LGIM's approach to responsible investing

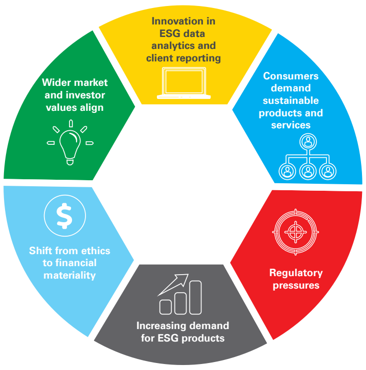
We believe responsible investing can not only mitigate risks, but also lead to better long-term financial outcomes without sacrificing performance.

Anton Eser
Chief Investment Officer

From diesel emissions to oil spills, there have been many tangible examples in recent years of how failures in the way companies are run can have a harmful impact on the environment, society and investor returns.

We believe responsible investing can mitigate the risk of such outcomes and has the potential to improve returns through the integration of environmental, social and governance (ESG) considerations, active ownership and long-term thematic analysis. Crucially, it can also unearth investment opportunities, which the market may not fully appreciate, and should not require a trade-off with performance.

Figure 1: Stars align for responsible investing



At LGIM, as one of the world's largest asset managers with a long history of corporate engagement on the most material long-term issues, we have the scale and ability to make a real, positive impact on the companies in which we invest and on society as a whole. We share this objective – made far more attainable by ongoing improvements in ESG data – with a growing number of clients.

Responsible investing cannot be just a box-ticking exercise. So from the votes cast by our industry-leading Corporate Governance team to the investment processes deployed in our funds, we continue to take steps to embed the principles of responsible investing across our entire business – and act on them.

At a time when populism is destabilising global politics, the world faces a growing debt burden and a demographic drag looks set to dominate growth prospects, we believe that such an approach is more necessary now than ever as new systemic threats continue to emerge.

Against this backdrop, there is a clear change in the behaviour of consumers, who are demanding more sustainable products and services due to a growing awareness that they are responsible for the societal and environmental implications of their choices.

A similar shift is underway among investors. Increasing numbers expect the asset managers most likely to deliver the greatest shareholder value over the long term to be those that truly recognise the importance of incorporating long-term themes alongside ESG considerations into their investment processes.

MANAGING THE MANAGERS

There are an almost overwhelming number of ways to characterise and conduct responsible investment strategies. We support the consensus view, established by the UN-backed Principles for Responsible Investment, that responsible investing aims to incorporate ESG factors, in order to better manage risk and generate sustainable, long-term returns.

Importantly, unlike other approaches, such as ethical investing, we define responsible investing as seeking to deliver desired financial outcomes, rather than being subject to moral or ethical considerations.

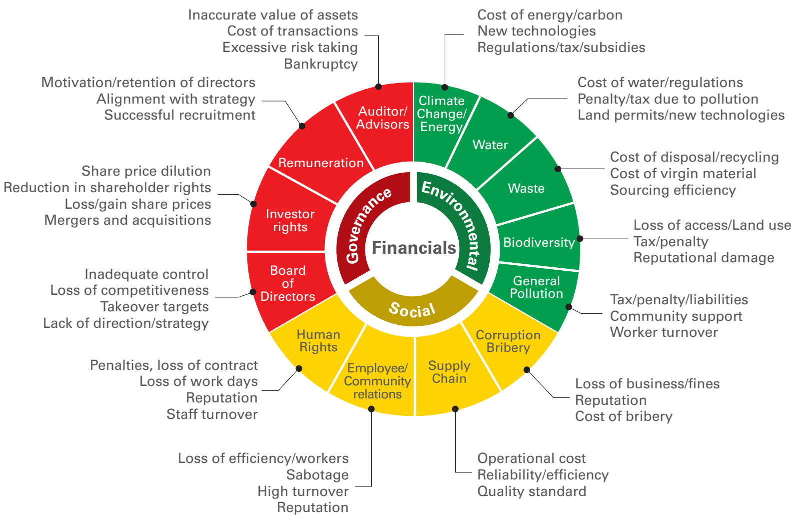
And while the collection of hard, empirical data on responsible investing remains somewhat in its infancy, a growing body of academic and industry work indicates that it can indeed engender better risk-and-return outcomes.

GUESS WHO'S COMING TO YOUR AGM

Active ownership forms a key part of how we conduct responsible investing, as we feel it is incumbent upon us to take our stewardship responsibilities seriously, not least because of our size. This is reflected in the following activity:

- Company engagement
- Using our voting rights globally, with one voice across all our active and index funds
- Addressing systemic risks and opportunities
- Seeking to influence regulators and policymakers
- Collaborating with other investors and stakeholders

Figure 2: ESG Risks



Insights gleaned by our Corporate Governance team, which spearheads much of this work, help us to assess a company's ESG profile. This is most comprehensively evaluated by looking at two different drivers of investment returns.

The first is how its business activities can impact its bottom line; for example, the risk of pollution by a miner leading to the loss of a key licence to extract resources from a country. The second is how long-term trends may determine consumer demand for products and services; for example, the implications of the global battle against plastic for petrochemical companies and demand for oil.

As a result, we conduct a combined research effort across asset classes to evaluate long-term themes – energy, demographics and technology – and understand how they shape, and are shaped by, the political environment.

MAKING RESPONSIBLE INVESTING MAINSTREAM

We have devoted significant resources to extending our capabilities in responsible investing across our business – from Global Fixed Income and Active Equities, to Index, Multi-Asset and Real Assets. We also work to make a positive impact through strategies such as our Future World funds, which go even further in addressing sustainability issues.

Markets, meanwhile, do not yet reflect the systematic incorporation of ESG considerations by their participants. But as investors are increasingly recognising that these factors play a crucial role in determining asset prices, we believe responsible investing is destined to become the new normal.

As it becomes mainstream, we are likely to see a virtuous circle of more investors demanding higher standards in order to allocate capital to companies, and more companies raising their standards in order to receive that capital.

We also expect growing numbers of investment decision-makers to view the consideration of ESG factors as a fundamental part of fiduciary duty, as they acknowledge that it need not entail the sacrifice of investment returns.

For our part, we will continue to endeavour to embed these principles in everything we do, in order to deliver sustainable, long-term returns for our clients and help bring about the real, positive change of which the world is in urgent need.

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