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Integrating ESG criteria in our Future World ESG Multi-Index funds[1]

LGIM's purpose is to create a better future through responsible investing. We believe environmental, social and governance (ESG) factors – such as climate change, social inequality and executive pay – are financially material. We see responsible investing as the incorporation of ESG considerations into investment decisions where possible.

Responsible investing, in our view, is essential to mitigate risks, unearth investment opportunities and strengthen long-term returns for investors.

ESG investing has continued to rise in popularity in recent years, with no signs of abating. But, with greater focus comes greater need for scrutiny, especially with increasing regulations in this space. With the multitude of different investment offerings implementing ESG considerations in different ways, making a fair assessment and picking the right portfolios for your clients can be a challenge.

Therefore, we believe as an investment manager it is important that we clearly explain our approach to ESG investing. In this article, we will demonstrate how we integrate ESG criteria into our Future World ESG Multi-Index funds. It also explains how these funds seek to avoid the potential pitfalls of ESG investing.

These funds have been designed for investors seeking demonstrable improved ESG outcomes. They aim to do just that, with objectives such as seeking to lower carbon footprint and lower carbon reserves intensity at their core.

[1]Note that Fund names of Future World Multi-Index 3-5 will be updated in July 2022 to include the term 'ESG'.

The five elements of ESG implementation

1. Active engagement

We believe in global engagement with companies, policymakers and other stakeholders to deliver positive change. As one of the UK's largest asset managers, our size and scale mean we can ensure our clients' voices are heard loud and clear on the ESG matters that matter most. Our dedicated Investment Stewardship team regularly engages with companies in which we invest, to address ESG risks and opportunities – both company-specific and market-wide – in order to generate sustainable benefits for our clients and wider society.

The team also exercises voting rights globally, across LGIM's active and index funds, holding companies to account on the issues that matter most to our clients. These range from climate change to fair pay and healthcare. Where necessary, we will vote against and even divest from companies if we do not feel they have made sufficient moves to improve in key areas.

Example: Climate Impact Pledge*

We support efforts to limit carbon emissions to net zero by 2050. Under our Climate Impact Pledge, we commit to helping companies within the funds to reach this objective. In line with our 'engagement with consequences' philosophy, we divest from companies that fall short of our minimum climate standards. However, we see divestment as a last resort, and continue to engage with companies we divest from to help them progress, with the potential of reinstating them in our funds if we see enough progress.

*Companies are divested from selected funds with £87 billion in assets (as at 31 Dec 2021), including funds in the Future World fund range. Companies are divested up to a pre-specified tracking error-limit. If the tracking-error limit is reached, holdings are reduced rather than fully divested.

2. ESG-integrated research

We have brought together experts from our Investments and Investment Stewardship teams to establish Global Research and Engagement Groups (GREGs) that devote significant time and resource to identify and tackle emerging ESG issues across a range of sectors.

The GREGs enable us to connect top-down macro and thematic views with bottom-up micro analysis of corporate and sector fundamentals, to unearth opportunities for potential long-term sustainable returns.

Our investment stewardship activities, combined with our collaborative active research, provide us with a strong framework for integrating ESG considerations both within the funds and within the underlying LGIM Future World building blocks.

An important output of this partnership is the creation of a set of exclusions. This means the funds' LGIM Future World equity building blocks will not invest in companies that fail to meet either globally accepted principles of business, or do not meet LGIM's minimum requirements on the carbon transition. These exclusions include companies:

- that generate 20% or more of their revenues from the mining and extraction of thermal coal power generation, or oil sands
- are involved in the manufacture and production of controversial weapons
- that generate more than 5% of their revenues from assault weapons
- that generate more than 10% of their revenues from the production or retail of tobacco products
- that are perennial violators of the United Nations Global Compact, an initiative to encourage businesses worldwide to adopt sustainable and socially responsible policies

ESG-enhanced index funds

The Future World ESG Multi-Index funds invest predominantly in LGIM index building blocks. These strategies seek to tackle sustainability risks on a product level using tools such as ESG scoring, 'tilting' and exclusions (mentioned above), via index construction or design.

The LGIM ESG score is our proprietary, rules-based approach to scoring over 13,000 companies[1] from an ESG perspective, using a number of key metrics including carbon emissions, supply chain policies and diversity.

The ESG score combines an environmental score, a social score and a governance score with adjustments made for a company's overall levels of transparency with regards to ESG issues.

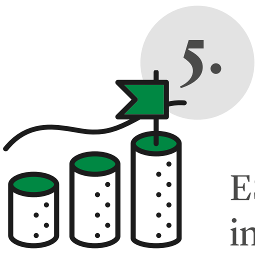
Our index funds use this tool to tilt from a market capitalisation base towards the best ESG companies and away from the worst, with stock and sector limits to prevent concentration risks.

ESG-enhanced active strategies

The Future World ESG Multi-Index funds invest in LGIM active funds that focus on ESG as a financial risk and integrate this at the sector and issuer level.

The GREGs provides crucial input on how LGIM active strategies within the funds are managed, by applying minimum ESG standards to companies which we invest in.

Our ESG scores are also used as a data input into the investment process for these active strategies, alongside further detail ESG analysis and fundamental research.



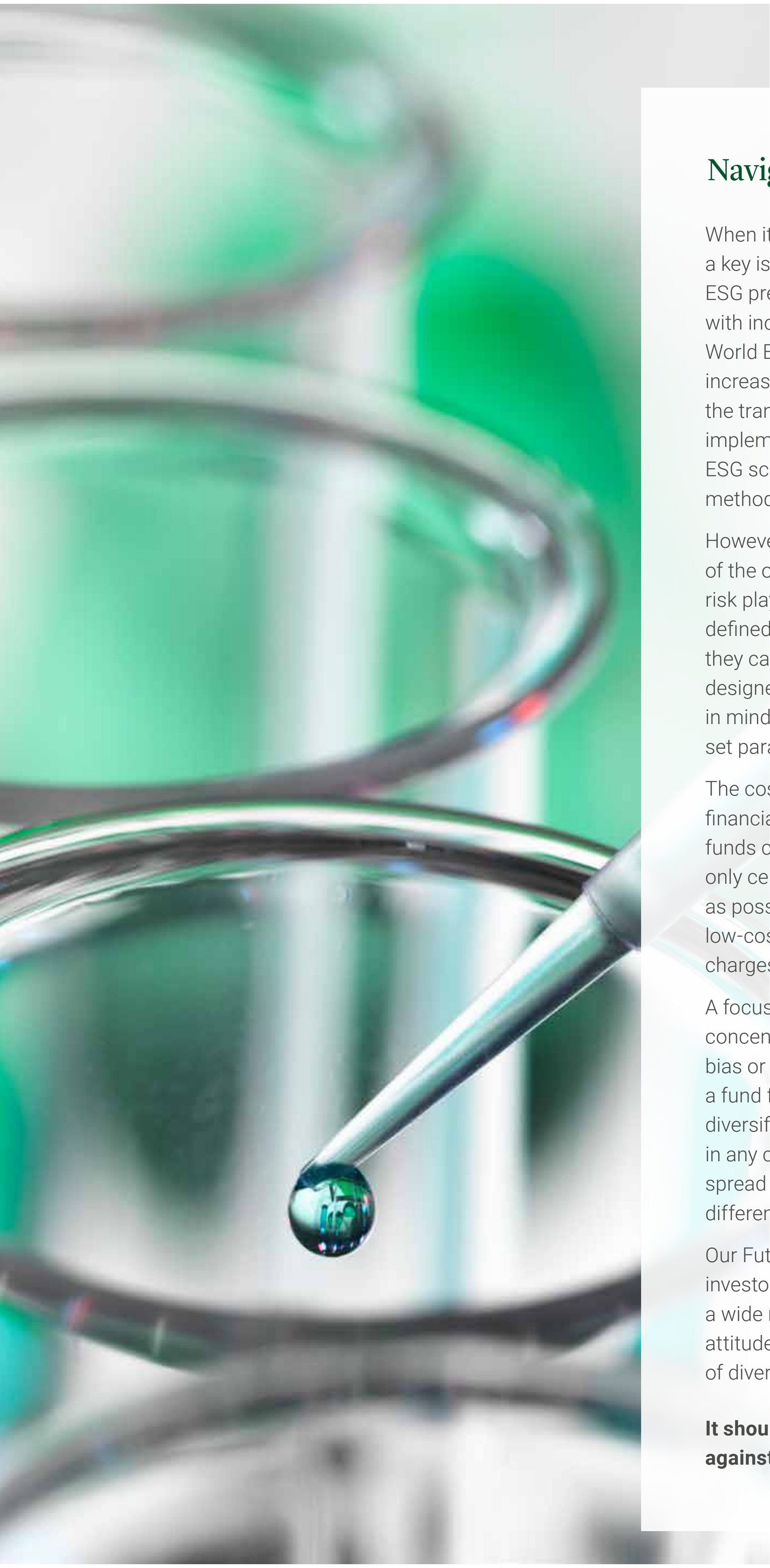
ESG-focused thematic investments

The funds invest in 'positive selection' baskets of alternatives, including sustainable timber and sustainable infrastructure stocks, and sustainable real estate investment trusts (REITs).

Our sustainable infrastructure basket contains renewable energy generators, clean water technology providers and sustainable networks. Our sustainable REITs invest in social housing and homeless accommodation, primary care buildings, GP surgeries and research centres.

Our sustainable timber basket holds listed companies owning physical forestry assets and is screened to ensure compliance with industry best practice standards for sustainable timber. The funds also invest in sustainable bonds issued by governments or supranational banks, as well as our Clean Energy and Clean Water ETFs.

[1]As at 25 May 2022



Navigating potential pitfalls

When it comes to making an investment recommendation, a key issue for financial advisers is embedding their clients' ESG preferences within the suitability processes, especially with increasing regulatory pressure. We believe the Future World ESG Multi-Index funds can help advisers meet their increasing commitments in this space. This is thanks to the transparent nature of how ESG considerations are implemented in the funds, including the use of our proprietary ESG scores, which are made public, as well as the methodology underpinning these, for ease of research.

However, we would urge financial advisers to not lose sight of the overall assessment of suitability, in which appetite for risk plays a fundamental role. The funds are risk-rated from 3-7, defined by Distribution Technology's Dynamic Planner, though they can also be mapped to other risk profilers. We have designed each fund in this range with a particular risk profile in mind, and we aim to keep any potential risk within set parameters.

The cost of ESG investments is another concern for many financial advisers as recent research has shown that ESG funds can often carry excessive fees. We believe cost is the only certainty in investing, so prioritise being as cost-effective as possible. As our funds predominantly invest in our own low-cost index building blocks, we can keep our overall charges low.

A focus on ESG factors can sometimes create unintentional concentration risk. ESG investing can lead to implicit growth bias or size bias, and exclusions can sometimes mean a fund focuses too much on specific sectors. We believe diversification is the key to prevent being overly concentrated in any company or sector, which means we ensure the funds spread potential risk by investing across a wide range of different sectors and themes and regularly monitor this split.

Our Future World ESG Multi-Index funds are designed for investors seeking to integrate ESG considerations across a wide range of different asset classes in line with their attitude to risk, without sacrificing the potential benefits of diversification and cost-effectiveness.

It should be noted that diversification is no guarantee against a loss in a declining market.

How the funds integrate ESG

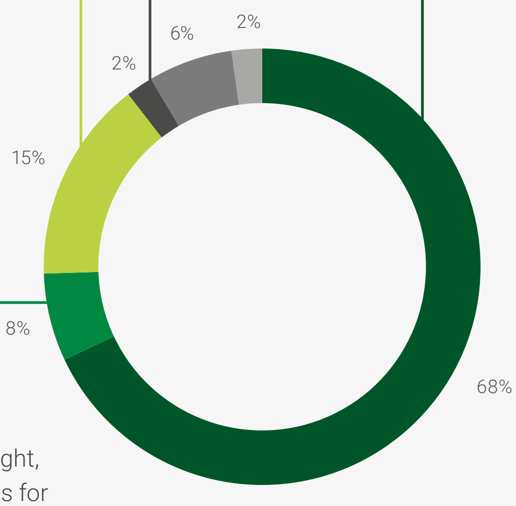
Example: L&G Future World ESG Multi-Index 5

ESG-focused thematic investments

- ESG screen to mitigate risks and select sustainable owners
- e.g. Forestry – ESG screening and engagement project on certification, deforestation and transparency

ESG-screened government bonds

- Sustainable bonds



ESG-enhanced index funds

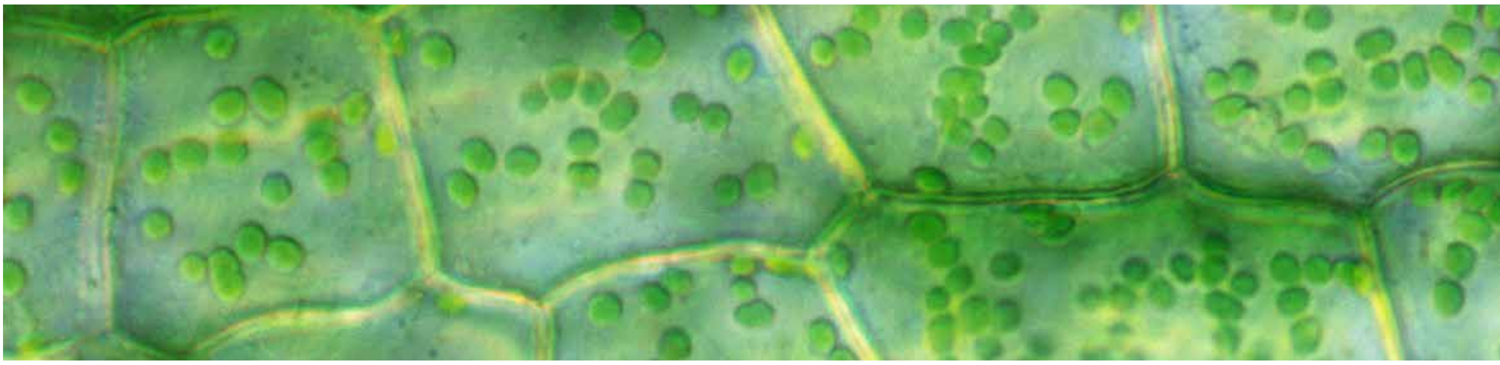
- ESG funds tilt towards (and away from) the best (or worst) companies and sectors based on our proprietary ESG score
- Enforce, enhance, engage model combines our investment stewardship and index investment expertise
- Exclusions apply

ESG-enhanced active funds

- GREGs-developed active ESG insight, including minimum ESG standards for investee companies
- A focus on combining alpha generation and ESG to deliver objectives
- ESG scores used as data input in the investment process

- ESG-enhanced index funds
- ESG-enhanced active funds
- ESG-focused thematic investments
- ESG-screened government bonds
- Cash
- Other

If you would like to learn more about these funds, please contact your usual LGIM representative.



Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM representative

LGIM talks

The LGIM blog

Key risks
Past performance is no guarantee of future results. The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

Assumptions, opinions and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass. It should be noted that diversification is no guarantee against a loss in a declining market.

The above information does not constitute as investment advice and depends on individual circumstances.

The risks associated with each fund or investment strategy should be read and understood before making any investment decisions. Further information on the risks of investing in the funds is available at www.legalandgeneral.com/fundcentre

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