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PARTNERSHIP SINCE 1590

A BERENBERG ESG OFFICE STUDY

Understanding the SDGs in sustainable investing

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Acknowledgements

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Berenberg would like to express our appreciation to the 49 organisations that completed this survey.

ESG Office

The independent ESG Office is responsible for the ESG policy, strategy, investment positioning, integration, product offering and innovation for Berenberg's Wealth and Asset Management division.

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Introduction

Berenberg has been managing sustainable investment mandates for decades. Alongside our core Environmental, Social and Governance (ESG) strategy, many of our clients have a range of specific ethical criteria. We have developed the resources to ensure that our investment processes can adapt to their changing needs.

Nevertheless, this ESG approach was a niche investment strategy until recently. We are now seeing the concept of sustainable investing emerging from the shadows of mainstream investing. Our clients are showing increased demand for a more thoughtful approach, away from a two-dimensional ethical filter (positive and negative).

This increased demand brings increased evaluation of investment opportunities and strategies. There is a greater need to identify a framework for comparison and benchmarking of investment approaches, and for understanding the non-financial return on an investment.

Berenberg recently became a signatory of the United Nations-supported Principles of Responsible Investment (PRI), and we are also members of the International Corporate Governance Network (ICGN). Berenberg established an ESG office in March 2018 to build on our sustainable investment credentials and address growing client demand. We are now looking at how our core ESG strategy can evolve.

The emergence of the United Nation's Sustainable Development Goals (SDGs) in 2015 was the latest attempt to bring about specific measures to improving the world's environmental and social footprint. Considering the growth of ESG investments in the recent years, these SDGs are well timed. Coincidentally or not, the SDGs are increasingly referred to in sustainable investment strategies.

To better understand the market sentiment towards the SDGs, we conducted a survey amongst investors to ascertain the interest and relevance of SDGs in investment strategies. The findings are set out in Part 1 of this paper, and we believe they make for an interesting read which we are delighted to share with you. It has helped to inform our own thinking, as we explain in this paper. We hope it might do something similar for you.

Throughout this paper the terms sustainable investment and responsible investment are used interchangeably. We consider them both as broad terms which cover ethical investment, negative and positive screening, norm-based screening, best in class selection, corporate engagement and other investment approaches which involve using ESG factors such as climate change, human rights and executive pay.

This paper is organised in two parts

The first part presents the results of our survey and aims to understand the perceptions of sustainable investing and the SDGs in the investor community.

The second part aims to understand how Berenberg can work with the investment community to understand the use of the SDGs.



Part 1: Results from our Survey

We designed this survey to give us a better understanding of the views of our clients and partners on sustainable investing and the SDGs. We sent the survey to various foundations, family offices, non-profit organisations, asset managers, service providers and academics. We received responses from 49 organisations.

We purposely collected feedback from parties we deemed knowledgeable on sustainable investing to ensure we received meaningful information. 96% of the respondents indicated that sustainability is part of their investment philosophy and 85% of the respondents indicated that they are aware of the SDGs.

Figures 1 and 2 illustrate where the respondents are from and the mix of respondent profiles. We were pleased to see reasonable diversification in each category (albeit with a strong European bias).

Figure 1: Responses by countries
n = 49

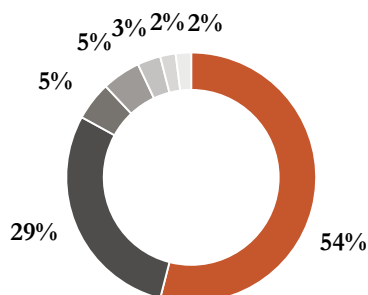
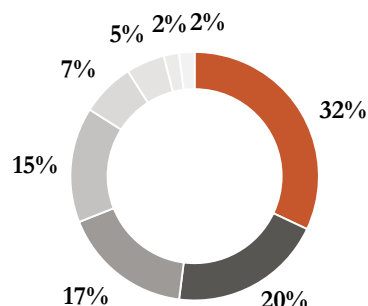


Figure 2: Respondent profiles
n = 49

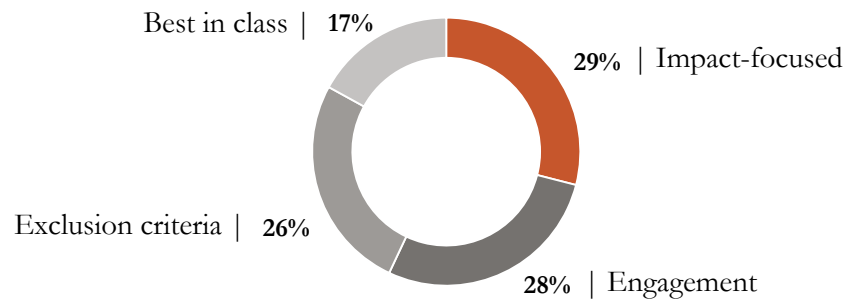


- | | | | |
|---------------|------------------|--------------------|---------------------------|
| ■ Germany | ■ United Kingdom | ■ Foundation | ■ Asset Manager |
| ■ Switzerland | ■ Luxembourg | ■ Service Provider | ■ Non-Profit Organization |
| ■ Singapore | ■ Malaysia | ■ Education | ■ Family Office |
| ■ Belgium | | ■ Fund Broker | ■ Company |

The main questions in the survey as well as the results are as follows:

Question 1: Which ESG investment strategies do you use?

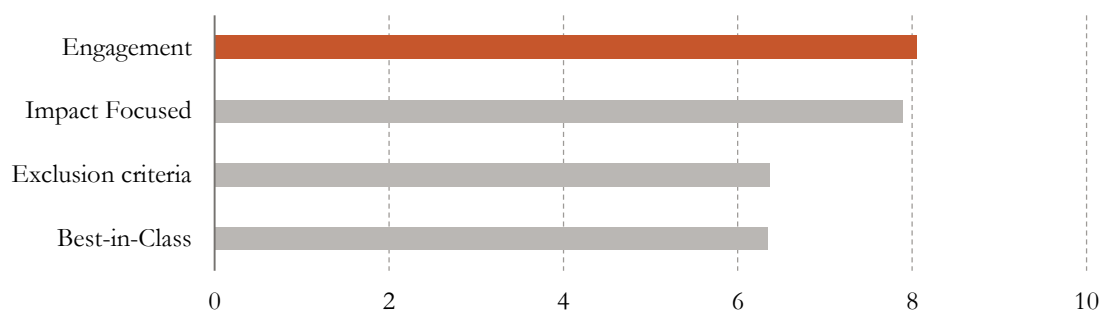
Figure 3: ESG investment Strategies
n = 49



The responses show a similarity between the use of impact-focused, engagement and exclusion criteria strategies. Respondents named best in class as the least used method. Best in class is the active selection of only those companies that meet a defined ranking hurdle established by ESG factors.

Question 2: On a scale of 1 to 10, which ESG investment strategy is critical to you?

Figure 4: Critical ESG investment strategies
With 10 being the most critical



Engagement and impact-focused are the most critical ESG investment strategies for the respondents. This could suggest that investors want their money to be managed more proactively.

We observe that question 1 shows that best in class strategies are used less than exclusion criteria; while in contrast, question 2 shows that best in class strategies are equally as critical as exclusion criteria. Exclusion criteria may be used more often than best in class strategies because they are easier to implement.

Question 3: Please rank the SDGs by importance.

Figure 5: The 17 SDGs ranked by importance
With 1 being the most important

1	Quality Education		10	Reduced Inequalities	
2	Good Health and Well-Being		11	Industry, Innovation and Infrastructure	
3	No Poverty		12	Responsible Consumption and Production	
4	Zero Hunger		13	Peace, Justice and Strong Institutions	
5	Climate Action		14	Sustainable Cities and Communities	
6	Clean Water and Sanitation		15	Life Below Water	
7	Affordable and Clean Energy		16	Life on Land	
8	Decent Work and Economic Growth		17	Partnership for the Goals	
9	Gender Equality				

When creating investment products, we should focus our efforts on the SDGs that are most important to the respondents. The top 4 SDGs are also skewed more towards the social aspects of the goals. (Refer to Figure 13 on our mapping of the SDGs across the three ESG factors)

Question 4: Which of the SDGs do you think are investible?

Figure 6: Top 5 and bottom 5 most investible SDGs
Rank in importance from question 3 in brackets

Top 5		Bottom 5	
1	Clean Water and Sanitation (6)	13	No Poverty (3)
2	Affordable and Clean Energy (7)	14	Reduced Inequalities (10)
3	Climate Action (5)	15	Gender Equality (9)
4	Industry, Innovation and Infrastructure (11)	16	Peace, Justice and Strong Institutions (13)
5	Good Health and Well-Being (2)	17	Partnerships for the Goals (17)

We can use the output above to compare with the answers in question 3. It is evident that there is a difference between the current supply and demand for investment solutions, and further work is needed to develop impact-orientated output as well as new investment products.

Three of the top five most important SDGs are outside of the top five most investible SDGs. For example, No Poverty is ranked as the third most important SDG in question 3. However, in question 4, No Poverty is considered as one of the least investible. It is also useful to see that the top three most investible SDGs seem to focus around the environmental perspective of the goals.

Question 5: On a scale from 1 to 10, in which markets do you think the SDGs are more relevant for use in a fund?

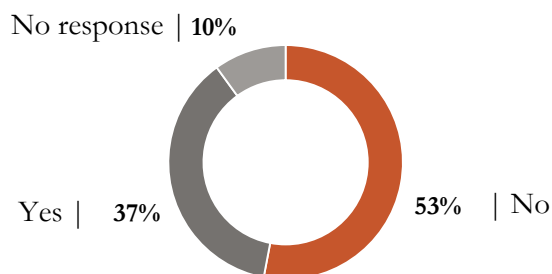
Figure 7: Relevance of SDGs in markets



On average, the respondents indicated that the SDGs would be equally relevant for use in Developed Markets and Emerging Markets funds. This suggests that the SDGs can be used across various markets globally.

Question 6: Are there enough impact-focused products in the market?

Figure 8: Opinion on sufficient amount of impact-focused products



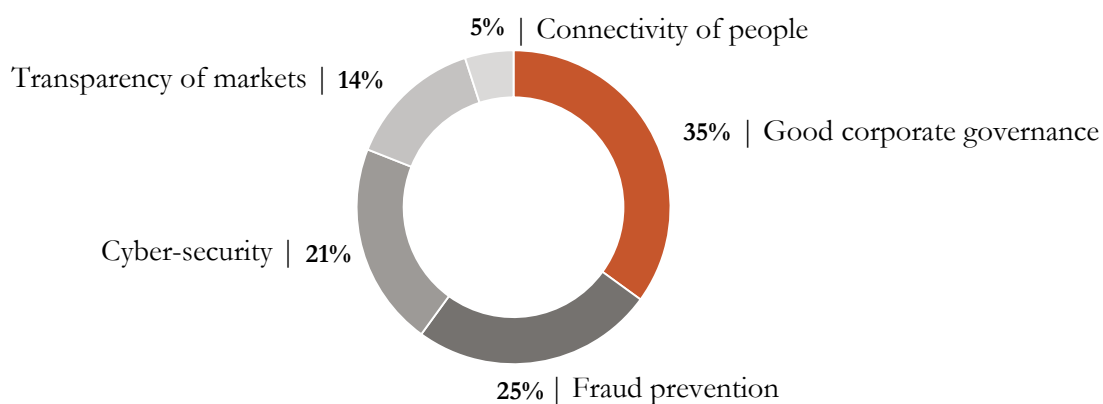
53% of the respondents indicated that there are not enough impact-focused products. This builds on the responses from questions 3 and 4, suggesting a need for investment products that embrace SDGs that have historically been considered less investible.

The respondents also gave the following additional comments:

- Impact investing is still a niche. Impact products need to be more accessible and investible.
- The challenge lies in measuring impact. It is difficult to see how funds will report to investors on the impact of their investments.
- We see a lot of “greenwashing”, but there are few genuine impact products.
- There is an important difference between top down negative screening and bottom up selection that focuses on companies that are creating impactful solutions.
- Unlisted companies are more likely to deliver impact aligned with the SDGs than listed companies. Unfortunately, the unlisted market is more difficult to access.

Question 7: Which of these other factors do you think should be considered, alongside the SDGs?

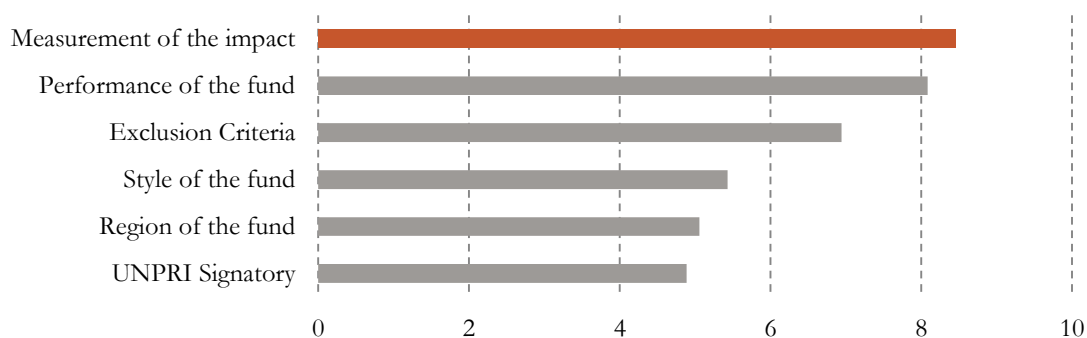
Figure 9: Additional factors to the SDGs



The pie chart reflects the diversity of interests within sustainable investing. 35% of respondents indicated that good corporate governance should be considered additionally to the SDGs. Market transparency, fraud prevention and cyber-security are also factors that are important to the respondents when making sustainable investment decisions. This ties into the need for a more proactive approach to investing (highlighted in question 2), where different investor preferences are taken into consideration alongside the use of SDGs.

Question 8: On a scale of 1 to 10, which factors are critical to you when selecting an ESG fund?

Figure 10: Critical factors when selecting an ESG fund
With 10 being the most critical



The respondents consider the measurement of impact and fund performance to be the most critical factors when selecting an ESG fund. This underscores the need for impact-focused products and proactivity when investing, as outlined in question 2 and 6.

It is evident that investors are becoming more engaged with the use of their investments and how they are making an impact. But they are not prepared to sacrifice the performance of their investments. Being a signatory of the UN Principles of Responsible Investment (PRI) is considered the least important factor. This may be as a result of the increasing number of PRI signatories, now at around 2,000 investment institutions, meaning it may be taken as given that an ESG fund manager would be party to the PRI.

Question 9: Will sustainable investments outperform conventional investments?

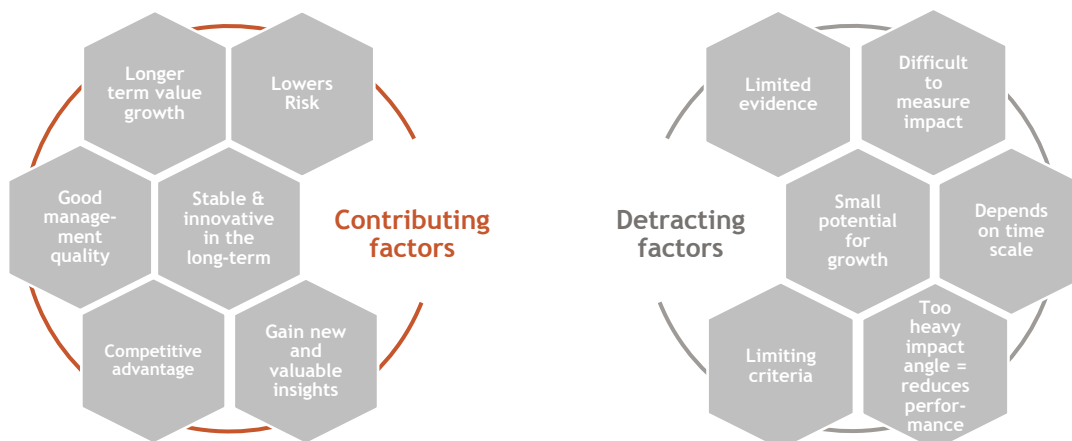
Figure 11: Opinion on whether sustainable investments will outperform conventional investments



71% of the respondents think that **sustainable investments will outperform conventional investments**, 23% believe they won't and 6% did not respond.

Respondents were then asked to comment and give examples of factors that affect whether sustainable investments will outperform. These are shown in Figure 12 below.

Figure 12: Contributing or detracting factors to the performance of sustainable investments



In conclusion, the survey results show a range of perceptions of sustainable investment strategies and the SDGs. Below we have outlined our key takeaways:

9 key takeaways

- 1 Engagement and impact measurement are the most critical ESG strategies.
- 2 Investors would like to see their money being used more proactively.
- 3 There is scope to create investment products for less accessible SDGs.
- 4 The SDGs can be used when investing globally.
- 5 There is a need for more genuinely impact-focused products that are accessible.
- 6 Measuring and reporting on the impact of investments will be challenging.
- 7 Good corporate governance should be considered alongside the SDGs.
- 8 The majority believe sustainable investments will outperform conventional investments.
- 9 Investment performance is important to investors and should sit alongside impact.



Part 2: Working with the investment community to understand the use of the SDGs

What do the survey results mean for Berenberg and our clients?

Our existing sustainable investment process can be outlined briefly as follows:

1. Negative screening
2. Idea generation
3. Research
4. Portfolio construction
5. Risk management through monitoring and engagement

As an investment house with an active stock picking approach, we have always endeavoured to understand a company's sustainability using both qualitative and quantitative methods under the structure of ESG. We use a flagging system which allows us to highlight controversies in companies. This encourages us to speak to company management teams on a regular basis. It helps us to understand better their growth drivers and their potential for change. This method also means we are not only investing in companies with advanced ethical or sustainable business practices, but also in companies who are on the road to improvement.

The survey results help to confirm that investor preferences are changing. Clients not only want to be investing sustainably, they also want to understand the impact of their investments and see the results of our engagement.

We will continue to run our existing sustainable investing strategies and leverage our expertise in selecting under-covered small and mid-cap stocks and creating segregated investment portfolios for clients. We have many clients who have a preference for staying invested under their chosen sustainable mandates. These mandates are often bespoke and help clients to balance the need for long-term returns with ethical criteria.

Nonetheless, we are now working on creating an additional investment strategy which includes understanding the impact and sustainable growth drivers of companies. We would like to be able to report to clients on the impact of their investment portfolios in a way that is easy to digest. Aligning companies with the SDGs is a good starting point and an important consideration when measuring impact, though it has its constraints which we explain below.



Constraints

It is important to highlight that there are constraints when aligning investments with the SDGs. A few examples:

- There are many different ways of interpreting the SDGs. Companies may feel the need to align their business to the SDGs, which could lead to false recognition. We do not want to encourage companies to align themselves to SDGs inaccurately. But at the same time, we do not want companies to be penalised by the market if they do not align themselves with the SDGs.
- As highlighted in question 4 of the survey, some SDGs are harder to invest in. Investing in renewable energy projects can be directly related to the SDG 7 “Affordable and Clean Energy”. However, investing in the SDG 16 “Peace, Justice and Strong Institutions” is more subjective.
- Measuring the impact that an investment might have on society is difficult. The time between an investment being made and seeing the actual impact can be long. With so many other factors affecting the result, it can be hard to prove there was a direct correlation. For example, it can be hard to prove that an investment in education 20 years earlier has been the main cause of an increase in employment. This is especially difficult if during the same time period there have been huge changes in technology, communication, international mobility and productivity.

Key constraints

- Different ways of interpreting the SDGs can lead to false recognition.
- Some SDGs are harder to invest in than others.
- Measuring impact is challenging.

Measuring impact

The Global Impact Investing Network states that “impact investments are investments made with the intention to generate a positive social and environmental impact alongside a financial return”¹. We can measure financial return on investments, but how do we measure impact?

Our existing sustainable investment philosophy monitors sustainability under the structure of ESG. To enhance our investment philosophy, and to begin measuring impact, we plan to map the SDGs to the companies we analyse. First, we have divided the SDGs between the three ESG factors. Please see Figure 13. SDGs that appear more than once are relevant across two or even all three factors.

Figure 13: Mapping the SDGs across the three ESG factors



¹ GIIN, 2018

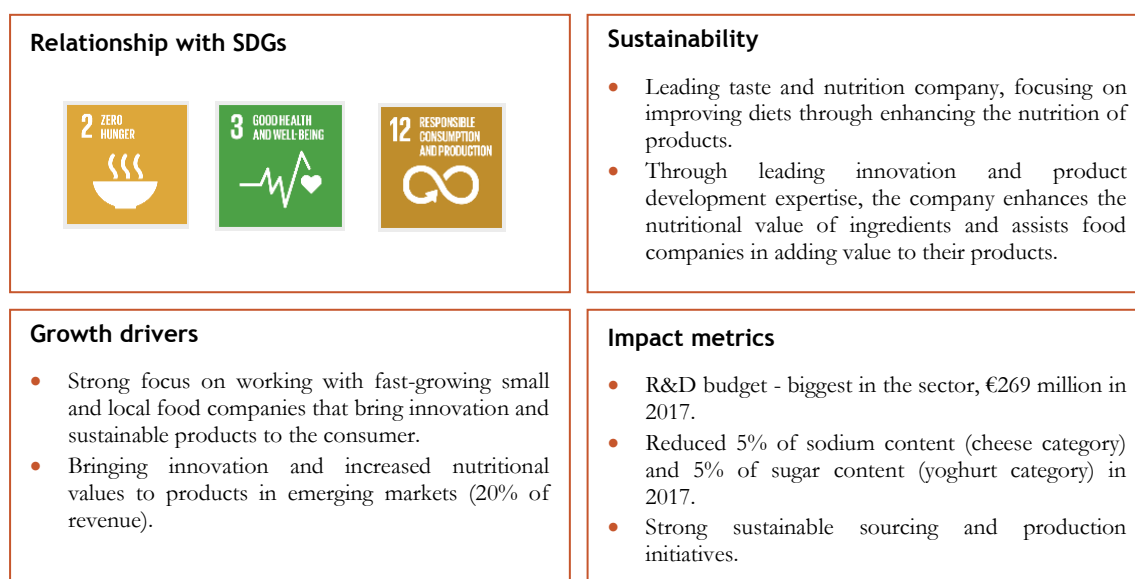
Mapping the SDGs to companies will take time. Some sectors will be more challenging. We hope our ongoing engagement with companies will help us to understand which of the SDGs are important to their management teams.

We plan to engage with companies on the following:

- Relationship with SDGs - encourage companies to map the SDGs to their business models
- Sustainability - understand their sustainable/unsustainable business practices
- Growth drivers - examine the potential for improvement in sustainability
- Impact metrics - outline metrics that can be monitored

We plan to use the impact metrics to regularly monitor and evaluate progress, and report to clients on our findings. Please see Figure 14 for an example of a company we have engaged with. Our initial findings are outlined in the four boxes below.

Figure 14: Brief example of a global leader in the food and beverage industry





Engagement

When we engage with companies on controversies, we plan to take them through the following progress journey:

1. Berenberg recognises controversies using ESG data providers and in-house research.
2. Berenberg engages with the company directly and requests an explanation.
3. The company acknowledges issues and provides feedback.
4. The company indicates strategies they are creating/amending to address issues.
5. The company implements new strategies.
6. Berenberg monitors the success of new strategies and evaluates whether improvements in sustainability are sufficient.

At Berenberg we have good relationships with our investee companies, and most of them are open to our engagement. However, if we are unable to receive adequate answers from companies when engaging directly, we will attempt to work with other industry bodies or shareholders as part of our institutional engagement. We also endeavour to report to clients on the outcome of this progress journey. We hope to involve them in the process and help them to understand the impact our engagement is having on their investments.

Moving forward

In the same way as we have always done, we want to make sure we approach this challenge from a place of understanding. The survey has been a useful tool for highlighting the need for investment products that can show genuine impact measurement and engagement. Investors want their funds to be used proactively, but they do not want to focus on impact to such an extent that they sacrifice investment returns.

At Berenberg, we hope to provide clarity around our measurement and engagement processes by integrating the SDGs into a new, additional sustainable investment strategy. We recognise that there are constraints to using the SDGs as a method of evaluation, and there are of course a large number of existing impact measurement tools. We will continue to look into alternative methods and compare the advantages and disadvantages of each.

Our expertise lies in selecting under-covered small and mid-cap stocks and creating bespoke segregated global investment portfolios for clients. We hope to leverage this deep understanding to engage with companies on the SDGs and sustainability. We will continue to use both qualitative and quantitative methods, and we aim to outline impact metrics we can monitor. Our long-term goal is to create a clear sustainable investment philosophy which allows our clients to make financial returns they can feel proud of, while also understanding the impact of their investments.



Conclusion

The survey results suggest that investors would like to see a new sustainable investment strategy which can report to them on the impact and effects of company engagement. We will attempt to use the SDGs to help with this process.

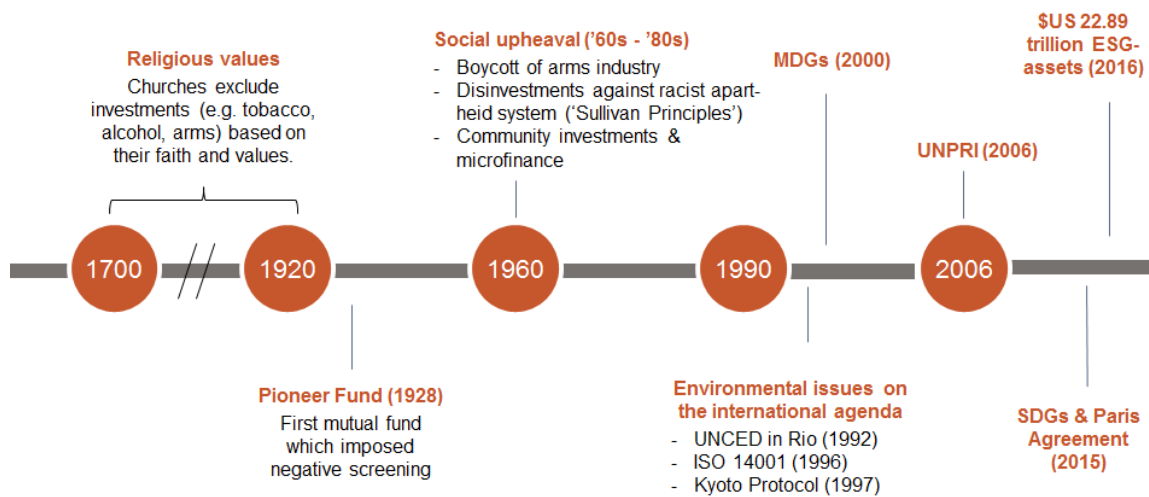
We are continually evolving, and aim to build the necessary in-house expertise to provide our clients with investment advice and portfolios that are aligned with their preferences. We want to work together with the investment community to create a solution that adds value to our clients. So, as we improve our sustainable investment offering, we continue to invite further feedback.

Appendix

How did we get here?

Below is a timeline showing a brief history of sustainable investing. Several time periods are explained in further detail in the following sections.

Figure 15: Timeline of sustainable investing



Source: Berenberg

The beginnings

The concept of integrating social and environmental concerns into investment decisions can be traced back some 200 years². However, sustainable investing was more widely discussed in the 1920s. Churches in the United States and Europe began to consistently exclude investments which were incompatible with their faith³. The most common exclusions were tobacco, alcohol, gambling and arms companies. In 1928 the Pioneer Fund was launched, the first (U.S.) mutual fund which imposed negative screens⁴.

² e.g. the Religious Society of Friends ("Quakers") during the 1700s and the Methodists

³ Kawaguchi, 2017

⁴ Sparkes, 2002



Between the 1960s and the 1980s, certain events led to changes in society and an increasing interest in the incorporation of values within financial activities:

- The protests against the Vietnam War
- The launch of the first socially responsible mutual fund, “Pax Balanced Fund”, in 1971
- The movement of microfinance⁵, started by Muhammed Yunus in 1976
- The introduction of the “Sullivan Principles⁶” in 1977

The term “socially responsible investment” (SRI)⁷ was born, encompassing negative screening alongside “non-economic motives”⁸ such as institutional and personal values⁹.

The 1990s

During the 1990s concerns around environmental and sustainable development issues increased. This was reflected in the milestones of the UN Conference on Environment and Development in Rio in 1992, the publication of ISO 14001 which “sets out the criteria for an environmental management system”¹⁰ in 1996, and the implementation of the Kyoto Protocol in 1997. These agreements fuelled debates on how to integrate environmental and social performance into investment processes, leading to longer-term investment thinking¹¹.

Corporate governance issues have played a role in investment decisions since at least 1970¹². But in the 1990s awareness started to increase. A poor corporate governance structure could lead to environmental or social mismanagement, which was considered a risk factor for investors. This increasing awareness culminated in the corporate scandals of the early 2000s, which brought the conversation into the public arena¹³.

The focus started to shift from including personal or religious values into investment decisions, towards a more detailed assessment of corporate and societal risks and opportunities¹⁴. This shift encouraged an increasing number of asset managers to analyse ESG factors alongside financial returns when researching investment opportunities.

⁵ “Microfinance refers to the practice of providing financial services, e.g., tiny loans, to poor people” (Renneboog, Ter Horst, & Zhang, 2008, p. 1726)

⁶ Requirements for companies in South Africa to combat the apartheid system

⁷ Also known as ethical investment (Sparkes, 2002, p. 22f.)

⁸ Bengtsson, 2008, p. 969

⁹ e.g. Commonfund, 2013; Louche & Lydenberg, 2006; Sparkes, 2002

¹⁰ ISO, 2018

¹¹ Kawaguchi, 2017

¹² Cheffins, 2012, p. 1

¹³ Tan, 2014 offers a comprehensive overview of several studies which tried to operationalise and/or measure the link of corporate government structures to financial performance

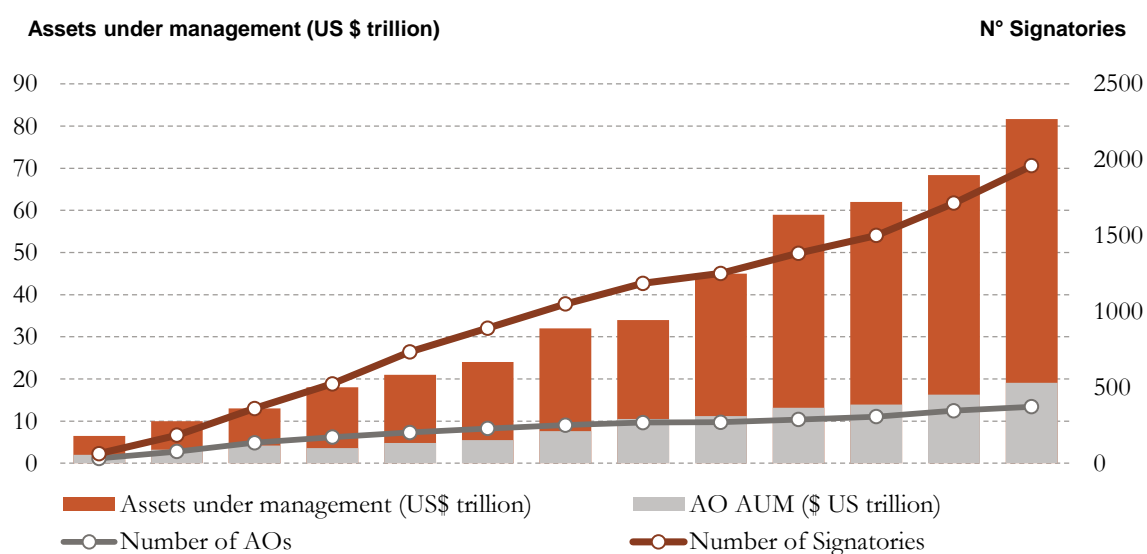
¹⁴ Kawaguchi, 2017

Since 2000

In 2000 the Millennium Development Goals (MDGs) were created to tackle global poverty, hunger, disease, illiteracy, environmental degradation and discrimination against women. The target date set for achieving the MDGs was 2015. Although not all the targets were reached, the MDGs were responsible for driving progress in international development. Most importantly, they helped to combat HIV/AIDS and other treatable diseases such as malaria and tuberculosis¹⁵.

2006 saw the launch of the Principles for Responsible Investment (PRI), devised by the investment community and supported by the United Nations. The PRI provides a voluntary framework by which all investors can incorporate ESG factors into their decision-making and ownership practices, and so better align their objectives with those of society at large. “The PRI is the world’s leading proponent of responsible investment. [...] It encourages investors to use responsible investment to enhance returns and better manage risks”¹⁶. By April 2018 over 2,000 investment institutions had become signatories, with more than US \$80 trillion in assets under management (see Figure 16).

Figure 16: Development of PRI



Source: UNPRI 2018b

The PRI is made up of six principles. The first three principles relate to the incorporation of ESG factors when selecting investments, and when engaging with companies to encourage improvements in corporate policies and practices. The other three principles encourage the investment community to implement and promote the principles.

¹⁵ UNDP, 2018a

¹⁶ UNPRI, 2018b



The growing number of PRI signatories suggests that investment managers believe responsible investment practices are important to their client base. It also reflects the view that ESG factors can affect the performance of investment portfolios and therefore must be given appropriate consideration by investment managers if they are to fulfil their fiduciary duties. If investors are pursuing long-term investment returns, incorporating ESG factors into their investment decisions can help to manage risks and identify opportunities¹⁷.

At the end of 2015, all parties to the UN Framework Convention on Climate Change (UNFCCC) signed the Paris Agreement at the COP21 Climate Change Conference. The purpose of the Paris Agreement is to keep the global average temperature well below 2 degrees Celsius above pre-industrial levels, while pursuing efforts to limit the temperature increase to 1.5 degrees Celsius. In short, it commits all countries within the UNFCCC to take action on climate change.

Furthermore, RE100 companies and other non-state actors promised to ensure that the ambition set out by the Paris Agreement is met or exceeded. RE100 is a collaborative, global initiative uniting more than 100 influential businesses committed to 100% renewable electricity. An increasing number of international companies have signed the RE100 pledge, such as Coca Cola, IKEA, Nestlé, Unilever and Google.

In 2016, the SDGs replaced the MDGs. This initiated a bold and transformative international agenda for sustainable development, with a new target date of 2030. The SDGs are a “universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity”¹⁸. There are 17 goals, outlined in Figure 17 below.

¹⁷ Bassen & Senkl, 2011

¹⁸ UNDP, 2018b

Figure 17: The 17 SDGs



Source: UN

We are now looking at ways we can integrate SDGs into our investment practices. The SDGs represent an opportunity to create a framework for selecting, monitoring and measuring investments based on their impact on society and the environment.

Today

There appears to be growing interest in sustainable investing and the use of ESG factors when selecting and monitoring investments. Factors that may have contributed to this growth include better data and analytics, and the investment preferences of the younger generation who are due to inherit money from previous generations. There are also a number of studies that provide evidence for a positive association between ESG factors and financial performance¹⁹.

The most widely used method of sustainable investing is still exclusionary/negative screening, with US \$15 trillion in assets under management²⁰, some 65% of ESG investment assets. Between 2009 and 2015 negative screening grew as a strategy used in Europe, likely because it was easy for clients to understand and could be applied in a straightforward way, such as by screening out tobacco companies or weapons manufacturers²¹.

One of the latest and most promising trends is impact investing. Impact investing is different to responsible investing. Responsible investing is interesting for investors whose sole purpose is financial return. It argues that “to ignore ESG factors, is to ignore risks and opportunities that have a material effect on the returns delivered to clients and beneficiaries”²². Impact

¹⁹ e.g., Barnett & Salomon, 2006; Eccles, Ioannou, & Serafim, 2012; for a meta-study/ overview see Friede, Busch & Bassen, 2015; MSCI, 2018

²⁰ GSIA, 2017

²¹ EUROSIF, 2016

²² UNPRI, 2018a



investing is pursued by investors who are determined to generate social and environmental impact in addition to financial returns. Although impact investing is the fastest growing sustainable investment strategy globally, with a compound annual growth rate of 56.8% between 2014 and 2016, the total assets under management of US \$248 billion in 2016 is still relatively small compared to that of negative screening²³.

The European Union's action plan on sustainable finance should help to create a common ground across the investment community. The PRI is now developing a programme that stimulates and helps signatories to align their responsible investment practices with the broader sustainable objectives of society, as currently best defined by the SDGs. It plans to provide research and education, facilitate collaboration and embed the SDGs into its work on public policy, investment practices (investment strategy, asset allocation, manager selection, incorporation in asset classes) and active ownership. Wherever possible, the PRI will do this in collaboration with UN organisations and other UN partners. Therefore, we look forward to engaging with the PRI and the investment community to find the most effective way of using the SDGs.

²³ GSIA, 2017



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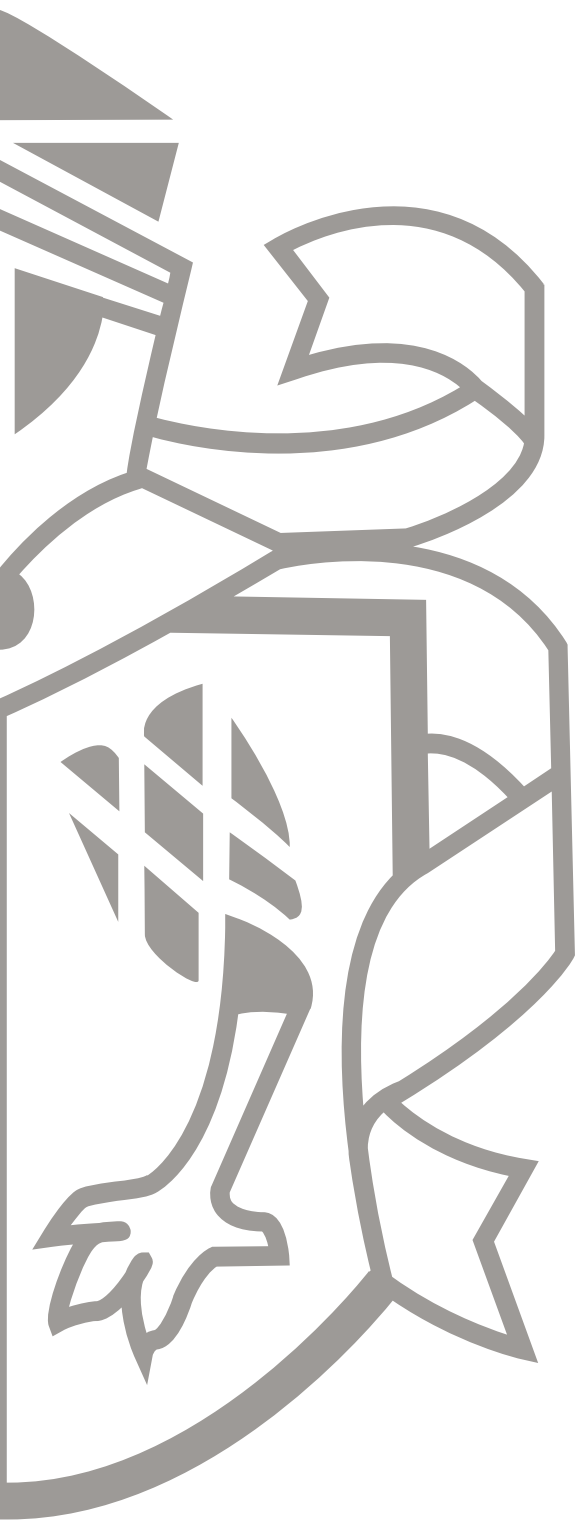


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