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Explanation on Robeco's SDG Framework for the SFDR requirements

The Sustainable Development Goals as a blueprint for sustainable investing

The Sustainable Development Goals (SDGs) were adopted by all United Nations member states in 2015 as part of the 2030 Agenda for Sustainable Development. Collectively, these 17 goals, with 169 underlying targets and over 200 indicators, are to be achieved by the year 2030 and aim to 'free humanity from poverty, secure a healthy planet for future generations, and build peaceful, inclusive societies as a foundation for ensuring lives of dignity for all'. Although the SDGs are part of an intergovernmental agreement, they formally call upon the private sector to contribute to their achievement.

Their universal nature, their relevance for the public, private and civil-society sectors, and their detailed outlining of the world's most urgent sustainable development objectives in a concrete set of goals with underlying targets, makes the SDGs a useful blueprint for sustainable investing. Understanding how companies impact the SDGs enables creating investment strategies that allocate capital towards companies that contribute to the SDGs, while avoiding financing those companies that undermine progress.

Robeco's SDG Framework

The Robeco SDG Framework provides an objective, consistent, and replicable approach towards assessing positive and negative SDG contributions within an investment portfolio. Using a 3-step approach the framework investigates to what extent a company positively and/or negatively impacts each of the SDGs (Figure 1), whereby impacts may range from highly negative (-3) to highly positive (+3) impact (see also Table 1).

Figure 1 - Robeco's SDG Framework

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

Step 1: Product Focus – What does the company produce?

The first step asks how much the products and services that companies provide positively or negative impact each of the SDGs and their underlying targets. Companies are assessed on an extensive set of key performance indicators (KPIs) with accompanying thresholds. Jointly, these KPIs and thresholds provide rules for determining how positive or negative the impact is of goods and services on the SDGs.

To illustrate, when analyzing a retail bank, the starting point is that we expect positive impacts on SDGs 8 (Decent Work and Economic Growth), and 9 (Industry, Innovation, and Infrastructure). The reason is that these SDGs have sub-target that actively call for the participation of the financial sector (targets 8.3; 8.10; and 9.3). However, we must be certain that the bank that is being analyzed actually positively impacts these SDGs. The KPIs and thresholds help to conduct this assessment. For instance, one KPI in our framework looks at the proportion of loans that the bank has outstanding to small-to-medium sized enterprises compared to the value of its total loan book. Should this exceed 15%, then we determine the impact to be positive, to a medium extent, for SDGs 8 and 9. Similarly, we have additional KPIs and related thresholds that gauge the share of consumer loans issued by the bank to clients in emerging markets (positively impacting SDG 1, target 1.5), the value of retail mortgage loans issued (positively triggering SDG 11, target 11.1), and so forth.

Step 2: Operational focus: How does the company operate?

Companies not only impact the SDGs through their products and services: their operations matter, too. Are they polluting, do they respect labor rights, do they refrain from corruption and do they have a well-diversified board? In step 2, analysts check if the way the firm operates is compatible with the SDGs. This includes comprehensive evaluations of a company's environmental policies, conduct track record, governance framework, etc. If material positive or negative impacts are identified, the SDG ratings can be adjusted. For instance, the RobecoSAM Gender Equality score is used to assess companies' performance on various dimensions of women empowerment.

Step 3: Continuous Monitoring—Are legal disputes public and controversies known?

In the final step, we check whether the company concerned has been involved in any controversies. A company can make the right products, operate in the right manner, and so meet the criteria set in steps 1 and 2, but still be caught up in controversies, such as oil spills, fraud or bribery. To identify whether a company is involved in a controversy, ratings and data from external providers are used to aid our in-house monitoring. If a controversy is found, the analyst determines whether this has material impacts on the SDGs. If the controversy is found to do significant harm, the final SDG Score for the company will be negative, regardless of any positives identified in Steps 1 & 2.

To determine severity, it is important to know not only the magnitude of the controversy, but if the controversy is structural or just a one-off, and if management has adequately dealt with it to prevent recurrence in the foreseeable future. The analyst can therefore propose to temporarily put the SDG rating at (-3) while awaiting management reaction and corrective measures. Moreover, in case more information is needed in order to make the correct judgment, we work with our Active Ownership team to start an engagement trajectory. This can help define whether or not the company has adequately dealt with a controversy and if the risk of future missteps is mitigated.

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The SDG Score

The outcome of this three-step analysis is quantified with a proprietary SDG rating methodology. All companies obtain an SDG score based on their contribution to the SDGs (positive, neutral or negative) and the extent of this contribution (high, medium or low) (Table 1).

Table 1 – SDG rating methodology

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

Following the three steps of the SDG assessment, a company has received an SDG score for each of the goals that it impacts through its products/services, its operations, and any potential controversies. This means that a company may impact multiple SDGs, whereby each of these impacts may be positive or negative at various impact levels. To calculate a final SDG score for the company, we apply a so-called "min-max" rule. This rule stipulates that if a company has negative impacts on an SDG ("min") the lowest SDG-score will be taken as the company's final SDG score, even though this company may have positive impacts on other SDGs. In turn, if the company only positively impacts SDGs ("max"), we take the highest SDG score as its final rating.

To illustrate: a company that has a positive-low (+1) impact on SDG 1 – No Poverty and a positive-high (+3) impact on SDG 8 – Decent work and Economic Growth, will get a final SDG score of +3, since this is the "max" score and no negative impacts have been identified. As another example, a company with a positive-medium (+2) impact on SDG 8 – Decent Work and Economic Growth, but a negative-high (-3) impact on SDG 16 – Peace, Justice and Strong Institutions will get a final SDG score of -3, since this is the "min".

This rule is important. The international treaty introducing the SDGs explains that they are "integrated and indivisible" . In other words, they should be treated as a whole rather than as 17 isolated goals, in order to ensure that progress on one goal does not undermine progress on another. The "min-max" rule warrants that companies with a negative impact on an SDG also have a negative final SDG score – allowing us to exclude such companies from investment strategies aimed at advancing the SDGs. This is a tremendous advantage over other scoring methodologies, such as taking an average or median of all scores. These leave room for a company having a positive final SDG score, even though it may simultaneously also cause significant negative impacts on other SDGs. With such an average or median score, the possibility of doing significant harm cannot be fully avoided. The "min-max" rule, in contrast, is based on the precautionary principle in sustainability aimed at avoiding harm.

Managing, maintaining, and improving the SDG Framework

Robeco's SDG Committee is responsible for maintaining, updating, and improving Robeco's SDG framework. This involves overseeing the continuous development of the KPIs and thresholds, ensuring that the systems and processes through which the SDG assessment are undertaken are of the highest quality, assessing proposed amendments to the framework, and ensuring high quality governance. The committee's membership comprises senior sustainable investing experts and members of our (credits and equity) investment teams.

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