For Qualified, Sophisticated and Professional Investors only

Making sense of ESG

A guide to Environmental, Social and Governance factors in long-term investment

M&G INVESTMENTS

What is ESG?

Underpinning long-term investment decisions

In a world of endless confusing acronyms, 'ESG' is one that investors need to understand. Put simply, ESG investing describes an approach that incorporates **Environmental**, **Social** and **Governance** factors into decision-making. It underpins a responsible investment approach, and allows investors to better manage risk and generate sustainable, long-term returns.

Environmental considerations can take account of an investment's impact on resources, including water, its greenhouse gas emissions or the level of waste and pollution it creates through its operations.

Social looks at things like working conditions, including child labour and employee diversity, a business' interaction with local communities and health and safety issues.

Governance, meanwhile, is all about how a company is run, and includes the independence of its board of directors, the structure of executive pay, its accounting policies and its tax strategy, for example.

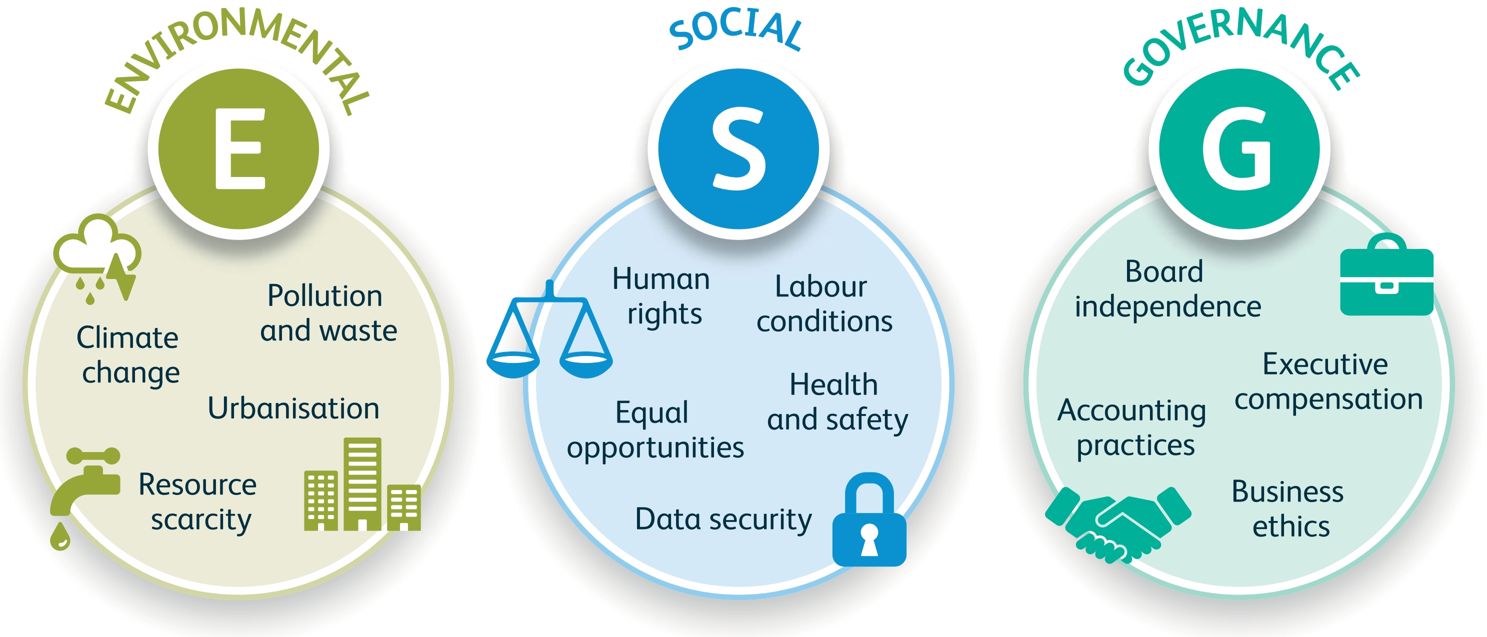
As part of a responsible approach to investment, all of these factors are considered, where appropriate, and incorporated into the wider analysis of any particular investment; whether that is company shares, fixed interest securities or property.

What ESG is not

While there are a variety of 'ethical' investment styles available (see glossary at the end of this guide), ESG is not the same as ethical investment in its many forms. Ethical approaches generally prioritise the 'moral return' over the financial return, and often target specific themes like the environment, or screen out what they consider morally dubious industries.

ESG, meanwhile, can be incorporated into any type of investment strategy, as it forms part of a holistic approach. It does not require the wholesale ruling out of investment in a given sector or company, but rather informs the decision-making process to ensure all the factors affecting risk and return, both financial and non-financial, are accounted for. The various ways ESG can be incorporated are highlighted on page 7.

The value of investments will fluctuate, which will cause fund prices to fall as well as rise and you may not get back the original amount you invested.



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Why does ESG matter?
Looking at the bigger picture

Investors have traditionally considered the 'financial' elements of an investment, including growth prospects, company cashflows and profitability, the yield on a fixed interest security or how much rent a building can generate. ESG considerations, however, look at the bigger picture, and examine 'extra-financial' elements that can have material effects on a given business or industry, especially over the longer term.

This matters for a number of reasons, not least of which is the increasing realisation that ESG factors are an important element in determining the risk and reward of an investment.

ESG factors help to determine the risk and reward of an investment

This could be a positive tailwind gained through solid employment practices creating more productive workers, or superior energy efficiency of a building bringing down the costs of maintaining it. Conversely, understanding ESG factors can also help to avoid value-destroying reputational damage, whether through corruption, damage to the environment or tax avoidance, particularly in a world where information spreads faster than ever before. Because of this, taking account of ESG factors is part of the fiduciary duties of investors towards their customers.

"Where is our money going?"

Of equal importance is the growing demand by individuals and institutions to know how their money is being invested, and if those investments are sustainable. By understanding ESG risks, investors can also understand how companies are managing those risks, and can hold them to account on ESG issues, encouraging them to improve. This helps investors to carry out their responsibilities as stewards of their clients' assets, and better live up to the expectations of society in general.

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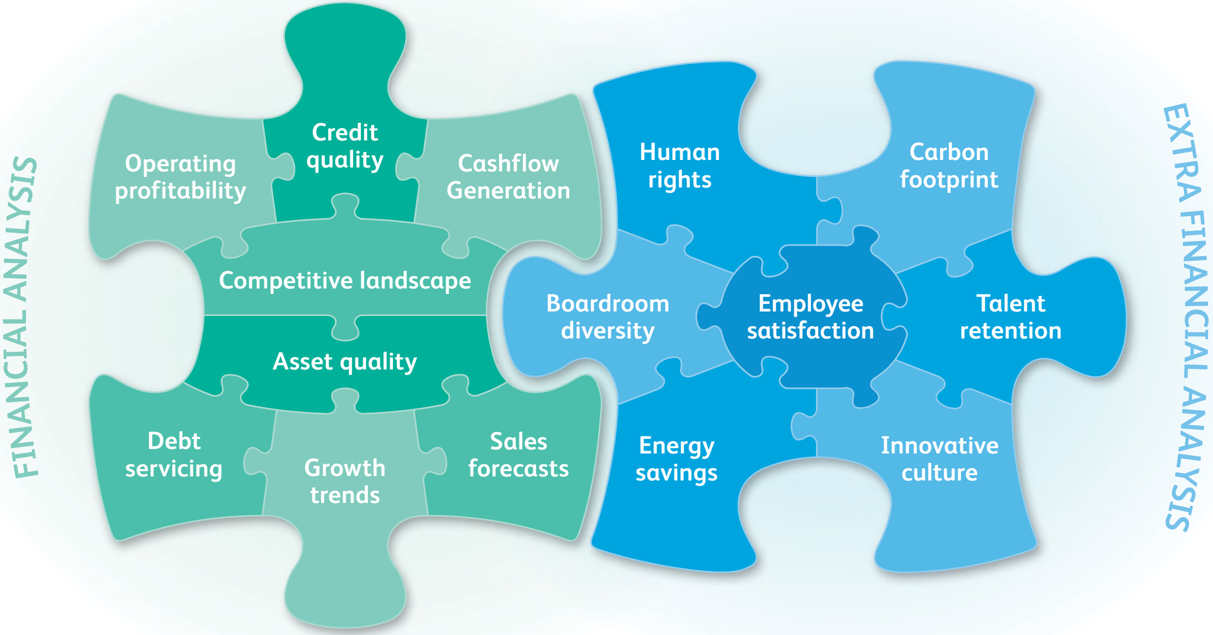
Piecing together superior returns



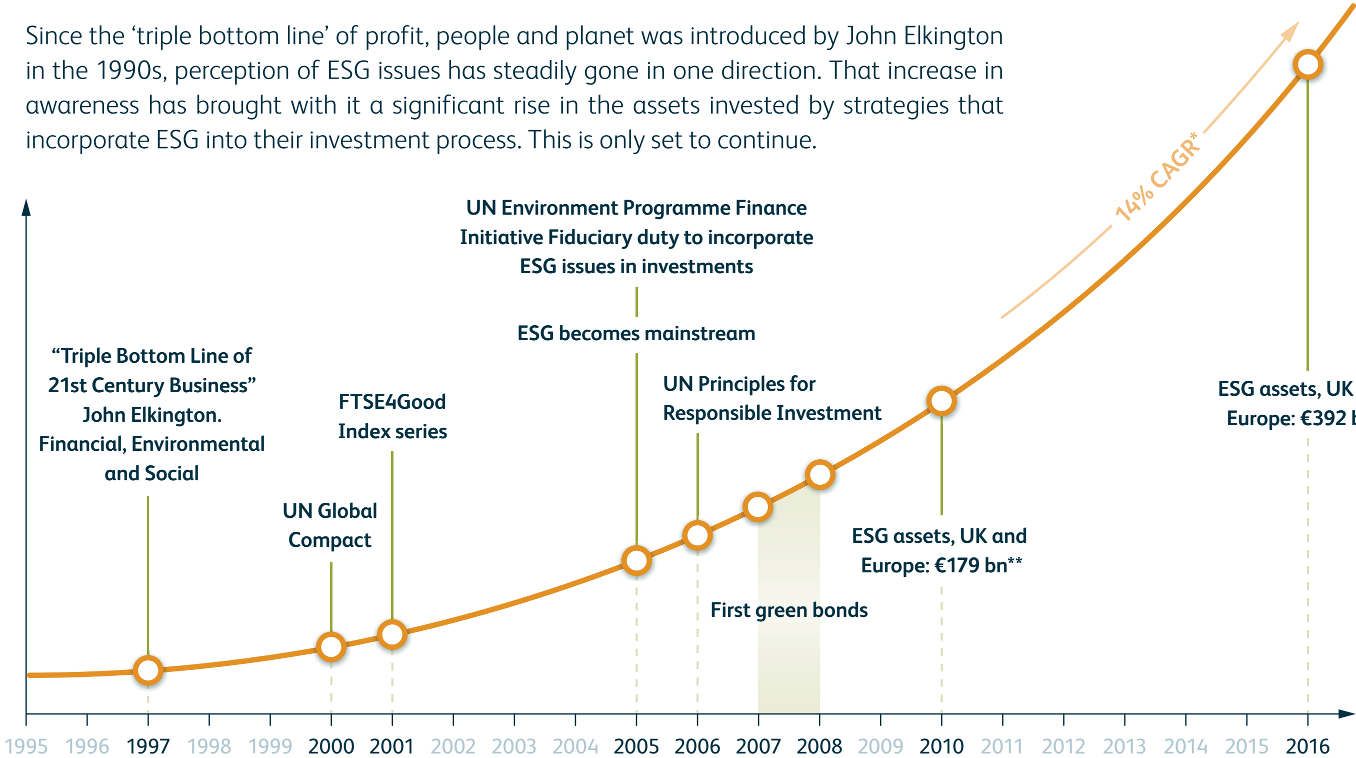
Systematic analysis of financial statements
(income – balance sheet – cashflow)

Systematic assessment
of ESG factors

20 years of ESG

The ESGvolution of responsible investment

Since the 'triple bottom line' of profit, people and planet was introduced by John Elkington in the 1990s, perception of ESG issues has steadily gone in one direction. That increase in awareness has brought with it a significant rise in the assets invested by strategies that incorporate ESG into their investment process. This is only set to continue.



*Compound annual growth rate. **Source: Broadridge FundFile, data as at end of July 2017 in EUR.

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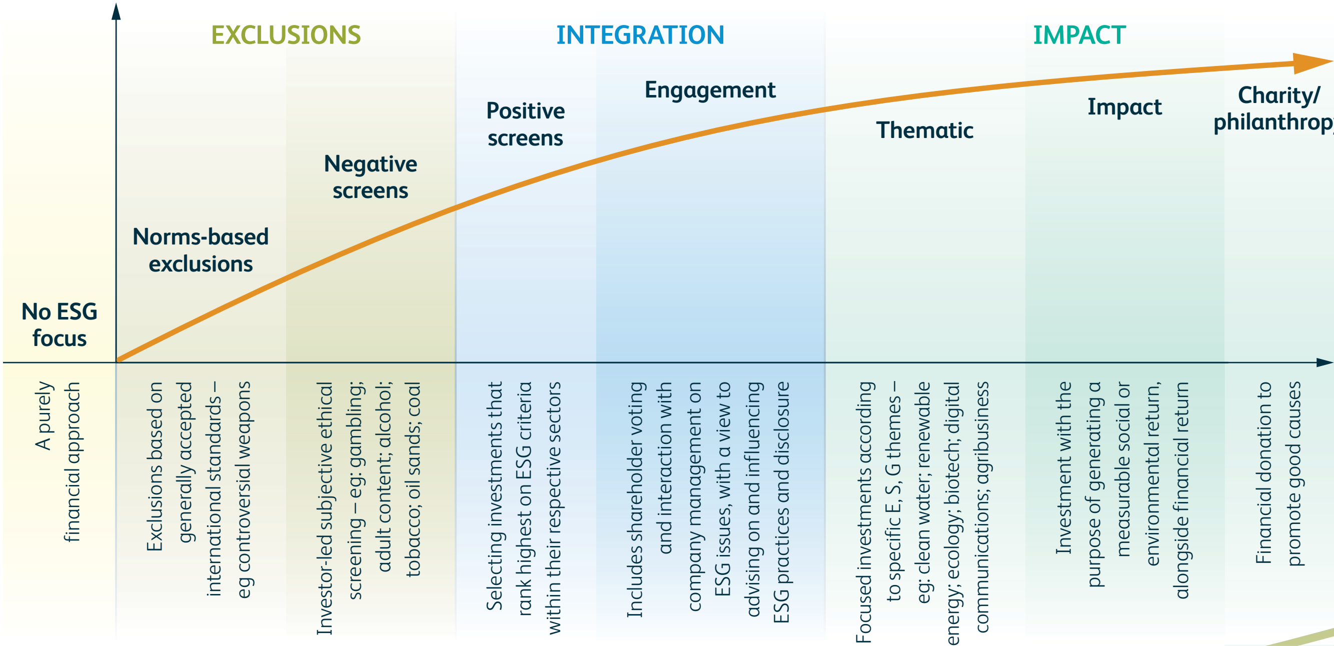
ESG Strategies

One size does not fit all

There are a number of strategies that investors who incorporate ESG may employ. They might exclude certain industries, engage with company management on ESG issues, or invest for Impact – the range is broad and varied.



Glossary

As its basis, Responsible Investment (RI) is the incorporation of environmental, social and governance factors (ESG) into the selection and management of investments. As RI has evolved, and gained increasing prominence in the decision-making processes of institutions and individuals, so too has the breadth of RI considerations, and the associated terminology. The following glossary identifies some of the more common terms associated with the wider RI arena.

Active Ownership

Investors having an active dialogue with company management on business strategy, results and ESG issues, and using their voting rights accordingly to support or vote against management. Active ownership efforts can help to reduce risk and enhance long-term shareowner value.

Best-in-Class

Focusing investments on companies that have historically performed better than their peers within a particular industry or sector, based on analysis of ESG factors. This is a form of positive screening.

Carbon Disclosure Project (CDP)

CDP is an independent, non-profit organisation that maintains a database of corporate climate change data, incorporating disclosures of individual organisations' greenhouse gas emissions and climate change strategies.

Carbon Neutrality

Carbon neutrality, or having a net zero carbon footprint, refers to achieving net zero carbon emissions by balancing a measured amount of carbon released with an equivalent amount sequestered or offset, or buying enough carbon credits to make up the difference. It is used in the context of carbon dioxide-releasing processes associated with transportation, energy production, and industrial processes, such as production of carbon neutral fuel.

Clean Energy

Energy from non-polluting sources, including solar, wind and water.

Cleantech

An investment theme, rather than an industrial sector, that may include investments in agriculture, energy, manufacturing and so on. Cleantech represents a range of products and services that either reduce or eliminate ecological impact, or require lower resource inputs.

Climate Risks

Risks stemming from climate change that have the potential to affect companies, industries and whole economies. There are a range of business risks associated with climate change, including regulatory developments relating to the transition to a low carbon economy, growing natural resource scarcity and potential reputational damage, as well as the direct impacts of climate change on the environment. These are all risks that need increasingly to be proactively managed.

Community Investing/Community Impact Investing

Providing capital to communities that are underserved by traditional sources of investment. Community investing generally provides credit, equity and basic banking functions to communities that would otherwise have no access.

Corporate Engagement

Using shareholder power to directly influence corporate behaviour or decision-making. This includes actions such as communicating with company management, collective engagement with other shareholders and proxy voting.

Corporate Governance

The procedures, processes and structures through which a company is directed and controlled. Responsibility for governance of companies lies with the Board of Directors, whose duties include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship.

Corporate Social Responsibility/Corporate Responsibility (CSR/CR)

The idea that a business should take account of economic, social, environmental and ethical implications in the running of its operations. There are a number of impacts related to CSR, including risk mitigation, cost implications, brand image and competitiveness.

Divestment

Selling or disposing of shares or other assets in certain investments. This is currently most readily associated with divestment from companies involved in the extraction of fossil fuels. Active ownership investors prefer engagement and often view divestment as a last resort.

Engagement

Regular and sustained discourse with a company or regulator and other central authorities in order to seek long-term positive outcomes.

ESG (Environmental, Social and Governance) Investing

A variety of investment approaches that incorporates environmental, social and governance factors into the investment process.

ESG Integration

Including ESG factors as an integral part of the investment decision-making process, with this extra-financial analysis integrated into the overall analysis of a potential investment.

Ethical Investing

An investment philosophy guided by moral values, ethical codes, or religious beliefs, generally associated with negative screening, and generally prioritises a moral return over a financial one.

Extra-financial Factors

Factors beyond those included in traditional financial analysis. In particular, environmental, social and governance considerations taken into account when evaluating the potential of an investment.

Global Compact (United Nations Global Compact)

A corporate sustainability initiative, asking companies to align strategies and operations with universal principles on human rights, labour practices, environmental concerns and anti-corruption, while taking actions that advance societal goals. This list is often used for negative screening.

Green Investing

An investment philosophy that considers the environmental impact of an underlying investment.

Impact Investing

An investment philosophy which supports companies that are working to provide significant societal or environmental benefit, in addition to generating a financial return.

Microcredit

Small, typically low interest, loans to entrepreneurs who have little or no access to capital or financing, typically within developing countries.

Negative Screening

A strategy of avoiding investing in companies that match pre-determined criteria – for example, if business practices are considered harmful to individuals or the environment, or are deemed not to be 'ethical'.

Positive Screening

Selecting investments that rank highest on ESG criteria within their respective sectors.

Principles for Responsible Investment (UNPRI)

The United Nations-backed Principles for Responsible Investment initiative is an international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors, and support signatories to incorporate these issues into their investment decision-making and ownership practices. In implementing the Principles, it is hoped that signatories will contribute to the development of a more sustainable global financial system.

Proxy Voting

Proxy voting allows shareholders to exercise their right to vote without having to attend company annual meetings. This can involve shareholders with voting rights delegating their votes to others who vote on their behalf.

Responsible Investment (RI)

As its basis, RI is the incorporation of ESG factors into the selection and management of investments. Over time, RI has come to encompass a range of strategies including ESG integration, thematic investing, ethical investing, socially responsible investing, sustainable investing, green investing and impact investing, among others.

Responsible Property Investment

RPI is an approach to property investing that recognises environmental and social considerations, along with more conventional financial objectives. It goes beyond minimum legal requirements, to improving the environmental or social performance of property, through strategies such as energy-saving measures.

Shareowner/Shareholder Advocacy

Using shareholder power to directly influence corporate behaviour or decision-making. This includes communicating with company management on environmental, social, governance, and transparency issues, filing shareholder proposals and proxy voting.

Socially Responsible Investment (SRI)

An alternative name for Responsible Investment.

Stranded Assets

Stranded assets refer to the potential for fossil fuel reserves to become 'un-burnable' due to rising operational costs associated with carbon pricing, as well as increasing regulation and public pressure for alternative sources of energy.

Sustainability Report

A report produced by an organisation to inform stakeholders about its policies, programmes, and performance regarding environmental, social, and economic issues. Sustainability reports are usually voluntary, and are sometimes independently audited and/or integrated into financial reports.

Sustainable Development

The concept of meeting present needs without compromising future generations. It encompasses social welfare, protection of the environment, efficient use of natural resources, and economic well-being.

Sustainable Development Goals (SDGs)

A United Nations sponsored project superseding the Millennium Development Goals, SDGs are a set of goals, targets and indicators covering a range of sustainable development issues that UN member states are expected to use to frame their agendas over the next 15 years.

Sustainable Investing

Long-term investment in a company, asset or sector that makes a positive contribution to environment, economy or society, in order to support or boost that positive contribution over time.

Task Force on Climate-Related Financial Disclosures (TCFD)

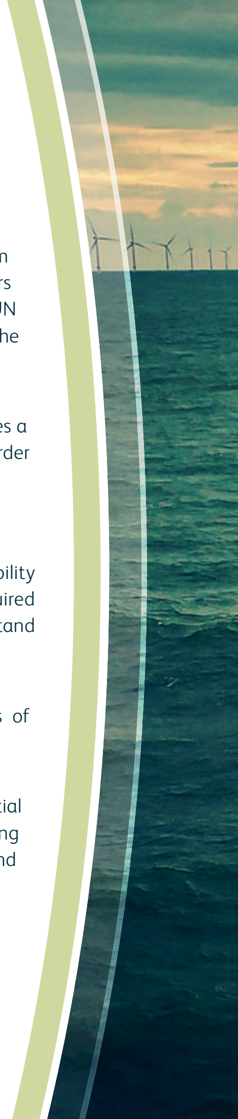
An industry-led task force, established by the Financial Stability Board (FSB), charged with helping to identify information required by investors, lenders and insurance underwriters to understand material risks in relation to climate change.

Thematic Investment

Thematic investment involves selecting assets on the basis of investment themes such as climate change.

Transparency

The degree to which an organisation discloses essential information about its structure and operations, assigning responsibility and accountability to management decisions and company actions.




CORPORATE SOCIAL RESPONSIBILITY
CORPORATE GOVERNANCE
RESPONSIBLE INVESTMENT
ENGAGEMENT
ESG
SUSTAINABILITY
IMPACT INVESTING
ACTIVE OWNERSHIP
PROXY VOTING
EXCLUSION POLICIES
ESG INTEGRATION
NORMS-BASED SCREENING

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