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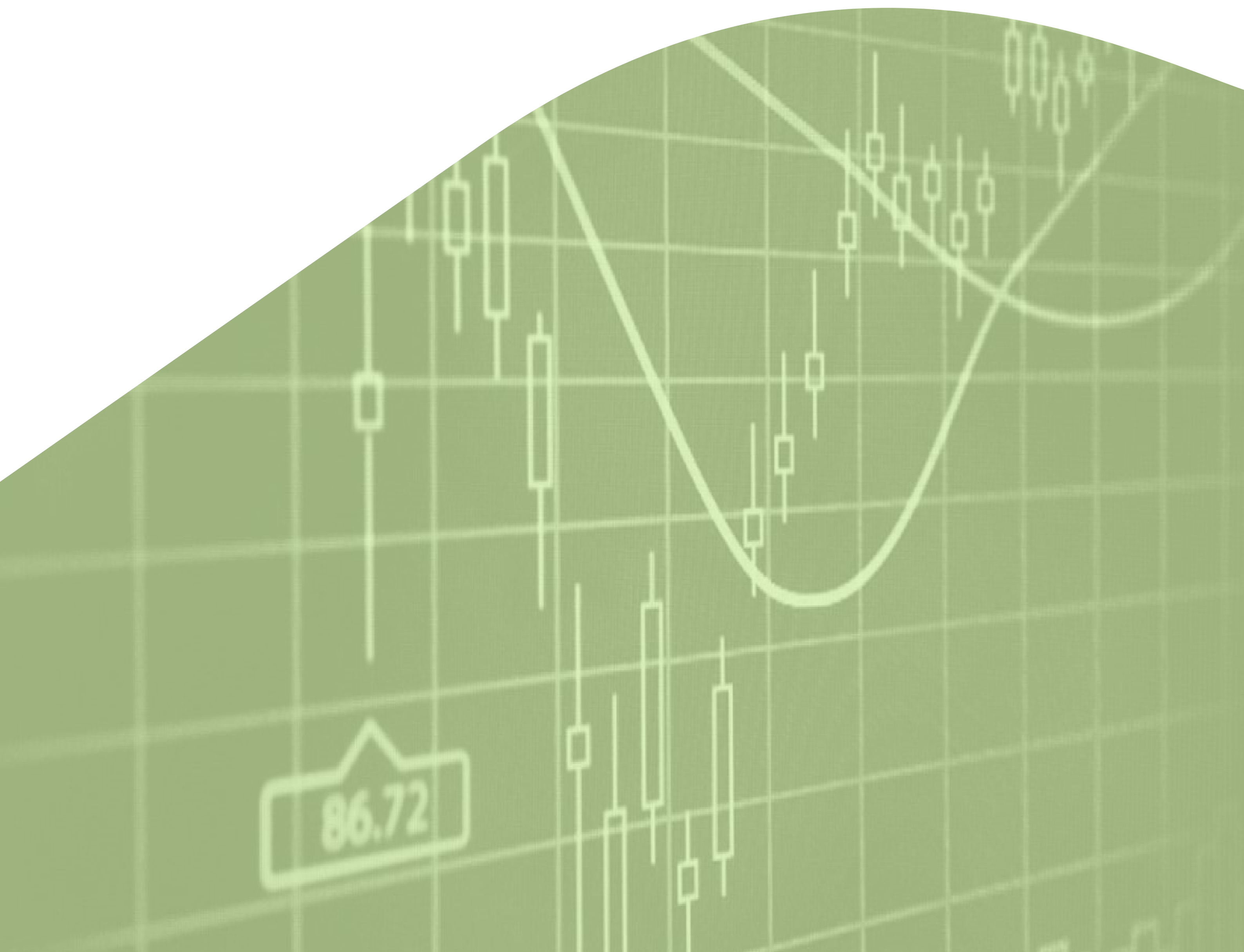
Sustainable Finance

Impact investing – Do SDG funds fulfil their promises?



ESMA Report on Trends, Risks and Vulnerabilities Risk Analysis

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Sustainable Finance

Impact investing – Do SDG funds fulfil their promises?

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Summary

Impact investing – i.e., investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return – attracts growing interest from investors. It is, thus, important for the sustainable finance work of ESMA and forms part of a specific workstream on greenwashing, as impact investing – while essential for progressing on the EU's sustainability objectives – may be prone to misleading, inaccurate or unsubstantiated claims. Impact investing – and ESG investing overall – have a key role to play in achieving sustainability objectives, thus the topic requires particular attention to ensure that products and strategies that aim to foster such objectives stand true to their claims. Impact claims are often based on well-known sustainability frameworks, including the United Nations Sustainable Development Goals (SDGs), which are a significant pillar of the international development agenda. Here specifically, these impact claims suggest a positive contribution to the fulfilment of the SDGs. Their achievement requires substantial financial resources, which can, at least partly, be sourced from private sector actors through the issuance of dedicated financial products. Increasing investor appetite for sustainable financial products has boosted the growth of investment funds claiming to contribute to achieving the SDGs (SDG funds). This article proposes and summarises a methodological approach towards identifying SDG funds and assessing the extent to which their holdings align with their claims by bringing together a unique set of different data sources. Our results highlight some of the challenges in assessing real-world impact claims and show that SDG funds do not significantly differ from non-SDG counterparts or ESG peers regarding their alignment with the United Nations SDGs. This raises questions as to whether funds claiming to contribute to the SDGs are actually fulfilling their promise to investors.

[1] This article was written by Sara Balitzky and Natacha Mosson. We are grateful to Federico Piazza and Adrien Amzallag for helping source the data.

Introduction and existing research

Forming part of the environmental, social and governance (ESG) investing sphere, impact investing receives growing attention, resulting from increased numbers of investors looking for sustainable investment vehicles that promise a tangible real-world impact. Impact investing, while not being subject to a harmonised definition, tend to be understood as going beyond pure ESG investing, in suggesting a positive and measurable contribution to the environment and/or society.[2] This increasing focus on impact investing requires regulators and supervisors to identify how the impact to be achieved by a financial instrument is presented and to assess if the impact claims hold true to the respective investment strategies.

Among the various existing sustainability frameworks, the United Nations Sustainable Development Goals (SDGs) are one of the most popular to convey the message of impact creation. They form part of the 2030 Agenda for Sustainable Development [3] and provide a framework to "*call for action by all countries – developed and developing – in a global partnership*" to tackle global challenges and end poverty, protect the planet and build more peaceful, prosperous societies by 2030 (United Nations, 2023). Adopted in 2015,[4] the SDGs comprise 17 goals[5], with 160 targets and 248 indicators.[6] These goals span across different ESG topics (e.g., climate action, sustainable cities and communities) and are thus **closely interlinked with various issues typically included in the ESG investing language,** therefore making them attractive to issuers to convey their impact claims to investors but can also create confusion as to the impact-dimension of the advertised product.

The framework's structure is, in its origin, mainly adapted to sovereigns (i.e., most targets are evaluated based on country-level metrics such as the percent reduction in poverty rate). However, growing public pressure and the need for a holistic approach to address global challenges have sparked the **need for private sector actors to adjust businesses' operations in line with the SDG objectives** (Ethical Corporation, 2018). Consequently, not only does the SDG framework itself provide a number of metrics against which corporates can report the different goals, but various attempts have also been made by international organisations or standard setters to translate a large number of the remaining targets and metrics in such a way that corporates can integrate them into their reporting activities (e.g., United Nations Global Compact, 2017, 2018; OECD, 2021). Yet, challenges persist.

While these efforts constitute a crucial step forward in bridging corporate transparency and disclosure issues, they are a work in progress, and **various challenges remain in terms of the quality and comparability of disclosures** and the voluntary nature of the different frameworks.

The SDGs and the financial sector

This broader development, alongside with calls for the financial sector to contribute towards achieving the transition to a more sustainable economy (European Commission, 2018) and the SDGs specifically (Suarez Giri and Sanchez Chaparro, 2023), has contributed to the growth of ESG-related financial products available to the market, including those that claim to provide exposure to the SDGs. Among these, **'SDG funds', i.e., funds stating to contribute**

[2] Many concepts exist in the commonly used ESG investing terminology but lack common, harmonised definition. As a consequence, ESG investing strategies such as 'impact investing', 'socially conscious investing', 'sustainable investing' are sometimes being used interchangeably. For this article, we understand 'impact investing' as strategies aimed at creating a concrete, measurable and positive impact on the environment or society, thus going beyond for example simple ESG exclusion strategies. SDG investing, in this context, falls into the group of impact investing due to the inherent nature and the goals of the United Nations SDGs (e.g., no poverty, zero hunger, quality education etc.).

[3] United Nations Department of Economic and Social Affairs: Sustainable Development – Transforming our world: the 2030 Agenda for Sustainable Development

[4] The SDGs proceed the United Nations Millennium Development Goals (2000-2015), which had a similar objective but focused exclusively on developing countries.

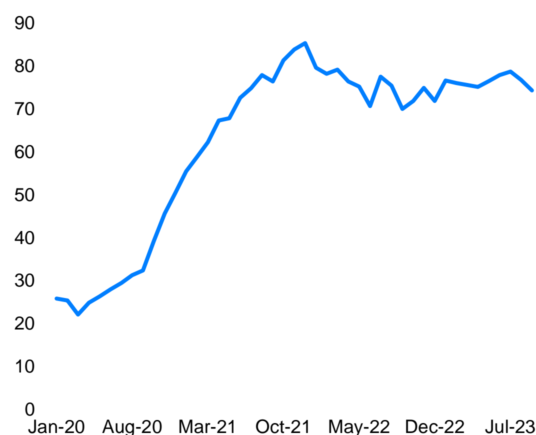
[5] The 17 goals are no poverty, zero hunger, good health and well-being, quality education, gender equality, clean water and sanitation, affordable and clean energy, decent work and economic growth, industry innovation and infrastructure, reduced inequalities, sustainable cities and communities, responsible consumption and production, climate action, life below water, life on land, peace justice and strong institutions, partnerships for the goals.

[6] For a comprehensive list of all goals, targets and indicators please consult the United Nations Statistics Division: SDG Indicators

towards achieving the SDGs, thus stating to create a positive real-world impact, are increasingly growing in popularity, with fund size (expressed in assets under management (AuM)) reaching EUR°74bn in September 2023 (Chart 1).[7]

While these funds can provide an attractive funding source to bridge the existing financing gap[8], they can also **raise impact washing concerns**, i.e., concerns about funds making impact statements that are not backed by their investment strategy and holdings. This is mainly due to the SDG's broad scope, the absence of harmonised and standardised reporting requirements for private sector actors against the SDG targets and the inherent difficulty in assessing the extent to which a single firm can help contribute towards targets that were originally mainly intended for sovereigns, e.g., "*Proportion of men, women and children of all ages living in poverty in all its dimensions according to national definitions*" (SDG indicator 1.2.2).

Chart 1
SDG fund size
SDG fund size tripled between 2020 and 2021



Note: SDG funds size, EUR bn.
Sources: Morningstar, ESMA.

These challenges can pose risks to investors, if they feel misled about the funds' sustainability claim, and are thus of **relevance to ESMA's investor protection objective**. Indeed, Schramade (2017) highlights the need for investors to understand that the SDG goals differ in the way through which their achievement can be reached through (private sector) investment, thus pointing to the need for advanced levels of investor education in this context. Relatedly, Heras-Saizarbitoria et al. (2022) refer to a "process of SDG-washing" where companies' engagement with the SDGs is carried out at a superficial level.

In its progress report on greenwashing, ESMA has identified impact-washing, including by misusing the SDGs, as a key issue.[9] Assessing to what extent funds' claims hold true is thus of importance for the wider work ESMA is carrying out relating to greenwashing.

While the market for SDG funds is still comparably small and thus financial stability concerns are fairly limited at this stage, they may also grow as the market develops. The rapid growth of SDG-themed financial instruments also warrants monitoring under ESMA's strategic priority to monitor and assess developments in the sustainable finance area. The popularity of the SDG framework further makes it an ideal starting point to assess real-world impact claims and thus allows for this article's results to serve as a benchmark for assessing impact investing claims against various sustainability frameworks.

In this article, **we first provide a methodology to identify SDG funds** and estimate the size of this market in the EU. This is an essential first step, given that SDG and more generally impact funds are not a defined category in the fund universe, and funds can use a multitude of ways in the naming of their products and wording of their issuance documentation to suggest that their product invests in sustainable assets. In this context, we shed light on the challenges in evaluating real-world impact claims.

In a second step, we analyse if and to what extent SDG funds differ from non-SDG funds in terms of non-financial performance by assessing their SDG-alignment. We further examine the extent to which SDG funds differ from broad ESG funds to understand **if SDG**

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[7] In 2022, the asset under management of SDG funds has been on a downward trend, similar to the overall ESG market, see ESMA, TRV No.2, 2023, August 2023 (Chart 58).

[8] As of 2023 the financing gap to achieve sustainable development is estimated at around USD 4tn for developing countries alone, while at the same time overall financing pressure for the SDGs increased following the Covid-19 pandemic and Russia's war of aggression against Ukraine.

[9] The full report can be accessed here: ESMA30-1668416927-2498 Progress Report on Greenwashing (europa.eu)

funds display specific characteristics and should be considered a specialised sub-group of ESG funds.

Existing research: First evidence on financial and SDG performance

The research on SDG funds is nascent – likely driven by the comparably small market size of these instruments and the complexity of the topics – and rather broad in scope, i.e., displaying a wide variety in terms of research angles and sub-topics being explored. So far, most research assesses broader mechanisms that can serve to channel financial flows towards achieving the SDGs (Zhan and Santos-Paulino, 2021, OECD, 2022) [10] and the challenges in assessing the success rate of SDG-related projects at the local level (Hacking, 2018).

Some evidence looks particularly at financial performance. For example, Marti-Ballester (2020) compares mutual funds in China focused on biotechnology and healthcare sectors related to the United Nations SDG 3 (Good Health and Well-Being) with their conventional counterparts and finds that **SDG-themed mutual funds exhibit similar risk-adjusted returns compared to market benchmarks**. Other research assesses the interlinkages between SDGs and sovereign's financial risk attribution. For example, Ten Bosch et al. (2022) find a significant negative relationship between country-level SDG performance and credit default swaps and attribute this to lowerperceived default risks for countries with higher SDG performance and vice versa.

The SDGs are also explored as potential benchmarking metrics to measure corporate sustainability performance, as shown by Zanten and Huij (2022) and Schramade (2017). Their findings particularly highlight the **importance of disentangling differing sustainability concepts such as ESG, SDGs and impact**. This further supports our comparison of SDG funds with ESG funds (made possible by splitting our non-SDG fund sample in those considered ESG vs non ESG funds), as this benchmarking provides an indication of whether SDG funds are similar to ESG funds.

Thus, while the SDGs can indeed play an important role in assessing businesses' sustainability impact, it is crucial to frame such an assessment in a way that discourages greenwashing (Johnsson et. al, 2020).

Our work adds to this research by exploring the impact dimension of SDG funds, rather than looking at their financial performance or ability to indicate risk levels. Specifically, we assess if SDG funds holdings confirm a concrete, measurable and positive impact creation by comparing them with non-SDG funds. This work sheds light on the many challenges associated with assessing 'impact' and proposes one methodological approach to tackle these.

The remainder of this article is structured as follows. The next section provides a description of the sample and data. The following section presents the results, and the last section concludes.

EU SDG funds: Sample and data

In order to identify and assess SDG funds in the EU, we construct a dataset drawing on **four different data sources** to combine traditional fund-level information with metrics and information that provide insights into entities' alignment with the SDGs and their performance against them. They include:

- Investment funds' documents, namely key investor information documents (KIID)/key information documents (KID), investment strategy extracted from prospectuses and funds' name indicated by Morningstar, which provide information on the funds' strategy and if/how alignment with the United Nations SDGs is ensured.
- Investment funds' portfolio holdings as of December 2022, made available by Morningstar.
- Information on corporates' SDG alignment as documented through the United Nations Global Compact initiative, and on sovereigns' SDG alignment as per the United Nations

[10] There are several tools in place to assess the existing financing needs such as the International Monetary Fund's SDG Financing Tool

SDG index. The United Nations Global Compact website provides information on the specific SDGs individual companies claim to contribute to and when they joined the initiative. The SDG Index provides data on how countries perform against the individual SDGs over a given year.

– Principle Adverse Impact (PAI) disclosures extracted from Morningstar: To compare funds, we additionally leverage information disclosed through PAI disclosures that form part of the Sustainable Finance Disclosure Regulation (SFDR).[11]

Identification of SDG funds

Given the absence of an universally accepted definition to identify SDG funds, we started constructing our sample by identifying all EEA-domiciled funds that make a claim relating to the SDGs in their regulatory communication. Employing natural language processing techniques and leveraging the work by Amzallag et al. (2023) on ESG-related terms in EU fund names and documentation allowed us to identify SDG-related terms in the fund's legal name, the fund strategy extracted from the prospectus by Morningstar and the KIID/KID.

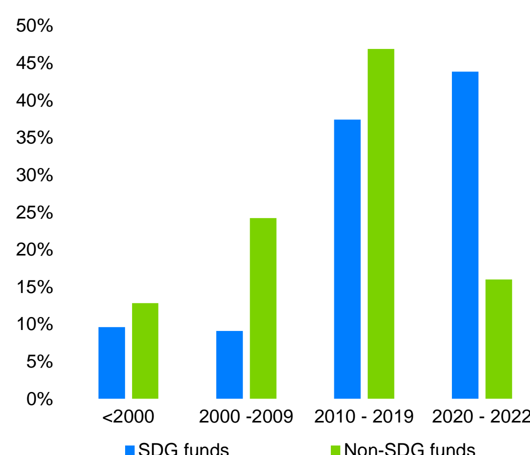
The funds whose name, strategy or KIID/KID include at least one term specifically related to the SDGs were kept and underwent extensive manual review. In particular, only those funds that make a statement to positively contribute to the SDGs or provide specific metrics on how their investment choices align with them are considered "SDG funds" for this study.[12] The sample of SDG funds then comprises 289 funds.[13]

Portfolio holdings and fund characteristics

As a first step, the portfolio holdings as of December 2022 were retrieved from Morningstar and combined with additional funds' characteristics from Morningstar Direct, such as asset classification, inception date or domicile. After keeping only actively managed equity, bond or mixed investment funds domiciled in the EU with portfolio holdings not older than 2021 and whose holdings are at least composed of three shares or bonds, **our final sample of SDG funds consists of 187 funds.**[14]

For benchmarking purposes, we identified, using the same filters, 14,446 funds that don't make any claim regarding the SDGs, yielding a full sample of 14,633 funds. Notably, 44% of SDG funds were launched after 2020 (Chart 2), signalling a strong market uptake.

Chart 2
Share of funds by launch year
Most SDG funds launched after 2010



Note: Share of SDG and non-SDG funds by bucket of launch's year (in proportion of the total number of funds in each category of funds).
Sources: Morningstar, ESMA.

[11] In the following we provide a brief overview of the data and the corresponding key characteristics. For more detailed information on the methodology and steps taken to clean, merge and analyse the data please refer to the corresponding forthcoming working paper.

[12] Several funds mentioned that their investments intend to not significantly harm the SDGs, which is different from a commitment towards achieving the SDGs. Elsewhere, some funds only dedicate a small share of their investment to the achievement of the SDGs. Finally, some funds mentioned the United Nations SDG as a potential framework to guide their investments, but among other frameworks and without providing concrete information on whether and how the SDGs would be used for investment decision making. All these funds were excluded from the sample.

[13] Given that our analysis is based only on English terminology, the number of 'SDG funds' reported here should be considered as a lower bound as only fund name, strategy, and KIID/KID written in English can be scanned.

[14] The rationale behind keeping only actively managed funds consists in the greater ability of the fund manager to tailor the fund specifically to the SDG and avoid any bias due to index composition.

Fund SDG involvement

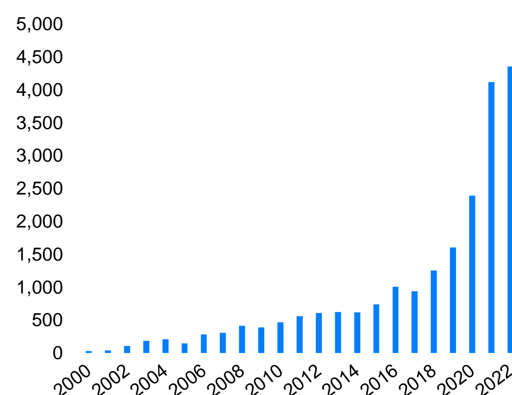
To assess if the SDG claims at the fund level are accurate, it is important to **obtain information on the portfolio underlying entities' ambition towards, and alignment with, the SDGs**. Since our SDG funds sample includes equity, bonds and mixed funds, identifying frameworks to support this assessment tailored to each distinct entity type, i.e., corporates versus sovereigns, is crucial. For corporates, we leverage the United Nations Global Compact framework to assess the firms in the funds' portfolio holdings and for sovereigns we rely on the Sustainable Development Goals Index (SDG Index) established by the Sustainable Development Solutions Network.[15]

Corporate SDG involvement

The **United Nations Global Compact** is a voluntary initiative whose aim is to "*accelerate and scale the global collective impact of business by upholding the Ten Principles*[16] *and delivering the SDGs through accountable companies and ecosystems that enable changes*".[17] Companies which voluntarily choose to join the initiative should commit "*to implement universal sustainability principles and to take steps to support United Nations goals*".[18]

Looking at the 21,977 companies participating in the initiative as of February 2023[19], we observe that over **half of them (52%) joined the initiative between 2020 and the beginning of 2023** (Chart 3) [20] while very few companies joined before 2005 (3%). This may be due to firms' increased sustainability efforts, but it could also signal impact-washing concerns, since most firms joined at a time of elevated scrutiny around private sector actors' contribution towards the sustainable transition and their potentially negative impact on the environment and society at large. Firms could perceive the initiative as an attractive opportunity to alleviate potential public scrutiny regarding their sustainability profile, without needing to take steps to ensure their actions reflect their public commitment.

Chart 3
UN Global Compact participants joining year
Most companies joined the initiative after 2019



Note: Year at which companies joined the United Nations Global Compact initiative.
Sources: UNGC, ESMA:

Merging the information retrieved from the United Nations Global Compact website with the fund portfolio holdings, we could map **4,209,375 (47% in terms of number and AuM) assets with a company participating in the United Nations Global Compact initiative.** This corresponds to 2,721 unique United Nations Global Compact companies.

Sovereign SDG involvement

The SDG index, which forms part of the annual Sustainable Development Goals report, provides a global assessment of individual countries' progress towards achieving the SDGs.[21] The

[15] Information retrieved from the SDG Index website: Sustainable Development Report - Sustainable Development Report (sdgindex.org)

[16] The ten Principles are derived from the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention against Corruption. They represent corporates' "fundamental responsibilities in the areas of human rights, labour, environment and anti-corruption". For further details, see The Ten Principles | United Nation Global Compact.

[17] Information retrieved from the United Nations Global Compact website: Our Mission | United Nation Global Compact.

[18] The United Nations Global Compact started in 2000 with a focus on sustainable development. Upon the introduction of the United Nations SDGs, the goals were included in the information companies could disclose.

[19] The United Nations Global Compact website lists the companies participating to the initiative.

[20] Companies who joined in 2023 will be excluded since the analysis focuses on the 4Q22 portfolio holdings, when the companies did not join yet the initiative.

[21] The assessment's underlying methodology has been peer reviewed in 2017 and underwent auditing by the

publicly available dataset contains information on 193 countries' performance against the SDGs and shows that as of 2022 on average, countries have an SDG Index score of 67.26 on a scale of 0 (worst) to 100 (best). However, this figure differs significantly between the individual SDGs. On aggregate, the funds in our sample hold 147,585 government bonds, of which 146,679 have been associated with an SDG index.

SDG funds can be expected to invest in countries with better SDG performance, thus justifying this additional focus on sovereign bonds.

Overall, our analysis illustrates the challenges in identifying and matching the different information needed to assess impact claims and thus sheds light on the **difficulty investors face in understanding how an SDG fund concretely contributes to the different goals**.

Comparing SDG and non-SDG fund characteristics

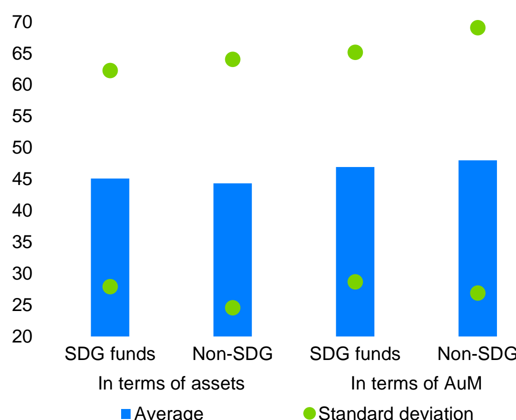
As a first step we compare the portfolios of SDG and non-SDG funds by looking at the average number of holdings along with broad sectoral and geographical exposure. This provides a general idea of the differences in portfolio construction. We then further assess if **SDG funds are, on average, more exposed to companies participating in the United Nations Global Compact (UNGC) initiative and to countries with comparably high SDG index scores**.

The preliminary analysis of portfolio composition and exposures shows a **greater portfolio concentration in SDG funds**. First, SDG fund portfolios are composed of fewer instruments (bonds and stocks) compared to non-SDG funds, with an average holding of 187 stocks and bonds for SDG funds compared with 586 for non-SDG funds. While holding fewer assets on average, SDG funds are also larger than non-SDG funds (see section "Sample and data" above), highlighting a greater concentration of holdings among SDG funds.

Exposure to companies participating in the UNGC

Chart 4 shows that **SDG funds do not differ significantly from non-SDG funds** in the extent to which they hold assets issued by companies participating in the United Nations Global Compact.

Chart 4
Exposure to UN Global Compact companies
No clear SDG and non-SDG fund distinction



Note: Average and standard deviation of exposures (in terms of assets and AuM) to companies participating to te United Nations Global Compact.
Sources: Morningstar, UNGC, ESMA.

The average exposure to companies participating in the United Nations Global Compact initiative is higher for SDG funds when looking at the number of assets (i.e., 45.1% versus 44.3% for non-SDG funds) but lower when looking at the share of AuM (i.e., 46.9% versus 48.0% for non-SDG funds). However, the differences in means are not statistically significant.

As a next step, we further break down the sample of non-SDG funds between (i) ESG and non-ESG funds[22] and (ii) the disclosure regime under the EU Sustainable Finance Disclosure Regulation (SFDR). This comparison enables us first to assess the performance of SDG funds at a more

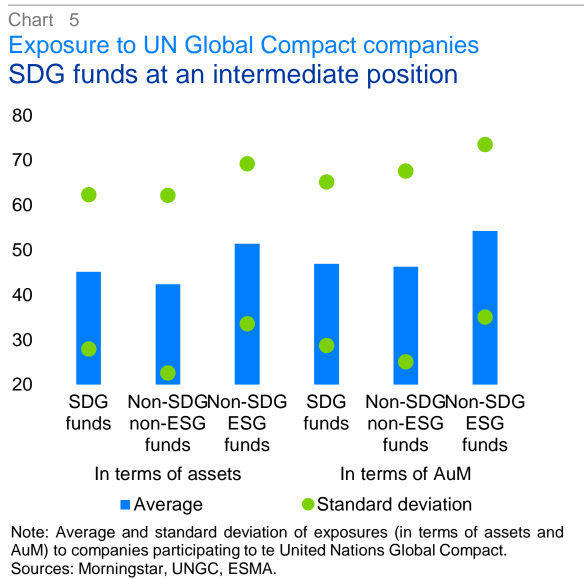
European Commission Joint Research Centre in 2019. The underlying data is derived from publicly available sources, including the World Bank, the World Health Organization and the International Labour Organization.

[22] As identified by Morningstar as of March 2023. Morningstar classifies a product as a 'sustainable investment' "if the use of one or more approaches to sustainable investing is central to the investment products overall investment process based on its prospectus or other regulatory filings" (see Morningstar, August 2022, "Morningstar Sustainable Attributes, Framework and definitions for the Sustainable Investment and Employs Exclusions attributes", the document can be found on Morningstar's methodology documents webpage).

granular level, by benchmarking them against different kinds of non-SDG funds. It also provides an indication of whether SDG funds are similar to ESG funds more broadly or to funds disclosing under SFDR Article 8 or Article 9 which allows us to assess where in the overall sustainable investment universe SDG funds would fall in terms of distinct characteristics. This is particularly interesting, since in contrast to SDG funds, SFDR Art. 8 and Art. 9 funds are defined and a common understanding around ESG funds exists, thus this comparison allows for a more granular assessment of SDG funds.

When splitting the non-SDG funds between ESG and non-ESG funds, SDG funds do not particularly stand out (Chart 5). **SDG funds have an intermediate position between non-ESG and ESG funds** when looking at the number of assets of companies participating in the initiative. But the average exposure (in terms of AuM) of SDG funds (47%) is very close to the average exposure of non-SDG non-ESG funds (46%). The differences in means in terms of AuM between SDG funds and non-SDG non-ESG funds is actually non-significant, while the difference between SDG funds and non-SDG ESG funds is significant at the 1% confidence level.

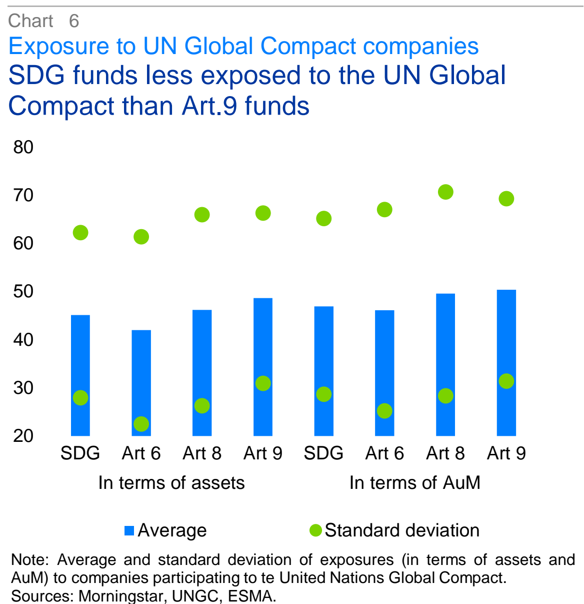
Chart 5
Exposure to UN Global Compact companies
SDG funds at an intermediate position



Note: Average and standard deviation of exposures (in terms of assets and AuM) to companies participating to te United Nations Global Compact.
Sources: Morningstar, UNGC, ESMA.

Compared with non-SDG funds disclosing either under SFDR Article 6, 8 or 9,[23] SDG funds seem to fare worse than SFDR Art. 9 and even Art. 8 funds, which may be concerning in particular considering the wide discretion for Art. 8 SFDR (Chart 6).

Chart 6
Exposure to UN Global Compact companies
SDG funds less exposed to the UN Global Compact than Art.9 funds



Note: Average and standard deviation of exposures (in terms of assets and AuM) to companies participating to te United Nations Global Compact.
Sources: Morningstar, UNGC, ESMA.

Considering the exposure in terms of either assets or AuM, the differences in means between SDG funds and non-SDG funds disclosing under Article 6 or Article 9 are significant. The differences in means between SDG funds and non-SDG funds disclosing under Article 8 are significant in terms of AuM but non-significant when looking at the number of assets.

Comparing the **PAI of funds in our sample shows further differences between SDG and. non-SDG funds**. PAI is information about the extent to which investments cause adverse impacts. While PAI at the product level is of voluntary nature, such disclosures are still useful to help assess how SDG funds are faring compared to non-SDG funds.[24]

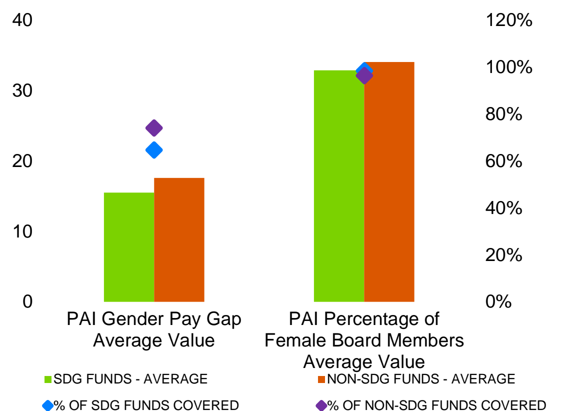
Looking at a selection of PAI indicators of relevance to different SDGs, SDG funds do not perform better compared to their non-SDG counterparts in absolute terms, while

[23] Article 8 funds are investment products promoting sustainability characteristics. Those disclosing under Article 9 are investment products with sustainable investment as their objective and Article 6 funds have neither sustainability characteristics nor sustainable investment objective. The SFDR disclosure regime is as of March 2023.

[24] Leveraging data from both Morningstar Sustainalytics (based on estimates) and the European ESG template

showing some relative divergences. Related to SDG 5 (gender equality), SDG funds' investee companies have a slightly lower average gender pay gap, but non-SDG funds have a slightly higher percentage of female board members (Chart 7).

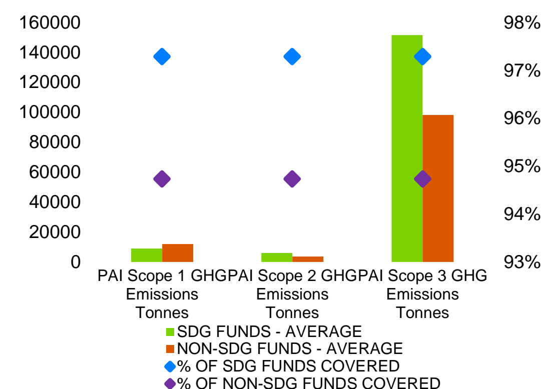
Chart 7
SDG vs non-SDG funds selected PAI values
SDG fund PAI values similar to non-SDG funds



Note: Average values of SDG vs non-SDG funds for the PAIs "Gender Pay Gap" and "Percentage of Female Board Members", and share of funds diclosing this information in % (right axis).
Sources: Morningstar Direct, ESMA.

Similarly, related to SDG 13 (climate action), SDG funds have slightly lower scope 1 greenhouse gas emissions (Chart 8).

Chart 8
SDG vs non-SDG funds selected PAI values
SDG funds have higher GHG emission values



Note:Average value of SDG vs. non-SDG funds for the PAIs on scope 1, scope 2 and scope 3 GHG emissions/tonnes, and share of funds disclosing this information in % (right axis).
Sources: Morningstar Direct, ESMA.

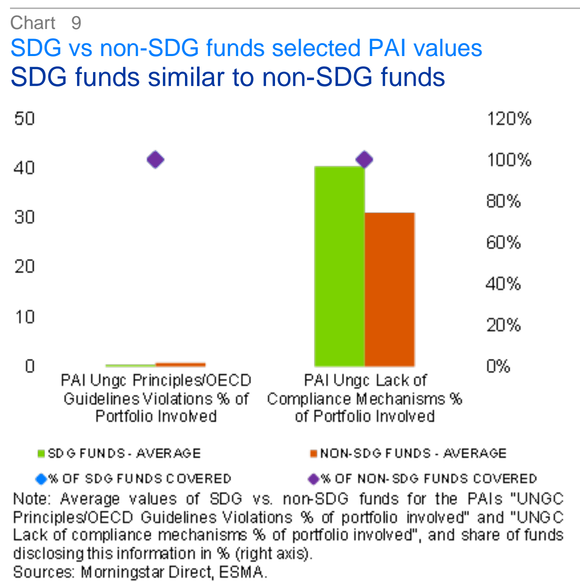
However, this is reversed for scope 2 and drastically different for scope 3 emissions, where **SDG funds seem to have more than 50% more emissions compared to non-SDG funds**.

The United Nations Global Compact principles and the Organization for Economic Cooperation and Development (OECD) guidelines can play a key role in achieving the SDGs, which is also reflected in the mandatory PAI disclosures where funds need to make available which percentage of their portfolio is involved in assets violating the United Nations Global Compact principles and/or OECD Guidelines as well as the percentage of their portfolio invested lacking United Nations Global Compact compliance mechanisms.

For the first disclosure, SDG funds perform slightly better than their non-SDG counterparts, yet a **higher share of their portfolio has a lack of United Nations Global Compact compliance mechanisms** (40 versus 31 for non-SDG funds, Chart 9).

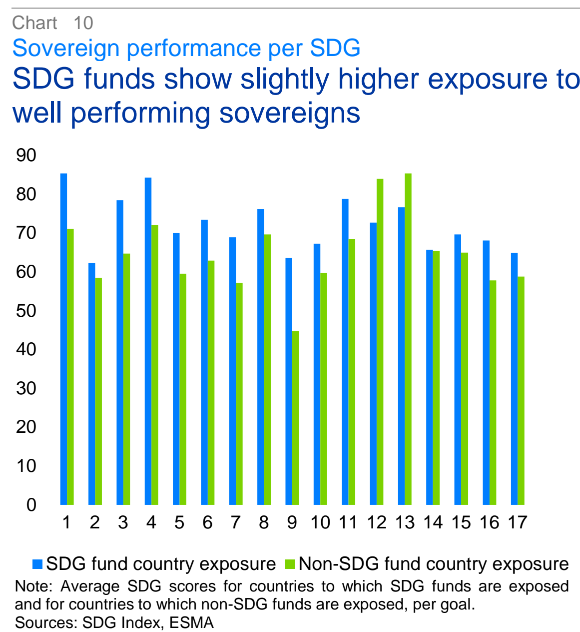
(EET) (based on reported data), we obtained at least some information on PAI for 98% of SDG funds and 96% of non-SDG funds in our sample from Morningstar data (95% and 96% respectively for reported data). Coverage is higher for SDG funds (based on reported data) compared with non-SDG funds (69% vs 35%). Coverage is also not homogenous across the different PAIs, where both SDG and non-SDG funds show the lowest coverage for indicators related to energy consumption intensity, social violations, gender pay gap and the average value of sovereigns' carbon intensity. For EET-retrieved coverage ranges 42% to 88% for SDG funds vs. 26% to 60% for non-SDG funds.

Chart 9
SDG vs non-SDG funds selected PAI values
SDG funds similar to non-SDG funds



Note: Average values of SDG vs. non-SDG funds for the PAIs "UNGC Principles/OECD Guidelines Violations % of portfolio involved" and "UNGC Lack of compliance mechanisms % of portfolio involved", and share of funds disclosing this information in % (right axis).
Sources: Morningstar Direct, ESMA.

Chart 10
Sovereign performance per SDG
SDG funds show slightly higher exposure to well performing sovereigns



Note: Average SDG scores for countries to which SDG funds are exposed and for countries to which non-SDG funds are exposed, per goal.
Sources: SDG Index, ESMA

SDG fund investment in sovereigns

Sovereigns are at the core of the SDG framework, with many indicators and targets providing metrics to assess a country's performance against the different SDGs. More than a third (38%) of funds in our sample hold sovereign debt representing 11% of AuM, stressing the **importance of assessing if their exposure differs in terms of country level SDG performance.**

Leveraging the data provided by the SDG Index, we observe that **SDG funds hold sovereign debt from countries that have a higher average SDG index score than non-SDG funds** (74 vs. 64 respectively). However, this comparably better performance is not systematically true across all SDGs, i.e., for some goals such as SDG 12 (responsible consumption and production) or SDG 13 (climate action) non-SDG funds have higher average index scores.

Additionally, a discrepancy between the individual goals exists in so far, as SDG funds average index scores can vary between 65 to 86 depending on the specific goal (Chart 10).

Holdings of development bank bonds

In parallel to private companies and governments, development banks have a concrete mandate to boost international development and are thus key actors in achieving the SDGs. Bonds issued by development banks are also often credited with high transparency around the proceeds allocation. Therefore, we analyse **whether SDG funds hold more bonds issued by development banks than non-SDG peers.**[25]

9% of SDG funds and 12% of non-SDG funds hold at least one bond issued by a development bank. When SDG funds hold bonds issued by development banks, they represent on average 15% of the fund AuM compared to 11% for non-SDG peers.

Conclusion: SDG funds not significantly different

The market for ESG investing has grown substantially over the last three years. Mirroring this trend, the **size of investment funds**

[25] The development banks found in the portfolio holdings include both international and national ones.

claiming to positively contribute towards achieving the SDGs tripled between 2020 and 2023. The contribution of the financial sector is crucial to help bridge the financing gap towards achieving the transition and ensuring sustainable development globally. However, the growing popularity of these products among investors raises potential impact-washing risks, as highlighted in ESMA's progress report on greenwashing. With their broad scope and the absence of a harmonised definition or specific requirements, SDG funds can be particularly prone to impact-washing.

SDG funds remain a small market in the EU (EUR 74bn as of September 2023, less than 1% of the EU fund industry), but they can pose risks to investors if they do not deliver what investors can legitimately expect based on the funds' claims. In addition, it is crucial that SDG products remain credible and attractive, given the tremendous financial resources needed to achieve sustainable development.

This article contributes to nascent research and current policy discussions, along with regulatory and supervisory efforts in this area, by i) developing a methodology to identify SDG funds and ii) providing a **first assessment of SDG funds' alignment with the United Nations SDGs**.

SDG funds are defined as investment funds claiming – through their name, investment strategy or KIID/KID – to contribute to the SDGs. Based on natural language processing techniques and extensive manual review, a sample of 187 EU funds making such claims was built. Two main data sources are used to assess the alignment of funds underlying assets with the SDGs: the United Nations Global Compact for companies, which is a voluntary initiative to support the SDGs, and the SDG index, which provides scores regarding the achievement of the SDGs at the country level. Bringing the different pieces of information together, we identify two important issues.

First, as most SDG funds do not clearly spell out how their investment strategy aligns with the concrete goals, it is necessary to bring together various pieces of information from different sources, meaning investors face substantial challenges in assessing how SDG funds contribute concretely towards the achievement of the concrete goals.

Second, **SDG funds do not seem to display greater alignment with the United Nations SDGs compared to non-SDG funds.** This observation holds true regardless of the different frameworks used for measurement. This article shows that those funds do not hold significantly more companies participating in the United Nations Global Compact or targeting specific SDGs. While our results suggest that, on average, SDG funds invest slightly more in sovereign debt issued by countries with high SDG index scores, the difference is limited and does not hold true for all goals. What is more, SDG funds do not have a higher exposure to development banks. All these findings are confirmed, and further refined through multiple regression analysis that will be detailed in a future working paper.

While the frameworks provided by the United Nations Global Compact and the SDG index are only two possible frameworks among others to assess the alignment of SDG funds, the results obtained with this analysis still raise several questions. In particular, they raise the question of whether these funds actually deliver on their promise to investors.

Arguably, claiming to contribute to the SDGs should require taking steps beyond simply excluding firms based on sectoral or geographical characteristics. It should also consist of the active and careful evaluation and selection of assets that have been proven to contribute concretely to specific SDGs.

Additionally, considering the popularity of the SDG framework as one of the best-known sustainability frameworks globally, impact-washing concerns are arguably elevated. Indeed, referencing the United Nations SDGs is likely to convey a sense of credibility, thus making funds basing their claims on associated keywords potentially highly attractive to sustainability-conscious investors. These concerns are transferrable to various sustainability frameworks and hold true for any real-world impact claims.

Against this background, **our analysis raises investor protection concerns as the funds claiming to contribute towards the SDGs do not appear to differ significantly from other funds in their exposure to firms signalling to concretely contribute to the UN SDGs**. This said, the market for SDG funds is relatively new and lacks common reporting standards against the different goals and targets for private sector

actors (as most targets are at the country level). Fund managers and supervisors are thus challenged in identifying appropriate assets.

Thus, while our analysis does not show significant differences between SDG and non-SDG ESG funds in terms of their holdings, there is still room to establish clearer requirements for these instruments. Their rapid growth also indicates a substantial appetite from investors and a growing number of potentially eligible assets, also confirmed by the growing number of private sector actors joining initiatives such as the United Nations Global Compact. Moving forward, it will be crucial that market mechanisms and clear rules ensure that sustainability frameworks, such as the SDGs, are not misused when employed as a reference tool for sustainability objectives.

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