional investors carried out by the Dutch Association of Investors for Sustainable Development (VBDO), the SDGs are on the agenda of pension fund boards, although most of them have yet to integrate SDGs in their portfolios.

### Why should investors embrace the SDGs?

There are many, often quite intuitive reasons why it is essential to incorporate SDG considerations into investment strategies. In an increasingly renewables-powered global economy, it is easy to foresee that the business models of companies such as coal miners, oil producers

**Figure 1: The UN Sustainable Development Goals**


Source: United Nations. Use of the UN SDG icons is for illustrative purposes only and does not imply endorsement by the UN.

and fossil fuel-based electricity generators will come under severe pressure. Although less obvious, the same applies to car manufacturers that do not adapt quickly enough to a world of electric vehicles. The financial consequences – in the form of fines, compensation and potential license withdrawals – can be very material for companies that fail to act in accordance with the SDGs. Environmental spills, bribery, money laundering and misselling are a few examples. Ignoring the SDGs could therefore ultimately affect every investor, reinforcing the relevance of SDG-linked investment strategies. Those companies that offer solutions to help achieve the SDGs may well be the winners of the future as well as attractive investment candidates.

## SDGs and Robeco

Robeco has been at the forefront of sustainable investing for more than two decades. Our long history of innovation and enhancing sustainable products and services is the result of close cooperation between our Credits team, Active Ownership team, and our sustainability research analysts. We were one of the first asset managers to launch an SDG-focused credit strategy.

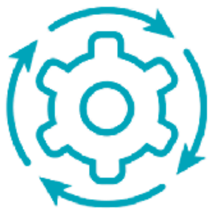
Depending on the strategy, Robeco applies various dimensions of sustainability to credit portfolios. These include exclusion, ESG integration, engagement, environmental footprint reduction, green bond screening, assessing issuers' climate strategies and constructing portfolios in alignment with the SDGs.

ESG integration, exclusion of the most controversial companies, and engagement have been an integral part of all our credit strategies for the last decade. Consistently integrating ESG information in the Robeco bottom-up credit analysis, and thus avoiding defaults or distressed situations, has significantly contributed to reducing downside risks in our credit portfolios. This is in line with our belief at Robeco that using financially material ESG information leads to better-informed investment decisions and benefits society.

# The SDG screening process

With 17 goals and 169 targets, the SDGs address a very broad range of issues, some of which have conflicting effects on each other. Robeco's proprietary SDG measurement framework provides clear, objective and consistent guidelines for dealing with these challenges and consists of a three-step approach.

**Figure 2 I This proprietary SDG framework, shown below, consists of a three-step approach**



| Product | Procedure | Controversies |
| --- | --- | --- |
| What do companies produce? | How do companies produce? | Are controversies known? |
| **Positive contribution examples:**<br>– Medicine, water, healthcare<br><br>**Negative contribution examples:**<br>– Shale gas, fast food, gambling | **Assess a company:**<br>– Governance factors<br>– Pattern of questionable conduct?<br>– Differentiate between firms with highest SDG impact | **Examples of controversies:**<br>– Spills<br>– Bribery and fraud<br>– Misselling |

## Step 1 – What do companies produce?

The first step links the products and services offered by companies to the SDGs and assesses to what extent they contribute to or detract from them. An extensive set of rules and key performance indicators (KPIs) are used for this and these are summarized in our guidebook, which links each sector and industry to specific SDGs that correspond to the products and services of the specific company. Having established the starting point of the sector's contribution and impact, Robeco's credit analysts then dig deeper to look at the individual companies within the sector. For example, for telecom companies, the starting point in terms of contribution is positive. Telecommunication is an essential part of the infrastructure needed to maintain a safe, secure and connected society. Industrialization and increased productivity are highly dependent on effective telecommunications and help make cities smarter and more sustainable. This means that the telecom sector can help build a resilient infrastructure (SDG 9), promote economic growth (SDG 8) and ultimately end poverty (SDG 1).

We then determine the extent of the contribution, which in the case of telecom is deemed to be low. Having established the starting point of the sector's contribution and impact, we then take a closer look at the individual companies within this sector. To this end, we have defined a set of KPIs per sector against which the individual companies are assessed. If, for example, more than 25% of a telecom company's sales are made in emerging markets (which have the most to gain from a good telecom network), we upgrade the impact from positive-low to positive-medium; or, if this figure is 33%, to positive-high.

## Step 2 – How do companies produce?

The second step is about how a company operates. Does it cause pollution, respect labor rights, respect the rule of law and have a diversified management team? In step 2, credit analysts check whether the way each company operates is compatible with the SDGs. The factors they examine include corporate environmental policies, the track record in conduct and the company's governance framework. If necessary, the company's SDG rating is adjusted accordingly.

## Step 3 – Are there any controversies?

The third and final step is to establish whether companies have been involved in any controversies. A company can meet the criteria in steps 1 and 2 by making the right products and operating in the right manner, but still be caught up in controversies such as oil spills, fraud or bribery. In this context, it is important to know if the controversy is structural or just a one-off, and whether management has taken sufficient precautions to prevent recurrence in the foreseeable future. The results of this three- step analysis are quantified in a proprietary SDG score and each company is scored on the basis of its contribution to the SDGs (positive, neutral or negative) and the impact of this contribution (high, medium or low). This is shown below in Figure 3.

**Figure 3 | Outcome three-step process quantified in SDG rating framework**

| Assessment | Impact | SDG Score |
|---|---|---|
| | High | +3 |
| Positive | Medium | +2 |
| | Low | +1 |
| Neutral | | 0 |
| | Low | -1 |
| Negative | Medium | -2 |
| | High | -3 |

Source: Robeco

Based on these proprietary SDG scores, Robeco's Credits team can screen the universe for corporate bonds issued by companies that contribute to the UN SDGs and exclude corporate bonds of companies that detract from them. As shown below, we then apply our well-established credit investment process to create a credit portfolio that, in our opinion, makes a positive contribution to the UN SDGs and aims to deliver attractive financial returns.

However, the fact that a credit has made it through the SDG screening is never the only reason to invest in it. We also conduct a fundamental credit analysis and will only take a position if we believe it is merited by its valuations relative to its fundamentals, and compared with issuers with a similar rating. After all, our aim is twofold: to contribute to the UN SDGs and deliver returns for clients.

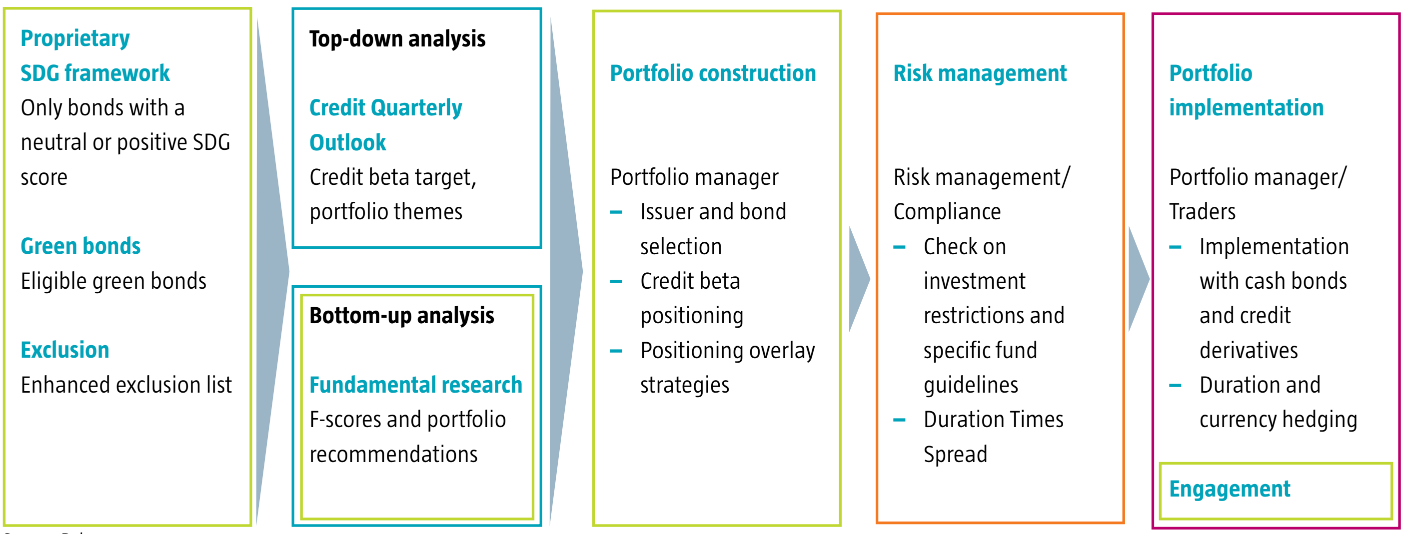
## Will the SDG screening cause sector biases in credit portfolios?

Robeco's Credits team has applied the SDG measurement framework to a credit universe of around 650 names. This universe is diversified in terms of sectors and consists of investment grade, high yield, and emerging issuers. The overall outcome was that 62% of the companies were assessed as making a positive contribution. Of the companies analyzed, 22% received a negative SDG score, and 16% received a neutral ranking. In 10% of cases, the scores were adjusted in step 2 and 3. It is difficult to approach SDGs purely through sectors. Nevertheless, a few general conclusions can be drawn from applying the SDG screening.

Grid operators and companies in the banking, healthcare, utility and communications sectors generally have a strong SDG profile, while companies in the food and beverage, automotive and energy sectors generally have a weaker one.

The weaker SDG profile of companies in the food and beverage sector might seem somewhat surprising. Intuitively, one would expect the food and beverage sector as a whole to contribute significantly to SDG 2 (zero

**Figure 4 | Investment process SDG Credits strategies**




Source: Robeco

hunger). Unfortunately, however, the opposite turns out to be the case. Both SDG 2 and SDG 3 (good health and well-being) require healthy and nutritious food. And herein lies the problem. Most food and beverage producers add too much sugar and/or fat to their products. The result is unhealthy high-calorie foods that are helping fuel the global obesity epidemic. More and more food manufacturers are adapting their product range to tackle this, but the proportion of healthy foods they produce is generally still far below the thresholds defined in our SDG framework.

Sectors that generally do not perform well in the SDG assessment include aerospace, defense, energy, tobacco and gaming. Sectors that have a more positive impact from an SDG perspective include telecoms, banks, grid operators and healthcare companies.

# Robeco SDG Credit strategies

Robeco currently offers five SDG Credits strategies: RobecoSAM Euro SDG Credits, RobecoSAM Global SDG Credits, RobecoSAM SDG Credits Income, RobecoSAM SDG High Yield Bonds and RobecoSAM Emerging SDG Credits. These strategies share the same SDG framework described above. Only bonds with an SDG score of zero or higher are eligible for inclusion in the portfolios; the strategies do not invest in companies that detract from these goals. As such, the strategies are designed to make a clear contribution to the UN Sustainable Development Goals and also outperform a mainstream corporate bond index or optimize yield and income (SDG Credits Income).

**RobecoSAM Euro SDG Credits** provides a well-diversified exposure to the Euro investment grade credit market and invests in companies that contribute positively to the SDGs. The strategy aims to outperform the Bloomberg Euro Aggregate Corporate Bond Index through active credit selection over a full credit cycle. The portfolio can take some off-benchmark positioning in high-quality high yield bonds and hard-currency emerging corporate bonds.

**RobecoSAM Global SDG Credits** provides a diversified exposure to the Global investment grade credit market and invests in companies that contribute positively to the SDGs. The strategy aims to outperform the Bloomberg Global Aggregate Corporate Bond Index through active credit selection over a full credit cycle. The portfolio can take off-benchmark positions in high-quality high yield bonds and hard-currency emerging corporate bonds (max 20% in each of the categories, which together cannot be more than one-third of the total portfolio).

**RobecoSAM SDG Credits Income** aims to provide an attractive yield and stable income throughout the credit cycle and invests in companies that contribute positively to the SDGs. The strategy is a multi-asset credit strategy and has no formal benchmark. However, the starting point is a portfolio that is equally split across global investment grade corporate bonds, global high yield corporate bonds and hard-currency emerging market corporate bonds. Depending on the phase of the credit cycle, the strategy can change its allocation to these different segments of the credit market to achieve the best risk-return profile for that particular market phase. For example, in a bear market phase, the emphasis will be more on capital preservation, which can be achieved by adding government exposure to the portfolio. In a recovery phase, the asset allocation moves more towards high yield, emerging market bonds and subordinated debt.

**RobecoSAM SDG High Yield Bonds** invests in corporate bonds with a sub-investment grade rating and has a structural bias to the higher-rated segment of the high yield market. It is actively managed, conducts bond selection based on fundamental analysis and allocates to companies that contribute positively to the SDGs. The strategy aims to outperform the Bloomberg Global High Yield Corporate Index, with the objective of providing long-term capital growth.

**RobecoSAM Emerging SDG Credits** is an actively managed, value-based strategy for those investors seeking a sustainable solution for their emerging markets exposure. Its objective is to achieve long-term capital growth by investing in a sustainable manner in quality, hard-currency emerging market credit. The strategy advances the SDGs by investing in the corporate bonds issued by companies whose business models and operational practices are aligned with targets defined by these 17 goals. It aims to outperform the JPM Corporate EMBI Broad Diversified index.

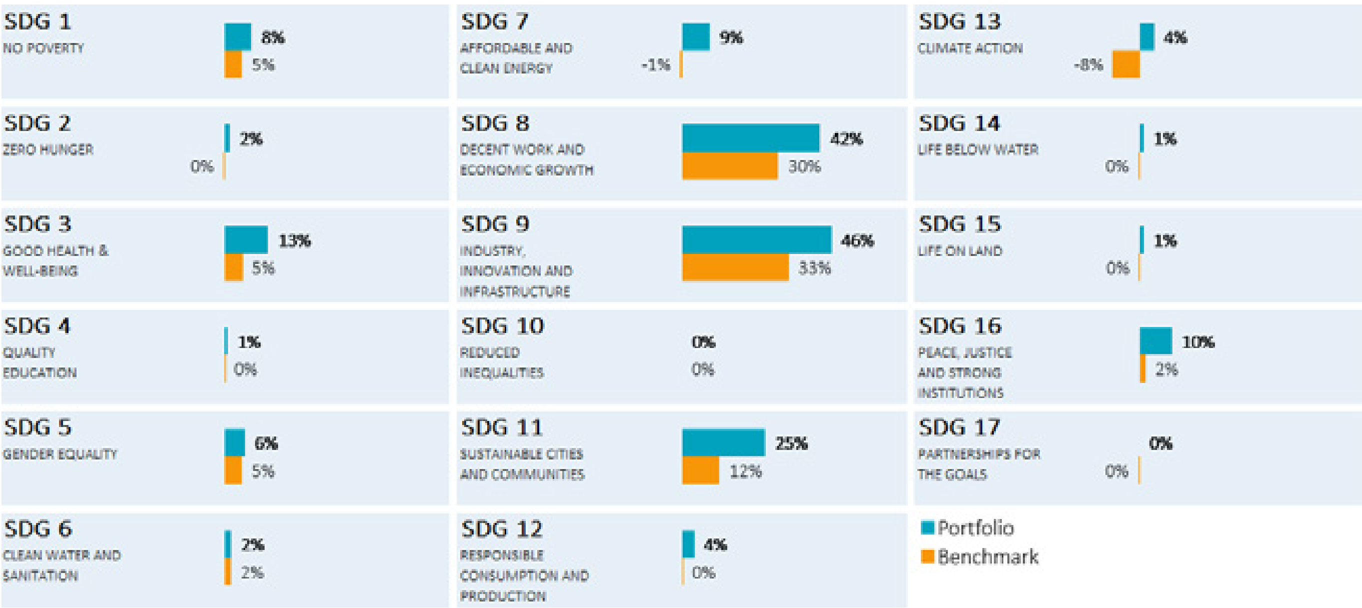
## Portfolio alignment with the UN's Sustainable Development Goals

For the SDG Credits strategies, we publish quarterly reports on how the portfolio contributes to the SDGs. Figure 5 provides an excerpt from this report for the RobecoSAM Global SDG Credits strategy as at the end of August 2021.

Additionally, we publish quarterly reports on the portfolio's environmental footprint relative to the relevant index, which varies depending on strategy. Figure 6 is an excerpt from this report for the RobecoSAM Global SDG Credits strategy at the end of August 2021, which shows the portfolio's impact on three environmental factors: greenhouse gas emissions, water use and waste generation.

Typically, the positive SDG screening will result in a more favorable environmental footprint for the portfolio (turquoise bars) compared to the index (striped bars). The index in this case is the Bloomberg Global Aggregate Corporates Index (EUR).

**Figure 5 | Contribution to the United Nations Sustainable Development Goals (SDGs)**




Source: Robeco. Net figures for individual SDGs. Data as at 31 August 2021.
Portfolio: RobecoSAM Global SDG Credits. Index: Bloomberg Global Aggregate Corporates Index.
This example is for information purposes only and is not intended to be investment advice in any way

**Figure 6 | Footprint ownership for 100 million USD invested**

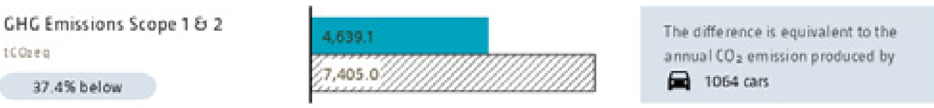
Footprint ownership expresses the total resource consumption the portfolio finances. Each assessed company's footprint is calculated by normalizing resources consumed by the company's enterprise value. Multiplying these values by the dollar amount invested in each assessed company yields the aggregate footprint ownership figures.

The selected index's footprint (for an equivalent USD amount invested in corporates) is provided alongside. Additional alerts highlight the portfolio's footprint relative to the index and equivalents of what that difference tangibly expresses: emissions, water use and waste generation are expressed in terms of tangible equivalents.

Sovereign and cash positions have no impact.

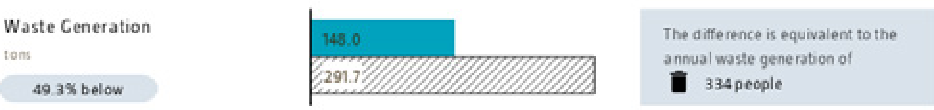
The "mUSD invested" refers to amount invested in the whole portfolio, but only corporates exposure in scope for Footprint Ownership are taken in consideration in this metric.

European average figures per year:
https://ec.europa.eu/eurostat




Source: Robeco data based on Trucost data. S&P Trucost Limited © Trucost 2021. All rights in the Trucost data and reports vest in Trucost and/or its licensors. Neither Trucost, nor its affiliates, nor its licensors accept any liability for any errors, omissions or interruptions in the Trucost data and/or reports. No further distribution of the Data and/or Reports is permitted without Trucost's express written consent.


Source: data based on RobecoSAM impact data.




Source: data based on RobecoSAM impact data.

Portfolio Index

Data as of 31 August 2021
Source: Robeco Switzerland Ltd. Certain underlying data is sourced from third-parties (such as e.g. CDP Europe Services GmbH).
Portfolio: RobecoSAM Global SDG Credits. Index: Bloomberg Global Aggregate Corporates Index.
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# What we've learned from three years of SDG credit investing

Global progress in meeting the 17 Sustainable Development Goals (SDGs) has been mixed, and many lessons have been learned since their adoption by United Nations member states in 2015. From an investment perspective, our three-year track record with our SDG Credit solutions has shown us that aligning credit portfolios with the SDGs does not come at the expense of financial returns.

## Investors are essential to meeting the goals

An important learning since the adoption of the SDGs has been that Covid-19 has reinforced their relevance, and that they present the best possible approach to managing global health while safeguarding environmental and economic sustainability.

Another key lesson is that investors are essential to meeting the goals. Allocating investment capital to companies that contribute to this global to-do list as well as avoiding financing those whose practices or products are not aligned with them helps ensure progress.

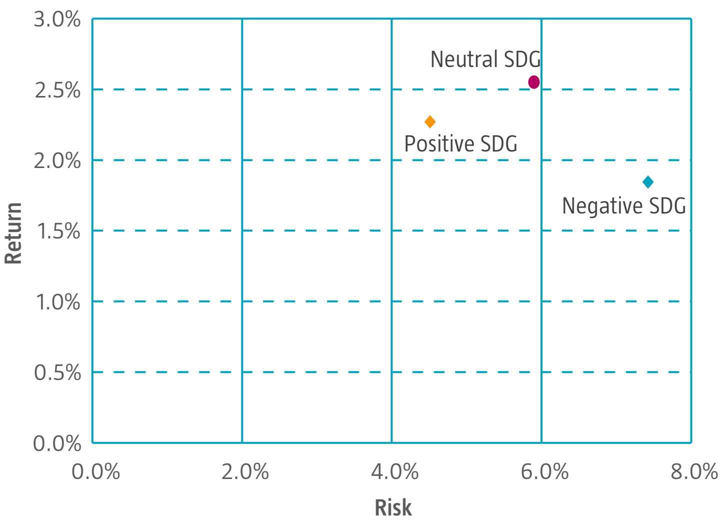
We've also seen that the universal nature and relevance of the SDGs, and their detailed outlining of the world's most urgent sustainable development issues in a concrete set of goals with underlying targets, make them a useful blueprint for sustainable investing. The SDGs enable investors to clearly show how they allocate clients' capital to companies that provide solutions to sustainability challenges.

And we have learned from our three-year track record with our SDG Credit solutions that aligning credit portfolios with the SDGs does not come at the expense of financial returns. The SDG screening process does not impede our ability to generate performance through bottom-up issuer selection: in fact, it has contributed positively to financial returns.

## SDG screening helps to mitigate downside risk

It is particularly interesting to see that in periods of heightened market volatility, as in the wake of the Covid-19-related sell-off, the SDG screening has helped to mitigate downside risks. This had already been evident from our initial analysis that showed that sectors that were positively aligned with the SDGs had lower credit risk and that, over a five-year period (as of December 2020), sectors with a positive or neutral SDG rating had a superior risk-return relationship compared to those with negative SDG scores. This is shown in Figure 7.

**Figure 7 | Investment grade credit: risk-return, five-year history**




Returns are monthly returns in excess of duration-matched treasuries. Risk is measured as the monthly standard deviation of these returns.
Source: Robeco, Bloomberg.
This example is for information purposes only and is not intended to be investment advice in any way.

## Holding strong over time

This is illustrated by the track records of our Global SDG and Euro SDG Credit strategies. The Global SDG Credit strategy was launched in May 2018 and has delivered a cumulative outperformance of 4.8% against the Bloomberg Global Aggregate Corporate Index (IH EUR class as of June 2021).[1] This outperformance is a result of bottom-up credit selection (+2.5%) and top-down beta management (+1.5%) as well as +0.8% contribution from the SDG screening. The exposure to names with a positive SDG assessment as well as avoiding investing in names with a negative SDG assessment contributed to returns.

[1] The currency in which the past performance is displayed may differ from the currency of your country of residence. Due to exchange rate fluctuations the performance shown may increase or decrease if converted into your local currency. The value of your investments may fluctuate. Past performance is no guarantee of future results. Performance gross of fees, based on gross asset value. In reality, costs (such as management fees and other costs) are charged. These have a negative effect on the returns shown. Periods shorter than one year are not annualized. Source: Robeco. RobecoSAM Global SDG Credits. Benchmark: Bloomberg Global Aggregate: Corporates.

# Conclusion

Euro SDG Credits outperformed the Bloomberg Euro Aggregate Corporate Index by a cumulative 1.3% (DH EUR class)[2] over the period that the SDG screening was applied (February 2019 to June 2021). This outperformance was driven mostly by the top-down beta positioning, while the SDG screening added 0.6% over this period.

SDG Credit Income is a total-return strategy and is therefore not managed against an index. This means we cannot follow the same performance attribution process to assess the contribution of the SDG screening. Nevertheless, we have seen that avoiding names that have a negative SDG assessment has helped to reduce risk in the portfolio.

Contributing to the SDGs makes a difference to society. Moreover, empirical analysis shows that investing with the SDGs in mind supports financial performance. Based on the track record of our strategies, we find that screening credits for their sustainability characteristics promotes our ability to avoid poor performers, while it does not limit our capacity to generate alpha through credit selection.

The SDGs are a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity. These 17 goals build on the successes of the Millennium Development Goals, while including new priority areas such as climate change, economic inequality, innovation, sustainable consumption and peace and justice. They take the quest for sustainability to the next level by making it tangible and measurable. Investors are taking a growing interest in investments that contribute to the realization of these goals and at the same time offer attractive returns. However, assessing a company's contribution to the SDGs can present challenges.

Robeco has developed a comprehensive proprietary SDG measurement framework with clear, objective and consistent guidelines for dealing with these challenges. Using this proprietary SDG framework, we can construct credit portfolios that are diversified across issuers and sectors, and which make a clear positive contribution to the SDGs, while also delivering attractive financial returns for our investors. Furthermore, our SDG screening can help reduce downside risks in credit portfolios, as it separates the wheat from the chaff and prevents investors from investing in companies with outmoded business models that have come under severe pressure. Examples include automotive companies that do not adapt quickly enough to a world of electric vehicles and traditional integrated oil producers. Companies that offer solutions to help achieve the SDGs may well be the winners of the future as well as attractive investment candidates.

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The funds have not been and will not be registered with the National Registry of Securities, maintained by the Mexican National Banking and Securities Commission and, as a result, may not be offered or sold publicly in Mexico. Robeco and any underwriter or purchaser may offer and sell the funds in Mexico on a private placement basis to Institutional and Accredited Investors, pursuant to Article 8 of the Mexican Securities Market Law.

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**Additional Information for investors with residence or seat in South Africa**
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The sale of the Fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. The Fund must not be offered or sold to the public in Uruguay, except under circumstances which do not constitute a public offering or distribution under Uruguayan laws and regulations. The Fund is not and will not be registered with the Financial Services Superintendency of the Central Bank of Uruguay. The Fund corresponds to investment funds that are not investment funds regulated by Uruguayan law 16,774 dated September 27, 1996, as amended.



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