March 2021

M&G Investments

# ESG Criteria and Sustainability Criteria

## M&G (Lux) Global Listed Infrastructure Fund

This document, referred to in the Fund's prospectus, provides further information on the ESG Criteria and Sustainability Criteria used by the Investment Manager when managing the Fund.

# Contents

# 1. Responsible Investing at M&G

## 1.1. M&G's Responsible Principles

M&G believes that ESG (Environmental, Social and Governance) factors can have a material impact on long-term investment outcomes. Our goal is to achieve the best possible risk-adjusted returns for our clients, taking into account all factors that influence investment performance. Consequently, ESG issues are incorporated into investment decisions wherever they have a material impact on risk or return.

We apply an active ownership approach through engagement with investee companies and voting at company meetings where we hold equity. This enables us to manage risks effectively and improve ESG standards across our portfolio to preserve and ultimately enhance the long-term value of the assets.

M&G seeks to support companies over the long term where possible, through their business and market cycles. This long-term approach means that there is a wide spectrum of both financial and non-financial factors that we need to understand when considering the long-term prospects for a business. This includes traditional governance issues, like remuneration and board composition, as well as environmental and social factors.

We believe that the long-term success of companies is supported by effective investor stewardship and high standards of corporate governance. We think that if a company is run well, it is more likely to be successful in the long run. Social and environmental issues can also have an important impact on a company's performance and successful development. We therefore look at how companies address these issues when we analyse them.

We are aware of our responsibilities as an investor and actively participate in responsible investment initiatives, including Climate Action 100+, Climate Bonds Initiative and the Principles for Responsible Investment (PRI). We are also involved with impact orientated organisations, including the Impact Management Project, the Global Impact Investing Network and the UK National Advisory Board on Impact Investing.

M&G takes a responsible, active and long-term approach that considers all of the relevant financial and non-financial elements of our investment.

## 1.2. Responsible Investing in Practice

ESG is a key component of our investment process and due diligence. We review potential investments for ESG issues through our own hands-on due diligence and by engaging with specialist advisers.

All our investment teams have access to a range of external ESG data providers, which ensures that the teams have sufficient ESG data and research that can be used by portfolio managers and analysts when engaging with companies on issues material to them. We have developed a proprietary 'ESG scorecard' for individual companies which incorporates a standardised section reflecting M&G's values which is combined with the Sustainability Accounting Standards Board (SASB) framework. In order to provide insight into analysis we have also been developing internal tools, including an 'ESG dashboard', and have created a databank of questions to identify material issues for specific industries and sectors.

M&G's Stewardship and Sustainability team oversee our stewardship of the companies in which we invest. Active voting is an integral part of our investment approach. M&G has a robust voting policy in which we seek to exercise our principles and stewardship responsibility. We believe exercising our votes adds value and protects our interests as shareholders. Proxy Voting records are published quarterly on M&G's website.

Regular meetings with company directors allow us to identify whether a company's strategy is aligned with our interests as long-term shareholders. Our active engagement with companies helps us to understand the issues affecting them and, where appropriate, to encourage positive change. Engagement activities are disclosed in M&G's Corporate Finance & Stewardship Report, which is published annually on our website.

# 2. Our Approach to Listed Infrastructure Investing

By its nature, the infrastructure sector is one where ESG considerations are not only unique and specific to the asset class, but where risks are prominent and evolving. By assessing and making efforts to mitigate against these risks, and by investing in businesses facilitating the energy transition, we believe we offer investors an opportunity to play an active role in this critical initiative. The Fund applies a Best-in Class approach. In addition, an approach that allocates to companies that are rapidly improving their performance assessed against the ESG Criteria and Sustainability Criteria is applied.

As the existential threats posed by climate change evolve at a rapid pace, sustainable infrastructure has become the foundational requirement of a low-carbon economy. As asset managers, we have a crucial role to play in allocating capital towards achieving this outcome. At the same time, the fixed, long-life nature of underlying assets, contracts, and exposures requires us to mitigate risk through the complete integration of material ESG considerations not only at the inception of the investment process but throughout the entire duration of the investment.

Our approach to sustainability is dynamic. Ongoing monitoring will allow us to identify new and potential risks, with the benefit of market liquidity in our listed infrastructure holdings allowing us to divest if circumstances change and/or a transgression becomes unresolvable.

Infrastructure is among the most prominent industry sectors in any assessment of climate change risk. The provision of energy and facilitation of transport, in particular, have clear environmental impact, but these sectors are also critical to the transition to a net-zero global economy by 2050. By assessing and influencing their impact, and by investing in businesses and assets that facilitate the transition, our Global Listed Infrastructure Fund seeks to deliver sustainable investor outcomes through a clearly defined and fully integrated process.

As investors in long-life, fixed infrastructure assets, a key priority is to adequately assess the long-term financial and operational sustainability of the companies we invest in. This due diligence process can only be completed by successfully embedding Environmental, Social, and Governance (ESG) considerations at every stage of our fundamental analysis.

Beyond mitigating the risks inherent to our asset class, some of which may only materialise over time, we expect our investee companies to demonstrate best practice, with a view to protecting and growing our clients' capital over time. In doing so, we must take into account risks and considerations specific to the infrastructure sector, with a focus on asset and business resilience, rather than taking a standardised approach.

We supplement our own analysis with third-party research but also engage regularly with our investee companies to ensure that beyond capturing the facts, we have a firm grasp of each company's corporate sustainability and direction of travel. Based on a clear understanding of a company's path to decarbonisation, environmental stewardship and more sustainable outcomes, we assess its resilience, its challenges and opportunities. Importantly, we also seek to understand how a company will respond to a fast-changing economic, regulatory, and social landscape.

This journey, and its pace of change, is the context in which we must assess companies' internal and external challenges, and the overall contribution towards their net-zero targets. (We define 'Sustainability' in this context – in line with the Bank of England's Climate Financial Risk Forum [1] – with the French Energy Transition Law[2] and with the World Economic Forum's definition[3].)

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1 The Bank of England's Climate Financial Risk Forum defines sustainability as 'the ability to meet the needs of the present without compromising the ability of future generations to meet their needs' LINK: https://www.bankofengland.co.uk/news/2020/june/the-cfrf-publishes-guide-to-help-financial-industry-address-climate-related-financial-risks

2 French Energy Transition Law, Article 173 - https://www.frenchsif.org/isr-esg/wp-content/uploads/Understanding_article173-French_SIF_Handbook.pdf - https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000031740341&dateTexte=20200724

3 The World Economic Forum defines sustainability as 'value creation which refers not only to economic value, but to the wider impact of companies on society and the natural environment, both today and in the future'.

# 3. ESG Risk and Opportunity in Listed Infrastructure

ESG considerations are increasingly pertinent to many facets of investing, yet we believe the infrastructure sector merits a specific level of scrutiny. Almost without exception, infrastructure investing entails exposure to long-life, immovable assets, as well as to their construction, maintenance, and enhancement.

Throughout and beyond an infrastructure asset's operating life, awareness and adaptation to externalities remains critical. These assets face the risk of being impacted by climate change (weather events, sea level increases, for example) and by fast-changing environmental, regulatory, and development risks. Such externalities include, beyond the immediate asset footprint: greenhouse gas (GHG) and particulate emissions, water attrition, waste management and impact on local communities. As a consequence, an ever-present risk to any infrastructure business is the stranding of assets and the potential loss of its licence-to-operate, whether for a single asset, a business segment, or indeed for the corporation itself.

While corporate governance practices within the infrastructure sector are generally seen as robust due to regulatory oversight and contractual operating requirements, we take a more conservative approach and subject our holdings to a stricter level of scrutiny. This is particularly important given the structural issues faced by the infrastructure sector as a whole, in light of the pressing challenges presented by climate change. Infrastructure businesses are at the vanguard of climate change, and they must expect to be more exposed to new and increasing scrutiny from regulators and society (transition risk), in addition to their natural exposure to the exogenous risks associated with climate change (physical risk).

This entails a duty for company managements and boards to be aware of the long-term implications of their decisions. One consideration that is often ignored in the infrastructure sector is the potential mismatch between typical management tenure and the extended timeline of its decisions' consequences.

## 3.1. Environmental Issues and Stranded Assets

Some of the main high-level risks revolve around assets' potential environmental impacts:

- Contribution to climate change and air quality (both direct and indirect);
- Construction phase considerations and local impact;
- Water, energy use and habitat;
- Decommissioning and reclamation.

We also expect stranded asset risk and obsolescence to potentially reduce long-term asset values. (In this context, we define the risk of 'stranded assets' as assets which are no longer able to earn an economic return prior to the end of their economic life due to regulatory or other issues. They are, in effect, assets which are subject to an accelerated obsolescence thereby impacting a company's expected returns.)

Inherent ESG-related risks in infrastructure assets which may lead to a decrease in profitability include:

- Political/regulatory (regime or policy change);
- Contractual terms and their enforceability;
- Management and board independence;
- Operating practices and potential loss of licence to operate;
- Social externalities (harm to other company stakeholders: employees, customers, communities);
- Labour practices and diversity.

## 3.2. Potential Benefits

Conversely, the provision of infrastructure and services is generally perceived as one of the cornerstones of economic progress and social good.

Drawing from the UN Sustainable Development Goals (UN SDGs) [4] and their underlying targets, we believe infrastructure investments can, for example, directly contribute to the promotion of:

- SDG 7: Affordable and Clean Energy – via the delivery of beneficial solutions (eg, renewable energy);
- SDG 8: Decent Work and Economic Growth via investment to facilitate and accelerate growth and promote job creation (roads, power generation, public transit, delivering job creation but also enabling economic growth through the transport of goods and people);
- SDG 9: Industry, Innovation, and Infrastructure;
- SDG 11: Sustainable Cities and Communities via investment to benefit society (clean water, recycling, schools, hospitals, connectivity, transport and mobility).

Importantly, the infrastructure sector is a key catalyst and facilitator of the energy transition through the deployment of cleaner forms of energy generation, as well as the reduction and/or capture of existing emissions. This is an important aspect of our investment approach, where we observe a unique combination of attractive investment returns with the opportunity to promote potential positive societal outcomes.

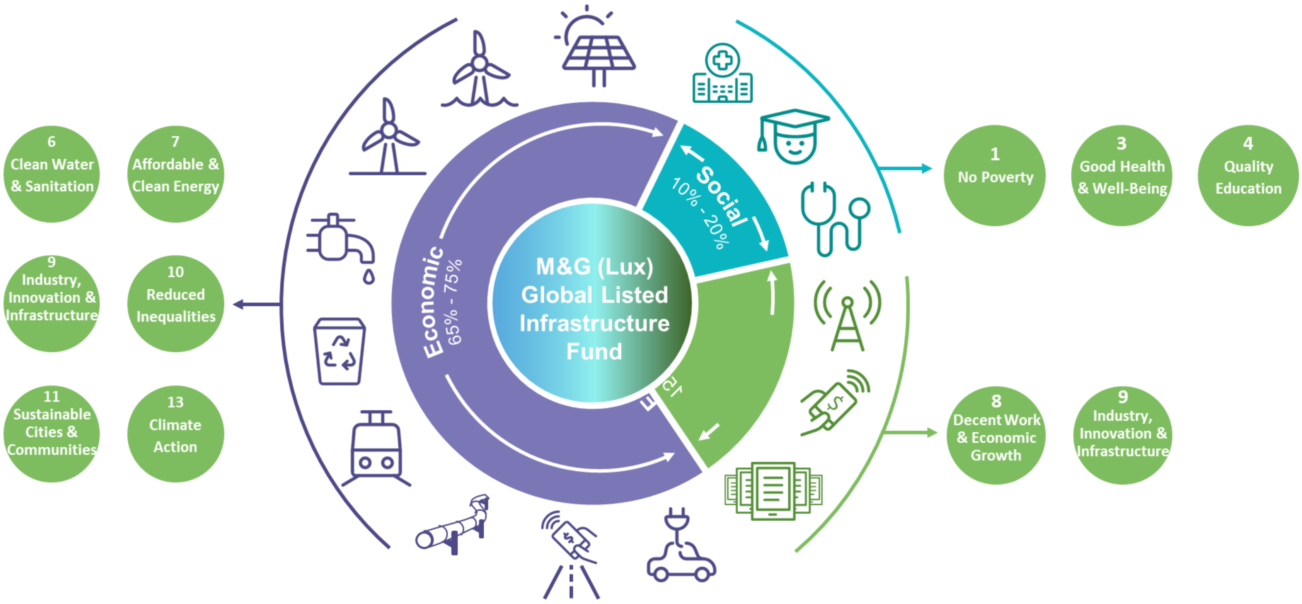
## 3.3. Breakdown of ESG Considerations by Sector

Examining some of the above considerations across our proprietary listed infrastructure framework:

| Infrastructure Sector | ESG Opportunities | ESG Risks |
|---|---|---|
| **Utilities** | Renewable energy<br>Provision of clean water<br>Waste recycling<br>Emission reduction technology<br>Provision of basic services | GHG and particulate emissions<br>Community impact<br>Reclamation & restitution |
| **Energy** | Provision of basic services<br>Facilitating the energy transition (eg, from coal to natural gas) | GHG and particulate emissions<br>Local impact<br>Reclamation |
| **Transport** | Economic growth<br>Mass transit<br>Cleaner transport (eg, electric vehicles) | Noise and air quality<br>Local impact/physical footprint<br>Reclamation<br>Health & safety |
| **Social** | Societal care/inclusion<br>Advancement/development safety | Labour practices<br>Contract performance |
| **Communication** | Connectivity and access | Data security, privacy |
| **Transactional** | Economic growth | Data security, privacy |
| **Royalty** | Lack of direct environmental impact | Stranded asset risk<br>Indirect exposure risk |

4 https://www.un.org/sustainabledevelopment/sustainable-development-goals/

Mapping the Fund to the UN SDGs




# 4. The Focus of our ESG Analysis

**Throughout our process, we perform both a relative and absolute analysis of ESG factors:**

- **Relative**, in the sense that industry peers can, in some cases, provide a 'benchmark' for comparison.
- **Absolute**, in the sense that risks to a business and asset values are at all times real and consequential, regardless of relative rankings.

**We then perform two additional forms of analysis:**

- **Materiality**: ESG issues and controversies, which might result in a significant overall impact on the business, its reputation, or its assets' value. While difficult to quantify, we typically use a maximum single-digit percentage (between 5% and 10%) revenue test as an initial step.
- **Direction of travel**: A view on the company's decarbonisation efforts, as well as addressing identified ESG controversies of any kind. This aspect of our process will inevitably require direct engagement to steer our investee companies towards carbon neutrality and the net zero goals of the 2015 Paris Agreement.

Both concepts require additional clarification:

**On Materiality, although we employ a sub-10 % revenue threshold as a preliminary reference point**, we review critical issues independently. In our assessment of materiality, we consider a number of factors, which, irrespective of a material direct financial impact, may in our view expose the company to reputational, social or compliance issues. It is also important to monitor how materiality might change over time. Here, we prefer to use the U.S. Securities and Exchange definition of a matter being 'material' if there is a substantial likelihood that a reasonable person would consider it important, i.e. when such fact or matter is likely to be considered 'decision-useful' [5]. This preliminary

5 U.S. Securities and Exchange August 12, 1999 Commission Staff Accounting Bulletin n.99 (amending Part 211 of Title 17 of the Code of Federal Regulations) and;

definition of the all-important concept of materiality is further reinforced by the addition that 'misstatements are not immaterial simply because they fall under a numerical threshold'.[6]

**On the Direction of travel: This assessment, more strategic and dynamic in nature**, is paramount to our analysis and is a key element of our investment decision-making. We support companies that are improving their operating practices, their environmental and societal impact, and companies that proactively address identified issues. Beyond increasing their level of engagement, **we would also expect companies to improve the quality and breadth of their disclosure**. Conversely, a move in the opposite direction (lesser engagement or lack of responsiveness, deterioration of key ESG metrics, isolated or as a trend) will lead to more intense engagement with the company's management and/or board, while at all times considering the prospect of potential divestment.

# 5. ESG Considerations within our Investment Process

## 5.1. Step 1: Pre-Screening for our Investible Universe

The global listed infrastructure asset class is commonly thought to comprise between 750 and 1,000 companies. By way of our investment and ESG Criteria and Sustainability Criteria, however, our own investible universe comprises fewer than 300 companies. We have our own fundamental criteria for the type of company in which we would be willing to invest, with ESG Criteria and Sustainability Criteria applied at the point of inclusion to the investible universe. For this purpose, we consider independent third-party data, commentary, and rankings as an initial step in our analysis. Specifically, we perform a screening of the investible universe based on the UN Global Compact (UNGC) principles, covering human rights, labour rights, bribery and corruption, and any environmental externalities. Any investment candidate flagging red or amber attracts specific scrutiny and must follow a specific process in order to be considered for inclusion or reviewed if already owned – as detailed in Section 6 (sub-section 6.1).

Specific to the utilities sector, which accounts for a significant share of the strategy's exposure, we strictly exclude companies deriving more than 30% of their revenues from coal-fired or nuclear power generation. Additionally, we exclude all coal extraction businesses or upstream hydrocarbon producers from our investible universe.

The reason for not applying a zero-tolerance policy to coal-fired power exposure is to enable us to support investment in companies that are phasing out legacy coal generation assets and committing to a positive contribution to the energy transition through an increase in renewable energy investments.

On this point, we strongly believe that purely taking a quantitative, screening-based approach to ESG can not only lead to missed opportunities, but that overdependence on third-party data can lead to irresponsible outcomes. Our own experience questioning and challenging third-party analysis has led to decisions that have both avoided negative outcomes and generated positive ones. Again, we value the analysis and data provided by third parties, but only as an input to our own work, rather than taking it as given. Some of the issues linked to excessive reliance on external ratings have been well publicised[7].

We also believe that through regular engagement with our investee companies, we may be better positioned to assess and influence a company's direction of travel.

In our minds, deep due diligence alone unlocks genuine insight for investors prepared to invest time and effort in a rigorous process. Our concern is that delegating our due diligence duties and deferring our judgement to external parties may, in fact, violate our duty of care. Conversely, we view this process as a crucial part of active investing and an opportunity for us to emphasise the importance of the criteria on which we have chosen to focus.

In conclusion, we believe it is paramount that we avoid overreliance on unverified derivative data both in its content or its format. We feel that this is not only an essential part of active investment but also where we can make a material difference for investors, since misunderstood risk often tends to be significantly mispriced.

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6 January 30, 2020 Public Statement by the SEC Chairman Jay Clayton on Proposed Amendments to Modernize and Enhance Financial Disclosures, Other On-going Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure. https://www.sec.gov/interps/account/sab99.htm and https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30

7 PG&E case study. https://conference-board.org/blog/sustainability/Where-External-ESG-Ratings-Fall-Short.

As a consequence, while we do access various sources to identify potential issues and to facilitate our engagement with companies, they are solely used to supplement and inform our analysis. The investment manager remains ultimately accountable for ESG-related considerations, engagement, and investment decisions, all within our pre-determined framework.

## 5.2. Step 2: Quality Assessment for Investment Candidates

When selecting candidates for portfolio inclusion, we assess their eligibility from an ESG perspective, based on our own infrastructure sector-specific quality assessment. While there are multiple ESG factors that investors might consider, we put particular emphasis on those specifically pertinent to our own investible universe.

- ESG considerations in Infrastructure Investing

  A Environmental

  i. Climate impact
  ii. Climate change exposure (direct and indirect)
  iii. Risk Management Process: Assessment, Disclosure, Mitigation/beneficial impact(s), including 'Say on Transition'
  iv. Physical footprint
  v. Project risk and stakeholder considerations
  vi. Operational track record and ongoing operating risk
  vii. Regulatory regime and standards
  viii. Decommissioning and reclamation requirements
  ix. Climate-related litigation whether existing or prospective

  B Social

  i. Societal impact (positive or negative)
  ii. Health and safety record and practices
  iii. Diversity, training and ongoing education
  iv. Community and stakeholder engagement
  v. Labour practices
  vi. Contract robustness
  vii. Third-party risk, including supply chain control systems

  C Governance

  i. Composition/independence of the board
  ii. Management accessibility
  iii. Levels of disclosure/transparency
  iv. Independence of auditors
  v. Shareholder representation and rights
  vi. Compensation policies and practices, including 'Say on Pay'
  vii. Cyber-security risk
  viii. Corruption risk

The above ESG considerations are incorporated into our quality assessment alongside other financial and operational characteristics.

- Financial and operational data points, including:

  a. Age of asset base and risk of stranding
  b. Regulatory and supervisory risks
  c. Pricing flexibility and allowable returns, where regulated
  d. Capital structure and balance sheet leverage
  e. Capital intensity

f. Capital deployment discipline and capital return approach
g. Physical footprint and natural barriers to entry
h. Industry structure
i. Indispensability of services or assets
j. Term and structure of contractual arrangements, including inflation-indexing
k. Geographic exposure (natural and economic)
l. Jurisdictional risks (typically political or regulatory)
m. Volatility of macro-drivers

## 5.3. Step 3: Quantification of ESG Risks

Following our ESG-related quality assessment, we attempt to quantify ESG risks for new investment candidates, to determine whether we have accounted appropriately for them in a company's valuation. We also review the company's preparedness and willingness to handle the risks identified by assessing its climate governance, its board and c-suite involvement in climate matters as well as the efforts it makes in upskilling its board, management and workforce on climate issues.

More recently, the magnitude of the impact of Covid-19 has provided ample awareness of vulnerabilities to global external shocks and we anticipate that regulators will require companies to reinforce their risk management efforts around this type of externality. We feel that a purely quantitative approach to risk assessment does not allow for the necessary flexibility companies must have to prepare for new risks which are difficult to price. A qualitative assessment of the company's risk management processes (agility, responsiveness, scenario testing) is essential. We expect much progress in this area over the coming years due to the acceleration of legislative action, across jurisdictions.

Quantification of ESG risk encompasses the following:

a. Scenario analysis
b. Revenue modelling
c. Cost modelling
d. Discount rate/cost of capital assumptions
e. Terminal asset value and/or terminal growth rate

From an overall risk point of view, appropriate portfolio-level exposures, such as the aggregate level of GHG emissions and GHG emission intensity, are also taken into account. Disclosures on carbon emissions still lack consistency across issuers, sectors, and countries, but we are committed to engaging with our investee companies to encourage them to improve the clarity and granularity of their disclosure by establishing Science-Based Targets (SBT) within the Task Force for Climate Related Financial Disclosure (TCFD) framework. We would also expect companies to make use of resources such as the Sustainability Accounting Standard Board (SASB)'s materiality map[8] and the tools provided by the Climate Disclosure Standards Board (CDSB).[9]

We strongly encourage investee companies to submit their data to the Carbon Disclosure Project (CDP)[10] in the hope that increased transparency will have a triple effect over the next few years: (a) encourage companies to measure and mitigate their externalities and (b) if needed, encourage them to reposition their business models towards greater sustainability, and (c) to help create a more level playing field for investors.

8 The Climate Disclosure Standard Board. https://www.cdsb.net/ which includes many useful tools such as the TCFD implementation guide https://www.cdsb.net/tcfd-implementation-guide

9 The Sustainability Accounting Standards Board and the Global Reporting Initiative, which are now collaborating on the development of joint standards. https://www.sasb.org/ and https://www.globalreporting.org/

10 The Carbon Disclosure Project https://www.cdp.net/en which helps issuers to gain a better understanding of their climate vulnerabilities and externalities through a detailed disclosure process.

With regards to investing in companies with existing fossil-fuel or carbon-intense assets (eg, energy generators), we will tolerate limited exposure in such businesses facilitating the energy transition, particularly where we have a role to play in supporting their decarbonisation efforts. Specifically, the utility sector is in the midst of significant upheaval, with widespread efforts to phase out carbon-intensive energy generation while increasing the share of renewables.

Following engagement with the Bank of England, we concluded that a well-structured and concerted approach to encourage companies to disclose their transition pathway to net-zero could be a vital step in accelerating our progress towards sustainability, as it would result in *de facto* mandatory disclosure.[11] [12]

## 5.4. Step 4: Ongoing Monitoring and Engagement

ESG considerations play an integral, essential part in the ongoing monitoring of each of the portfolio's holdings. This includes:

a. scrutinising company disclosure,

b. engaging with management (and boards, where applicable),

c. addressing any issues flagged by companies, stakeholders, independent sources, and/or the press, and

d. assessing the company's evolving risks and opportunities within the broader context of its economic, social and natural environment.

In other words, in the same way that we project and forecast financial outcomes, we must build a forward-looking view of climate, regulatory, and stakeholder requirements around key issues.

Irrespective of any specific change in the portfolio, our exposures are subject to a quarterly, independent review in partnership with M&G's Stewardship and Sustainability team.

For issues more specific to the infrastructure sector, we also undertake information-sharing and identification of key issues with M&G's InfraCapital team (our private equity group dedicated to infrastructure investments), the Infrastructure Finance team, and the Impact Financing teams.

Finally (and as encouraged by the Bank of England and European regulators), M&G engages regularly with regulators, academics and industry peers via formal and informal working groups. We do this to stay abreast of upcoming developments on climate-related risk, on governance best practice in relation to climate change and, more generally, on the transition to a net-zero economy through the greening of financial systems.

## 5.5. Investment in Cash, Near Cash, some Derivatives and Collective Investment Schemes

In assessing counterparties and issuers for cash management (including cash and near cash), derivatives counterparties, and manufacturers of collective investment schemes, M&G's ESG analysis focuses on understanding downside risks arising from ESG factors. This principally relates to considering the likelihood of sustainability risks affecting the creditworthiness of such entity or otherwise affecting the exposure taken financially.

In addition, subject to the next paragraph, for derivatives, and collective investment schemes, M&G considers the underlying exposure and forms a view on whether it is appropriate for the Fund. For derivatives relating to single names or specific baskets of securities, appropriateness is assessed by whether the underlying would be an appropriate investment for the Fund if bought directly. For investments in actively managed collective investment schemes, excluding money market funds, the underlying fund must pursue an ESG strategy, even if the ESG Criteria and Sustainability Criteria the underlying fund applies are not identical to the Fund's.

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11 Climate Change Financial Risk Forum Guide 2020 - https://www.bankofengland.co.uk/climate-change/climate-financial-risk-forum

12 Yale Law Journal: Who bleeds when the wolves bite? Delaware Supreme Court Chief Justice Leo E. Strine Jr. April 2017. https://www.yalelawjournal.org/feature/who-bleeds-when-the-wolves-bite-a-flesh-and-blood-perspective-on-hedge-fund-activism-and-our-strange-corporate-governance-system - and 'Towards Fair and Sustainable Capitalism' Harvard Law School Forum on Corporate Governance https://corpgov.law.harvard.edu/2019/10/01/toward-fair-and-sustainable-capitalism

Where exposure to indices is taken via derivatives and/or passively managed collective investment schemes, the index may contain securities that would not be permitted if held directly. Similarly, investments in money market funds, may provide exposures, e.g. to securities that would not be permitted if held directly. In each of these cases, M&G will consider the sustainability risks arising from such securities being in the index or money market fund and consider alternative methods of exposure where appropriate.

# 6. Exclusion/Restriction Policies

M&G does not invest in securities issued by companies directly involved in the manufacture, development or transfer of cluster munitions and anti-personnel landmines. M&G uses information provided by a third-party Responsible Investment services provider to identify companies flagged for involvement in the production of such munitions. This exclusion is applicable to all actively managed M&G funds.

## 6.1. Exclusions/Restrictions within the M&G (Lux) Global Listed Infrastructure Fund

The exclusions are categorised into 1) norms-based exclusions, 2) sector-based and/or values-based exclusions and 3) other exclusions to align with the Fund's investment policy.

Companies that decline to disclose or communicate in sufficient detail about their involvement in activities listed in the Exclusion Criteria will be excluded. Investments that newly contravene the Exclusion Criteria will be sold if initial engagement attempts are unsuccessful.

### Norms-based exclusions

The M&G (Lux) Global Listed Infrastructure Fund excludes companies deemed to be in breach of the UN Global Compact Principles of human rights, labour, the environment and corruption (see Appendix 8, sub-section 2).

The exclusion/restriction list is monitored on an ongoing basis. We use the ISS Overall Flag as categorised by its traffic light signal, which assigns an overall flag to companies linked with any failures to International Standards for Responsible Business Conduct. This is used in conjunction with MSCI's assessment about whether a company is in compliance with the United Nations Global Compact Principles.

### Sector-based and/or values-based exclusions

Companies and/or sectors exposed to business activities assessed by the fund manager to be damaging to human health, societal wellbeing, the environment, or otherwise assessed to be misaligned with the Fund's sector-based and/or values-based criteria will be excluded from the Fund's direct investments.

The current exclusions are set out in the tables that follow:

| Exclusion/Restriction Criteria: Environmental | | |
|---|---|---|
| **Issue** | **Rationale** | **Criteria** |
| **Carbon-intensive power generation and nuclear power** | Fossil-fuel derived power, such as the generation of electricity from thermal coal, is environmentally damaging due to emissions of carbon dioxide and other pollutants.<br><br>Although nuclear power generation does not emit greenhouse gas emissions, it poses serious environmental and health risks linked to the generation of radioactive waste and has an overwhelming net-negative impact. | The Fund:<br><br>• Limits any one holding's share of coal-fired power generation to a maximum of 30% of revenues.<br>We use a revenue test rather than a generation-mix test to account for the prominence of integrated or multi-utilities in the investible universe. But we believe adhering to the revenue threshold by itself is not sufficient. We believe it is essential for us to be able to, on an exceptional basis, invest in companies which although involved in coal-fired power generation, are committed to (and taking steps to) transforming their energy mix. It is our conviction that we can better support the goal of decarbonisation by supporting issuers with unique business models and demonstrating a genuine commitment to transition. We commit, however, to careful supervision of their progress, which must be evidenced by the progressive reduction in their $CO_2$ intensity. Our exclusion thresholds and the annual monitoring of our $CO_2$ intensity at an individual and portfolio level serves as a safeguard against any creeping involvement.<br>• Limits any single investment's share of power generated from nuclear energy to 30% of revenues.<br>While nuclear energy can be considered as a relatively 'clean' source of energy, it is not without its risks and controversies – specifically to do with the risk of exogenous shocks and the longer-term requirements around nuclear waste and reclamation. In specific circumstances, nuclear energy can be considered an ally of the transition to net-zero, and we are willing to have a limited exposure to this form of energy generation. |

| Exclusion/Restriction Criteria: Social | | |
|---|---|---|
| **Issue** | **Rationale** | **Criteria** |
| **Adult entertainment** | Adult entertainment has been shown to be in some cases addictive, exploitative of workers and often easily accessed by children for whom it can be emotionally damaging. | The Fund excludes companies involved in the production of adult entertainment.<br><br>We apply a 0% threshold for revenues derived from producing, directing or publishing adult entertainment materials. |
| **Alcohol** | Alcohol has been proven to lead to addiction, have adverse health effects when excessively consumed and provoke an increase in anti-social behaviour. | The Fund excludes companies involved in the production of alcohol. |
| **Gambling** | Gambling has been proven to be addictive and can lead to oppressive debt, which disproportionately affects the poorest in society. It can also be harmful to psychological and physical health. | The Fund excludes companies involved in the provision of gambling services. |
| **Tobacco** | The consumption of tobacco leads to serious health risks, including cancer, heart disease, stroke, lung diseases, diabetes and chronic obstructive pulmonary disease (COPD). It also carries unacceptable societal risks. | The Fund excludes companies involved in the production and/or distribution of tobacco, or companies with an ownership in these companies.<br><br>We apply a 0% revenue threshold for tobacco producers and a 10% revenue threshold for distributors. |
| **Controversial weapons** | Controversial weapons have an indiscriminate and disproportional humanitarian impact on civilian populations. They may cause severe harm to civilians during and after conflicts, and generate significant long-term health and safety effects for the civilian population. | The Fund excludes companies involved in anti-personnel mines, chemical, nuclear and biological weapons, cluster munitions, depleted uranium and white phosphorous munitions, blinding laser, non-detectable weapons from the investment universe.<br><br>We apply a 0% revenue threshold for all controversial weapons. |

| Exclusion/Restriction Criteria: Social | | |
|---|---|---|
| **Other weapons** | Although legally used in many democratic countries across the world, weapons are designed to injure and kill, and can be misused by both governments and individuals alike. | The Fund excludes companies that derive more than 5% of their revenues from the manufacturing of weapons or tailor-made components thereof.<br><br>Weapons are defined as products or basic components of products that have been 'designed to injure/kill' and are used exclusively for military purposes. Tailor-made components are components that are developed primarily in order to be integrated into a weapon system. |

The following considerations form part of our **qualitative** stock selection investment process.

| **Other ESG considerations** | | |
|---|---|---|
| **Biodiversity** | Biodiversity is an important investment consideration as it provides biological resources, ecosystem services, and absorption of pollution. Biodiversity is therefore considered in the Fund's ESG assessment and screening. | Where biodiversity is identified as a key business risk, the Fund qualitatively assesses how companies manage their operations and their impact on biodiversity, as well as if they have clear policies and targets for improvement. |
| **Water use** | The overuse of water can have serious adverse effects on farming, the environment, and ultimately the climate. Water use is therefore considered in the Fund's ESG assessment and screening. | Where water usage is identified as a key business risk, the Fund qualitatively considers how companies manage their operations and their impact on water usage, as well as if they have clear policies and targets for improvement. |
| **Controversial countries** | Countries that perpetrate, violate and infringe international human rights standards do not support socially responsible investment practices. | The Fund makes a qualitative evaluation of the country in which a company operates when assessing its eligibility for the investment universe, particularly if based in a country where there are serious concerns over human rights violation.<br><br>While this does not constitute a formal constraint on investment in the company, additional due diligence is performed when the company is state owned or state funded. |

| Other ESG considerations | | |
|---|---|---|
| **Taxation** | Taxes provide funds for public services such as healthcare, education and infrastructure. Companies paying a fair amount of tax in the countries in which they operate is regarded as the socially responsible thing to do. | We endeavour to ensure that companies in our investment universe adhere to the OECD Guidelines for multinational enterprises on taxation (see Appendix 7, sub-section) and push for additional disclosure where necessary. |
| **Death penalty** | The death penalty system can be applied in an unfair manner and can be influenced by skills of attorney, the victim's social class and race, and where the crime took place. The death penalty also carries the inherent risk of executing an innocent person. | The Fund qualitatively considers if a company is based in a country which enforces the death penalty, although this does not implicitly constitute a restriction on investment. |

## Other exclusions

The Fund may also exclude any investments assessed to be otherwise in conflict with the ESG Criteria and Sustainability Criteria.

## Alerts linked to directional change

Under any of the following circumstances, we commit to undertake a full ESG review of a portfolio holding and begin engagement with the company when:

a. a holding's MSCI rating is downgraded to CCC
b. a holding receives (or is downgraded to) an AMBER or RED flag from ISS.

Any of the above breaches in portfolio holdings are investigated, and findings shared and discussed with the ESG-IOM. Where a material ESG breach or concern is not satisfactorily dealt with by a portfolio company's management and/or board after a maximum period of two years, the holding would be divested.

ESG's role in the investment process

| Stage 1 | Stage 2 | Stage 3 | Stage 4 | Stage 5 |
|---|---|---|---|---|
| **Pre-screening** | **Quality assessment** | **Quantification of ESG risks** | **Ongoing monitoring and engagement** | **Engagement outcome** |
| **1. Hard exclusions**<br>• Tobacco, alcohol, adult entertainment, gambling and controversial weapons<br>• Coal-fired power (up to 30% rev)<br>• Nuclear energy (up to 30% rev)<br><br>**2. Third-party rankings**<br>• Ethical considerations:<br>— ISS-Ethix UN Global Compact<br>• ESG considerations:<br>— MSCI | Independent analysis of ESG and related issues<br>• Assessment of Environmental, Social and Governance disclosure and processes<br><br>• Assessment of material risks specific to infrastructure:<br>— Climate change<br>— Physical footprint<br>— Age of asset base and stranding risk<br>— Regulatory risk | Evaluation of risk vs return potential<br><br>• Stock level:<br>— Scenario analysis<br>— Revenue modelling<br>— Cost modelling<br>— Discount rate<br>— Terminal asset value/growth rate<br><br>• Portfolio level<br>— Carbon intensity | Quarterly oversight with Corporate Finance and Stewardship team<br><br>• Lack of responsiveness on any engagement issues<br>• Lack of progress on climate related disclosure or targets (with regards to carbon intensity in particular)<br>• Downgrade from GREEN to RED in UNGC<br>• Downgrade to B or CCC in MSCI. | • Satisfactory engagement outcome<br>• Divestment (within a two year period from engagement, if the company is unresponsive to our engagement on a material issue) |

# 7. Active Stewardship

## 7.1. Active Ownership

Active ownership is an essential element of our investment approach. Through meetings with management and voting at the Annual General Meetings, we can use our voice and votes to encourage our companies to act in the best interests of stakeholders and towards the UN SDGs. By encouraging open conversation with companies, we can share our thoughts and ideas regarding key issues, to encourage transformation towards a more sustainable economy.

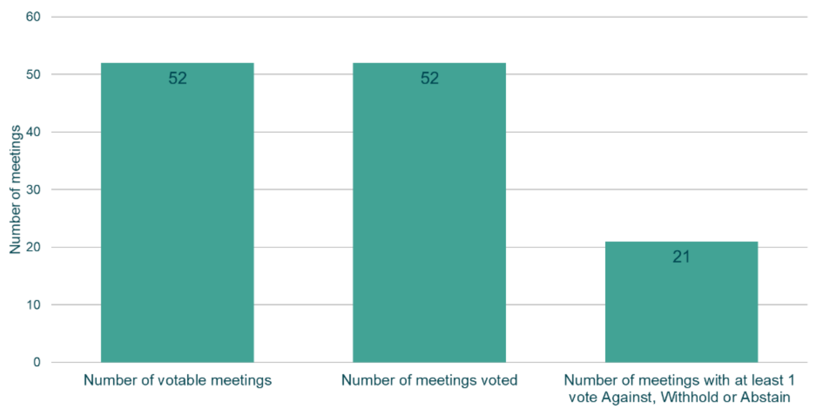
## 7.2. Voting

The fund manager for the Global Listed Infrastructure Fund has exercised his vote on all proposals submitted by companies held in the portfolio since the Fund's inception.

The chart below illustrates the voting activity from June 2019 to June 2020, across the portfolio's holdings. Detail of the M&G voting policy and record is available from our Stewardship and Sustainability team or on our website.

We endeavour to support the companies in which we invest but we have voted and will continue to vote against management or board directors when we disagree on topics such as a specific director election or re-election, the company's remuneration policy or strategic issues which are put to the vote, or, alternatively where we feel we lack the necessary disclosure to make an informed decision.

Meetings overview



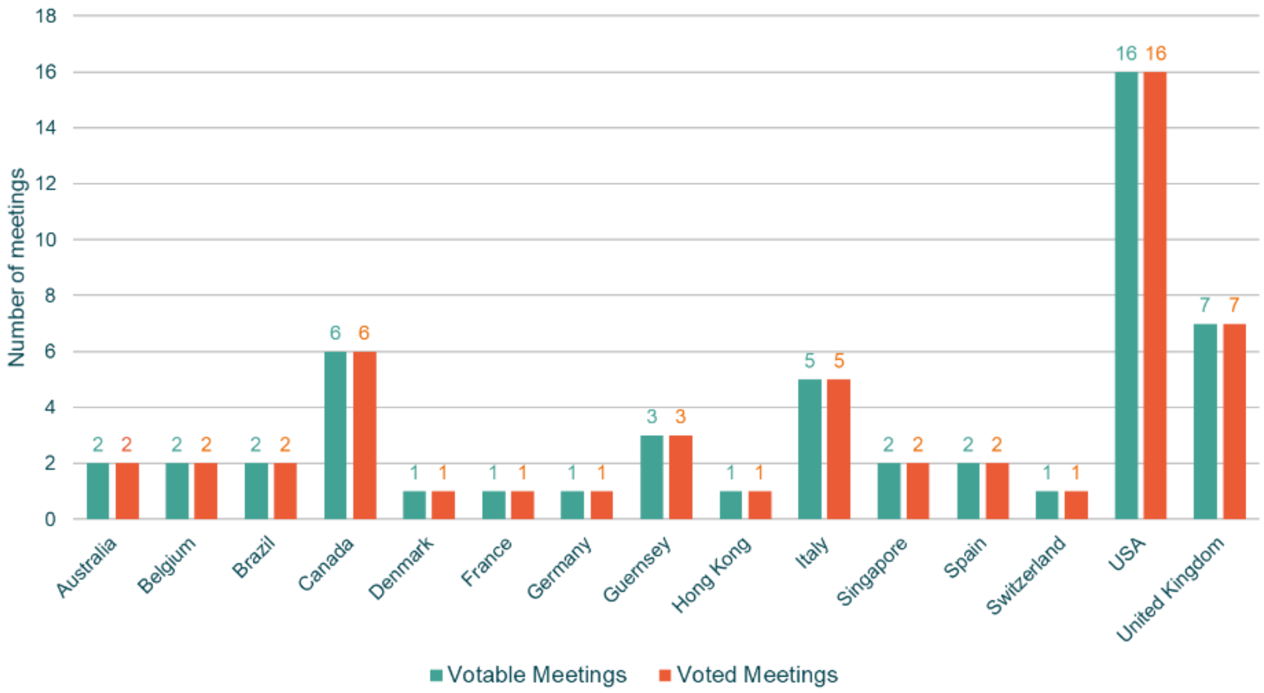

### M&G's Stewardship and Sustainability team

We have a large and well-resourced in-house team focused on engagement with our investee companies, which supports the Fund's investment team on issues that can affect our investments over the long term. This dedicated in-house team is a central function that ensures oversight and accountability for stewardship and targeted, high-quality engagement on ESG issues.

The team coordinates M&G's stewardship activities, engaging with companies on issues from corporate governance to environmental sustainability, alongside the investment teams. Closely linked to this engagement work, the team undertakes M&G's voting responsibilities at shareholder meetings, which we see as one of our central responsibilities as long-term shareholders.

The team is responsible for coordinating M&G's participation in various external initiatives and investor collaborations, including the UK's Investment Association, the Investor Forum, the Institutional Investors Group on Climate Change and the Asian Corporate Governance Association. The team also supports M&G's Responsible Investment Advisory Forum in maintaining our relationship with responsible investment-oriented organisations, in particular the UN-backed Principles for Responsible Investment (UNPRI).

Meetings by market




## 7.3. Strategic ESG Engagement

Gibson Energy (a Canada-based energy midstream infrastructure company) is a recent example of our strategic engagement. We sought to encourage the company to develop a sustainability strategy and shared, at the company's request, best-practice examples of ESG disclosure and practices. We engaged primarily with the company's chief administrative officer, and team, to help Gibson refine its approach and move the company further along its sustainability journey. We shared a comprehensive list of sector-relevant sustainability assessments, including those from MSCI, SASB, UNPRI and the World Economic Forum, and explained what we looked for in effective reporting. This was the latest in a series of close engagements with the company spanning several years, which has significantly influenced its strategic direction.

In May 2020, Gibson Energy launched its inaugural sustainability report: 'Setting Our Sustainability Roadmap'. We felt rewarded by the strong messaging from its chairman and its chief executive, and the demonstration of an increased focus on environmental responsibility in a challenging industry. The company shared detailed plans to integrate ESG into its strategy by embedding ESG metrics throughout the business, from sustainability key performance indicators (KPIs), carbon intensity, and investments in initiatives that focus on GHG emission reduction and energy efficiency.

# 8. Appendix

## 1. The United Nations Sustainable Development Goals (SDGs)

| | | | | | |
|---|---|---|---|---|---|
| **Goal 1:** | **No Poverty** | **Goal 7:** | **Affordable and Clean Energy** | **Goal 13** | **Climate Action** |
| **Goal 2:** | Zero Hunger | **Goal 8:** | Decent Work and Economic Growth | **Goal 14:** | Life Below Water |
| **Goal 3:** | Good Health and Wellbeing | **Goal 9:** | Industry, Innovation and Infrastructure | **Goal 15:** | Life on Land |
| **Goal 4:** | Quality Education | **Goal 10:** | Reduced Inequalities | **Goal 16:** | Peace, Justice and Strong Institutions |
| **Goal 5:** | Gender Equality | **Goal 11:** | Sustainable Cities and Communities | **Goal 17:** | Partnerships |
| **Goal 6:** | Clean Water and Sanitation | **Goal 12:** | Responsible Consumption and Production | | |

## 2. The Ten Principles of the UN Global Compact

### Human Rights

- Principle 1: businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.

### Labour

- Principle 3: businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labour;
- Principle 5: the effective abolition of child labour; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.

### Environment

- Principle 7: businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies.

### Anti-Corruption

- Principle 10: businesses should work against corruption in all its forms, including extortion and bribery.

# 3. The Principles for Responsible Investment

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress towards implementing the Principles.

# 4. Glossary of Terms

**Asset:** Anything having commercial or exchange value that is owned by a business, institution or individual.

**Asset class:** Category of assets, such as cash, company shares, fixed income securities (bonds) and their sub-categories, as well as tangible assets such as real estate.

**Best-in-Class:** An approach to Responsible Investment, whereby companies and issuers with strong ESG credentials are selected, which are those that typically lead their peer groups in respect of sustainability performance.

**Engagement**: Interaction with company management on various financial and non-financial issues, including ESG. Engagement allows investors to better understand how a company operates and how it interacts with its stakeholders, as well as advising on and influencing company behaviour and disclosures where appropriate.

**Exclusions**: Excluding or restricting investment in companies based on the sector in which they operate or for other specific criteria, i.e. they are deemed to be in breach of the United Nations Global Compact principles on human rights, labour, the environment and anti-corruption.

**Exposure:** The proportion of a fund invested in a particular share/fixed income security/index, sector/region, usually expressed as a percentage of the overall fund.

**Fundamentals:** A basic principle, rule, law, or the like, that serves as the groundwork of a system. A company's fundamentals pertain specifically to that company, and are factors such as its business model, earnings, balance sheet and debt.

**Index:** An index represents a particular market or a portion of it, serving as a performance indicator for that market or segment.

**Liquidity:** Refers to the ease of turning assets into cash when needed. A company's shares are considered highly liquid if they can be easily bought or sold, since they are regularly traded in high numbers.

**Materiality**: The percentage of a company's revenue that contributes to the impact being measured.

**Risk**: The chance that an investment's return will be different to what is expected. Risk includes the possibility of losing some or all of the original investment.

**Risk management**: The term used to describe the activities the fund manager undertakes to limit the risk of a loss in a fund.

**Share**: An ownership stake in a company, usually in the form of a security. Also called equity. Shares offer investors participation in the company's potential profits, but also the risk of losing all their investment if the company goes bankrupt.

**United Nations Global Compact**: A United Nations initiative to encourage businesses worldwide to adopt sustainable and socially responsible policies and to report on their implementation.

**Valuation**: The worth of an asset or company, based on the present value of the cashflows it will generate.

**Volatility**: The degree to which the price of a given security, fund, or index changes. It is calculated as the degree of deviation from the norm for that type of investment over a given time period. The higher the volatility, the riskier the security tends to be.

**Voting**: As the partial owners of a company, shareholders have the right to vote on resolutions put forward at a company's annual general meeting. These resolutions include the re-election of directors, executive remuneration and business strategy, and may also include resolutions put forward by shareholders.

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