Advancing SDGs through fixed income: supply versus demand

Sustainable investing solutions are accelerating as data gains greater sophistication. This development enables investors to create targeted, bespoke solutions, where sustainable investments reflect personal or corporate preferences and ambitions.

By *Ronald van Loon*

In this article, we explore the feasibility of aligning capital allocation decisions to individual SDGs through the lens of a fixed income investor, we evaluate how green, social and sustainable (GSS) bonds are mapped to SDGs and look at the subsequent dynamic between GSS supply and their alignment to SDGs, favoured by a sample investor cohort: Dutch pension funds.

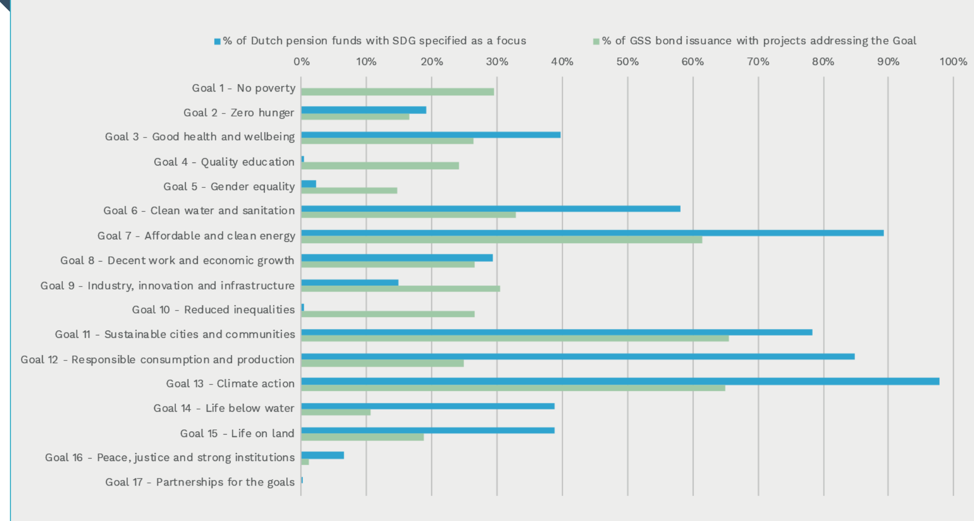
Sustainable investing through the lens of the SDGs

To achieve the ambitious SDGs by 2030, a substantial further redirection of investments is needed. Investors play a pivotal role and in this context data assumes paramount importance. In recent years, significant strides have been made in data availability for SDG indicators thanks to enhanced disclosures by issuers and increased investment from asset managers and third-party data providers in bottom-up research. These exciting developments have paved the way for a more targeted approach to sustainable investing, enabling the creation of portfolios that align investment opportunities with specific SDGs and the sustainability goals of end-investors. For investors, the SDGs present a remarkable opportunity to channel investments into sectors that not only yield financial returns but also create tangible societal outcomes.

SDGs in fixed income: the case for GSS bonds

Unlike traditional bonds, GSS bonds are ‘use of proceeds’ instruments that fund projects that have positive environmental outcomes (green bonds), social benefits (social bonds), or a mixture of both (sustainability bonds).

FIGURE 1: FOCUS SDGS OF DUTCH PENSION FUNDS



Sources: BlackRock survey of Dutch pension funds and BlackRock Capital Markets as of July 2023

ILLUSTRATION: SHUTTERSTOCK

> ‘All Dutch pension funds that have published focus SDGs have at least one of SDGs 7 and 13, or both, in their focus lists.’

The unique dedicated use of proceeds that is a core pillar of the structure of GSS bonds has the potential to deliver impact to investors and generate positive environmental and social outcomes, providing a clear pathway for advancing the SDGs.[1] This asset class is unique as it can be utilised as a funding mechanism for both the public and private sectors. It provides an avenue of public-private partnership in tackling today’s key global challenges, including mitigating climate change, enabling social advancement, eliminating social inequalities, and reversing biodiversity loss.

Investor demand: the case of Dutch pension funds

On the demand side we look in particular at long-term institutional investors with good data availability with regards to focus SDGs: Dutch pension funds.

We have analysed documents from the 50 largest Dutch pension funds and extracted the focus SDGs. Of the 50 largest funds, 39 have made explicit which SDGs they wish to target, representing 93% of assets under management of the top funds.

A few trends emerged. The SDGs that are most heavily supported as measured by % of AUM are the two that are associated with the environment: SDG 13 (Climate action) and SDG 7 (affordable and clean energy). In fact, all Dutch pension funds that have published focus SDGs have at least one of SDGs 7 and 13, or both, in their focus lists. SDG 11 (sustainable cities and communities) and SDG 12 (responsible consumption and production) are also well supported, and one can imagine these being well supported in focus lists as they can be targeted relatively easier by capital market instruments.

Mind the gap: mapping supply to investor demand

The SDG breakdown on the demand side (by percentage of AUM) is compared in Figure 1 to the SDG breakdown on the supply side (by percentage of market value). A few trends stand out. The climate and clean energy objectives of SDG 7 and SDG 13 rank very high in absolute terms on the demand side and on the supply side. What this shows is that there is no shortage of supply and demand for assets that can promote climate and energy efficiency goals. As said before, of the 39 funds that we polled, all had at least SDGs 7 or 13 (or both) as a focus SDG. Although 7 and 13 are also well covered in green bonds, the figure shows that demand exceeds supply in this sample and there appears plenty of latent demand for financing the energy transition and climate initiatives relative to the current supply of GSS assets.

More GSS bonds

In this article, we have combined two recent themes on the supply side and on the demand side of the capital markets, to highlight overlap and shortfall gaps in what SDGs investors can advance through GSS bonds versus what SDGs investors want to advance through their investments. SDGs that are relatively ‘under-supplied’ by the bond market suggest that there is scope for further growth of issuance of GSS bonds to meet demand. We welcome and promote future issuance in bonds that specifically target these SDGs.

This relatively simple comparison has highlighted some themes on what role capital markets can play in advancing the UN SDGs. ■

1 See: www.icmagroup.org/assets/documents/Sustainable-finance/2023-updates/Green-Social-and-Sustainability-Bonds-A-High-Level-Mapping-to-the-Sustainable-Development-Goals-June-2023-220623.pdf

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SUMMARY

To achieve the ambitious SDGs by 2030, a substantial further redirection of investments is needed.

GSS bonds have the potential to provide a clear pathway for advancing the SDGs.

There is a mismatch today between focus SDGs of Dutch pension funds and projects financed by outstanding GSS bonds.

There is a role here for targeted engagement in stimulating GSS supply in currently underrepresented areas.

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