

## OUR APPROACH TO ESG

*With more than 30 million investors globally who look to us to both safeguard and grow their investments, we think about risks and opportunities in the context of delivering value to investors. This attitude shapes our approach to environmental, social and governance (ESG) considerations, which is multifaceted and founded on three pillars.*

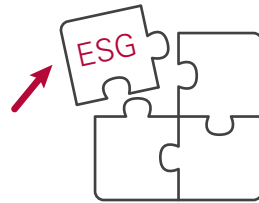
### Product construction



Incorporating  
ESG objectives

Our range of ESG index funds employs exclusionary screening, meaning exposure to certain companies is prohibited, owing to their failure to meet a set of independently established ESG standards.

### Portfolio management

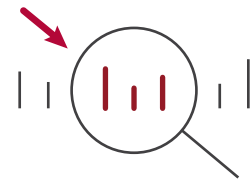


ESG integration

Financially material ESG information is measured systematically within the investment process across our range of funds. ESG risk ratings are assigned to companies and no investment opportunity is off limits.

We look to the managers of our active funds to assess companies' ESG risks on a case-by-case basis. We have different approaches for our active funds managed in-house, our active funds managed externally and our index funds.

### Investment stewardship



Oversight of  
portfolio companies

Our index funds are long-term owners of companies and we seek to positively influence corporate behaviour through our investment stewardship programme, which focuses on four key principles. In order of significance, these are:

- Board composition
- Executive compensation
- Risk and strategy
- Governance and structures



## Incorporating ESG objectives

Vanguard takes a thoughtful and deliberate approach to developing new products. We aim to deliver value through the quality of our funds, rather than offering niche products in line with the latest fads. Vanguard advocates broadly diversified, low-cost portfolios of equities and bonds. Our dedicated ESG funds reflect these principles.

### What do we exclude?

Each of our ESG index funds has different exclusionary screens depending on the index they track.

As an example, a developed world all-cap ESG index fund tracking a particular ESG index might exclude: companies in violation of UN Global Compact principles, producers or manufacturers of adult entertainment, alcohol, firearms, fossil fuels, gambling, nuclear energy and tobacco.



## ESG integration

Across our active funds and index fixed income funds, we incorporate the assessment of financially material ESG information in the investment research and decision-making process. The practice is most visible in our range of actively managed funds, with different protocols for in-house and externally managed products, as well as equity and fixed income funds.

### 1 In-house active equity

Vanguard's Quantitative Equity Group, which manages several quantitative equity funds and a portion of other Vanguard equity funds, examines governance issues when evaluating earnings growth prospects to identify companies that could be over-managing their earnings or have a higher probability of earnings manipulation.

### 2 In-house active and index fixed income

Vanguard's Internal Credit Research Group assesses risks at the sector and issuer level and determines a credit profile, which includes a rating on event risk, credit trend and ESG risk.

We seek to understand if market pricing adequately reflects material ESG risks.

ESG risk ratings can be low, medium or high depending on the issuer's susceptibility to ESG risks and the associated financial impact.

If an ESG risk arises that impacts event risk and/or credit trend, the sampling algorithm will be updated, which could result in a change to the bond's ESG credentials and therefore the size of position we hold.

### 3 Active funds managed externally

The Vanguard Portfolio Review Department regularly engages with existing and prospective managers to assess their ESG practices and understand how ESG issues inform their investment processes.

Each manager has a distinct process for assessing ESG considerations in their research and decision-making.

Our external managers have full proxy voting responsibilities for the portions of the funds they manage, enabling them to integrate their proxy voting activities and company engagement into their investment strategies.



## Oversight of portfolio companies

A long-term perspective is central to our approach to stewardship. Through multiple channels we promote leading corporate governance practices, which we believe will deliver long-term value to all investors.



### Advocating

We advocate with groups of constituents in the market to inform and articulate our governance.

To this end, we:

- Publish content to communicate our views.
- Support and participate in industry working groups.
- Speak at industry events/conferences.
- Comment on regulation, certain reporting frameworks and standards.
- Engage with media and press inquiries.



### Engaging

We have ongoing, direct dialogue with portfolio companies and other stakeholders about corporate governance topics.

This may include discussions with:

- Corporate board members.
- Company executives.
- Activists.
- Regulators.
- Thought leaders.
- Active sub-advisors.



### Voting

We vote the Vanguard funds' proxies in support of good governance.

Our voting is based on:

- A thoughtful, considerate process that is used across the global portfolio of funds.
- Internal policies and guidelines informed by research.
- Knowledge and experience of senior team leaders and analysts.



## What impact does ESG have on returns?

Our comprehensive research<sup>1</sup> indicates that ESG equity funds differ from the broad market in terms of risk and return, but these differences are mainly driven by fund-specific criteria, rather than a common ESG factor. Therefore, it is critical that investors carefully assess the important and unique attributes of ESG funds to understand the potential difference in performance compared to equivalent broad market indexes.

<sup>1</sup> Plagge, Grim (2020), Have investors paid a performance price? Examining the behaviour of ESG equity funds, Journal of Portfolio Management Vol 46 Issue 3 Ethical Investing 2020.

### **Investment risk information**

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

### **Important information**

**For professional investors only (as defined under the MiFID II Directive) investing for their own account (including management companies (fund of funds) and professional clients investing on behalf of their discretionary clients). In Switzerland for professional investors only. Not to be distributed to the public.**

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