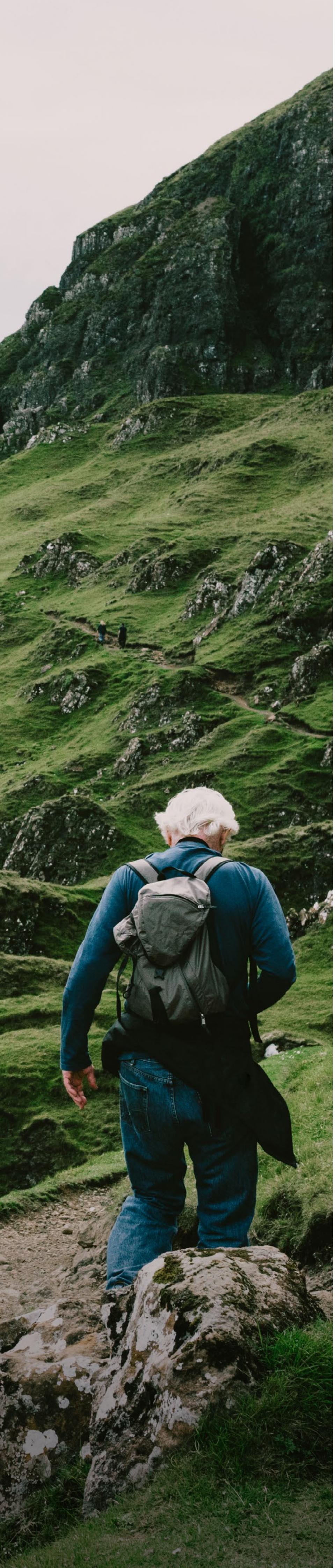
For customers

Our guide to responsible investment

Responsible investment is widely defined as the incorporation of environmental, social and governance (ESG) factors when making investment decisions. It’s about our values and common future, but it’s also about recognising that these factors can impact long-term investment performance. Here we outline the different approaches used and explain why ESG considerations are important to help grow your savings over the long-term.



Investing for a sustainable future

Our world is constantly changing. Economic and societal disruption can come from unexpected places. Crises, such as the coronavirus pandemic or the war in Ukraine can rock our sense of stability. They also strengthen our sense of collective responsibility, showing what can be achieved when we pull together.

This feeling of urgency in the face of a shared challenge is more important than ever. Major threats such as climate change and nature loss require unprecedented global action – and the clock is ticking. At the same time, we can't ignore serious social problems, whether it's racial inequality, gender discrimination or human-rights abuses.

These challenges form a backdrop to the growing focus on sustainability. Companies are paying increasing attention to their environmental and social impacts.

Individuals are also making positive changes in their daily lives, such as switching to renewable energy, recycling and buying environmentally friendly products. But have you considered whether your pension or stocks and shares ISA are aligned with a sustainable future?

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Why does responsible investment matter?

As well as the impacts on society and the environment, how companies respond to issues such as climate change could have an effect on investment returns. That means investing in funds that consider environmental and social factors could be beneficial to your savings, although this isn't guaranteed.

We believe there's a strong connection between a company's long-term performance and its approach to managing ESG risks and opportunities.

Examples of ESG factors include:

Environmental

- Climate change
- Nature
- Waste and pollution
- Water use and conservation
- Deforestation
- Natural resource use
- Clean technology
- Green buildings
- Renewable energy

Social

- Human rights and labour standards
- Product safety and liability
- Workplace safety
- Workplace benefits
- Diversity/inclusion policies
- Data protection and privacy
- Community involvement
- Nutrition and health
- Supply chain/ controversial sourcing

Governance

- Board independence
- Board diversity
- Anti-corruption policies
- Shareholder rights
- Compensation structures
- Corporate political contributions/lobbying
- Corporate behaviour/ corruption

The value of investments may go down as well as up. You may get back less than you invest.

ESG risk

Famous for disrupting the transportation system, and more recently the meal delivery market, Uber is a tech company that links customers and drivers. With its mission to 'make life easier to navigate for everyone', it has made a significant impact on society. However, its performance has been challenged by its labour standards and policies – an ESG 'social' factor. Its business model has relied upon drivers being self-employed. But after a lengthy legal process, in February 2021 the UK Supreme Court ruled that Uber now must give workers rights, including the minimum wage and holiday pay to all its drivers in the UK. There are similar legal rumblings for Uber in other countries too, showing the importance of understanding how a company treats its key stakeholders.

ESG opportunity

Ørsted is one of the world's largest renewable-energy companies, with a focus on large offshore wind farms. Over the past decade or so the company has undergone a complete transformation from its origins in fossil fuels, to focusing predominantly on green-energy solutions. Ørsted aims to power 30 million people with clean offshore wind power by 2025. The world needs to invest enormous sums of money to shift the energy system away from fossil fuels, and Ørsted has positioned itself to address this growth opportunity. Many investors will classify this as an 'environmental' investment, specifically focused on tackling climate change.

Common approaches

There are different types of approaches to responsible investment, including labels such as ethical, sustainable and impact. These may differ in terms of objective and criteria used, but all incorporate ESG factors in various ways. Broadly speaking, there are three ways of using ESG information when investing:

ESG integration

This approach doesn't generally have any set environmental or social objectives. The fund manager will still look to maximise financial return. However, it means ESG factors are considered in the investment decision-making process. This can be through 'negative screening' where certain companies may be excluded from a portfolio, based on a defined set of ESG criteria e.g., exposure to weapons or coal. Or it can be through 'positive screening' where companies that have positive or improving ESG performance relative to their competitors are favoured. 'Tilts' can also be used. This is where investments favour companies with higher ESG credentials. For example, ESG tilts may reduce the carbon footprint of a fund by decreasing exposure to carbon-intensive companies and favouring carbon-efficient or low-carbon companies. Fund managers may also engage with the companies they invest in, with a view to positively influencing their ESG policies.

Impact

Impact funds invest in companies and projects that actively aim to deliver a measurable social or environmental impact alongside a financial return. For example, an impact fund may invest in a company focused on social housing, i.e. helping to make good and affordable homes available to all, irrespective of financial background.

Thematic

These funds focus on specific themes, such as climate change, sustainable agriculture, water, healthcare, or gender equality. For example, a sustainable water fund will invest in companies that address the challenges related to the supply, quality, and allocation of clean water.

ESG in active and passive investing

There are two main types of investing – active and passive – and each approach incorporates ESG in different ways. While they differ in terms of approach, both can actively use engagement and voting at shareholder meetings to help encourage positive change and behaviours within companies

Active investing is when a fund manager 'actively' maintains a portfolio of investments, deciding when to buy and sell depending on a range of factors.

For example, as part of their assessment of a company prior to investing in it, an active fund manager may look at the financial results of that company, meet the executive management team, or do a tour of one of their factories. They can combine both a qualitative (for example, does the company have the right culture?) and a quantitative assessment (for example, is the company reducing its greenhouse-gas emissions?)

The fund manager may decide not to invest in a company due to poor management of ESG factors, or to sell an existing investment if a company is showing deteriorating ESG performance.

Impact investing, in the strict sense of adding real environmental and social benefits, is often seen as better suited to active fund management.

Passive investing is when a fund's holdings copy or 'track' a benchmark (for example the FTSE 100 Index) by investing in the same companies, in the same proportions, as that benchmark.

These funds tend to cost less than active funds as there is no fund manager discretion involved. They can take ESG factors into account by tracking a benchmark that itself considers ESG factors.

For example, a passive ESG fund might exclude particular company types or sectors, or include only firms with strong ESG credentials. It can also mean 'tilting' the fund's investments so that it holds more or less of certain types of companies than the parent benchmark, for example reducing the fund's allocation to carbon-intensive stocks and increasing the allocation to companies with higher ESG scores.

Helping to grow your savings over the long term

There's increasing evidence that there's a positive connection between a company's performance and its approach to managing ESG factors, which in turn could have a positive impact on your savings. Recent years have seen a significant rise in demand for funds that consider ESG factors. The Global Sustainable Investing Alliance estimated in their '2022 Global Sustainable Investment Review' that there are currently US$30.3 trillion sustainable assets under management.[1]

Your pension and the climate emergency

Fund managers need to think very carefully about their exposure to climate risks, whether it's from government policy, technological innovation, changing consumer preferences, or disruption caused by extreme weather. All companies can be affected by climate change, but some are at more risk than others. For example, fossil-fuel companies may lose business as economies transition to renewable energy. As action to combat climate change builds momentum, many of their assets, including coal mines and oil fields, could lose significant value. On the other hand, companies that are focusing on solutions to climate change, whether through products or services, are likely to benefit from the transition to a low-carbon future.

[1] Source: The Global Sustainable Investment Review 2022, published by The Global Sustainable Investing Alliance.

Are my savings invested with a responsible approach?

If you invest in a workplace pension scheme default fund (the fund you're automatically invested in if you don't make your own investment choice) then you may already be invested in funds that incorporate ESG. If you have savings in a different pension fund, an ISA (Individual Savings Account), or a general investment account, your investments are unlikely to incorporate ESG considerations unless you have actively selected a fund that has an ESG approach.

Fund factsheets and Key Investor Information Documents (KIID) should provide detail about the ESG criteria a fund looks at. If you're not sure if a fund meets your own ESG objectives, you may want to speak to your financial adviser. If you don't have one, you can find one at on the **Money Helper** website. There may be a charge for this advice.

With UK pension and savings assets totalling over £8.8 trillion[2], the ability to influence change is significant.

[2] Source: The Global Sustainable Investment Review 2022, published by The Global Sustainable Investing Alliance.

Responsible investment at Aegon

As a long-term savings provider, with over 30 years' experience managing responsible investments, we realise that we have a key role to play in addressing global issues such as climate change, social inequality and unethical business practices.

We continue to focus on understanding and managing the impact of climate change on our business and customers. In 2019 we committed to net-zero greenhouse gas emissions for our pension default fund range by 2050 and to a 50% reduction in emissions by 2030.[3] Our **Climate Roadmap** provides an overview of our short, medium and long-term emissions reduction targets that help measure, track and guide our progress.

In 2023 we were appointed as signatory to the UK Stewardship Code – a set of 12 voluntary principles that sets high standards for responsible investment on behalf of UK savers and pensioners.

Collaboration is key and we're committed to using our influence to drive positive change and create a more sustainable future. We've signed up to the UN Principles for Responsible Investment and joined initiatives like the Institutional Investors Group on Climate Change (IIGCC).

Finally, for those looking beyond their default fund option we offer a range of options that consider environmental and social factors, designed to suit your investment preferences.

Please see fund factsheets or Key Information Documents for details of fund-specific risks.

The value of investments may go down as well as up and you may get back less than you invest.

This document is for information purposes only. Reliance shouldn't be placed on this information when taking individual investment decisions. If you need any help, please speak to a financial adviser. You can find one in your local area through: moneyhelper.org.uk

[3] Source: Measured using carbon footprint across our full range of default funds. Emissions targets don't apply to individual funds. 2030 target applies to scope 1 and 2 emissions from listed equities (shares) and corporate fixed income (bonds) only.

In 2019 we committed to net-zero greenhouse gas emissions for our pension default fund range by 2050 and to a 50% reduction in emissions by 2030.[4]

[4] Source: Measured using carbon footprint across our full range of default funds. Emissions targets don't apply to individual funds. 2030 target applies to scope 1 and 2 emissions from listed equities (shares) and corporate fixed income (bonds) only.

Find out more about responsible investing at **aegon.co.uk/ responsibleinvestments**

If your personal circumstances mean you need any additional support, or if you'd like a large print, Braille or audio version of this document, please visit **aegon.co.uk/additionalsupport** or call +44 (0) 3456 081 680 (call charges will vary).

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