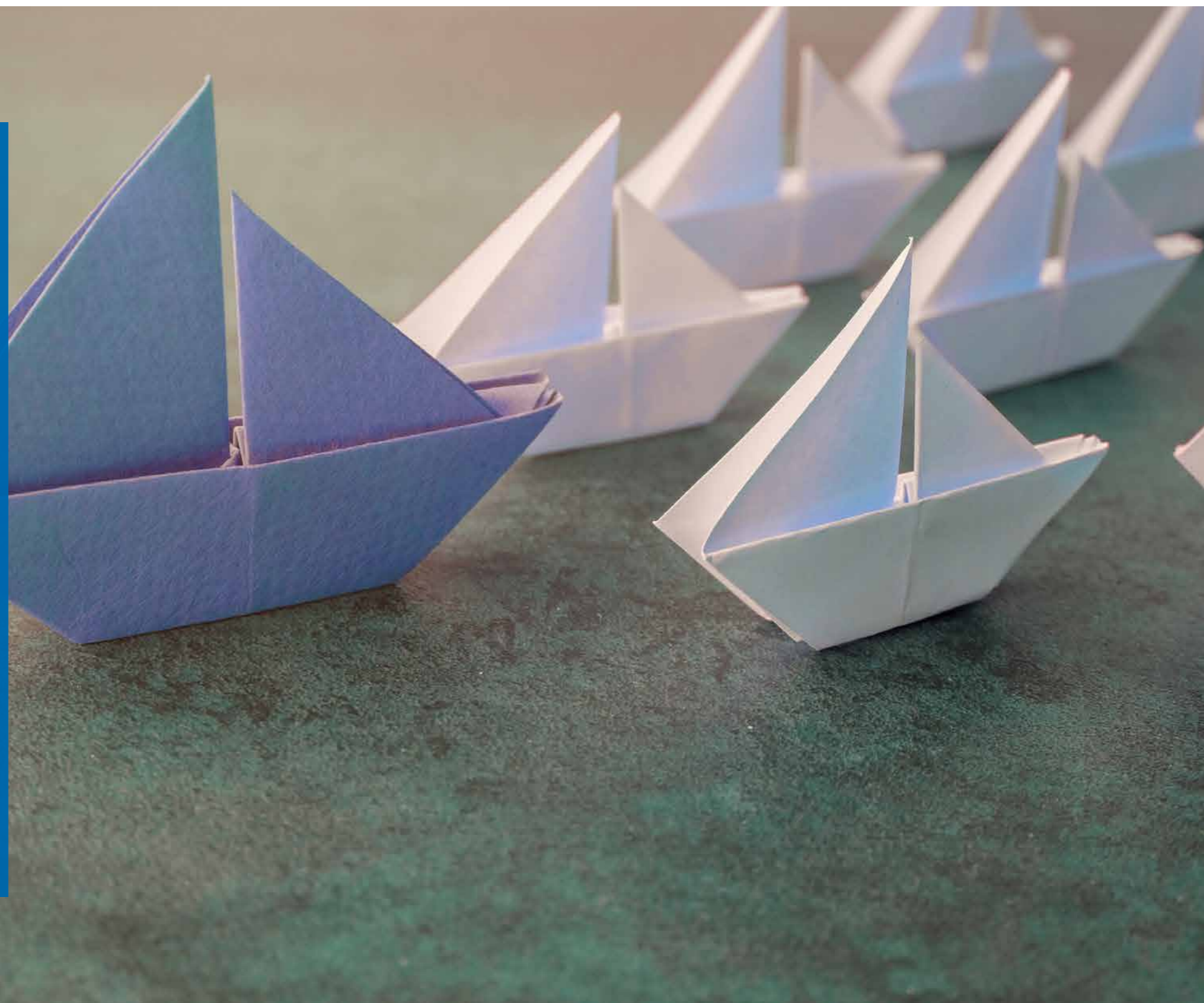




Responsible investment policy & framework for private credit

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1. Our approach to responsible investment

1.1 LGIM Real Assets' responsible investment beliefs and purpose

Responsible investment is an investment approach which integrates environmental, social and governance (ESG) factors into investment analysis and decisions to deliver long-term sustainable investment returns.¹ At LGIM Real Assets (LGIMRA), we believe a responsible and sustainable approach to real assets investment management will enable our business to deliver long-term positive value to all our stakeholders, and has the potential to create real world impact. Our overarching purpose and guiding principles (see Figure 1) are embedded into our culture, asset management and investment process.

We believe that effective integration of ESG factors is important for our business for the following reasons:

- a. LGIM believes that well-governed companies that manage not only their stakeholders but also their impact upon the world around them, are more likely to deliver sustainable long-term returns
- b. Consideration of ESG issues is about risk management and is, therefore, part of fiduciary duty
- c. Companies are intrinsically linked to the economies (and societies) in which they operate and investors, therefore, have a responsibility to the market as whole
- d. The ultimate goal is to protect and maximise the long-term investment returns for our clients' interests, which means that ESG factors must be taken into account



Figure 1: LGIM Real Assets' purpose and guiding principles for responsible investment



¹ LGIM applies The Investment Association industry definitions of Responsible Investment as our standard framework. The IA Responsible Investment framework published in Nov 2019 categorises and provides standard definitions for the different components of responsible investment., <https://www.theia.org/campaigns/sustainability-and-responsible-investment>

1.2 Our approach to responsible investment in private credit

Our private credit portfolio currently includes investments in corporate and alternatives, infrastructure and real estate debt.

As a long-term investor, we have a responsibility to protect our clients' capital through integrating ESG and climate change considerations into our investment process. We believe this leads to better risk management and will drive the long-term value of our investments over the coming decades. For example, by avoiding borrowers who do not maintain their social licence to operate or by avoiding energy assets which may become obsolete in a decarbonising world, we can minimise the long-term risks in our portfolio.

Our approach to all investments in private credit is to ensure the E, S and G are fully considered as part of the wider investment decision-making process. We do this by taking both a top-down and bottom-up approach to assessing ESG risks, which enables us to mitigate downside risks to financial performance.

²In addition to a separate assessment of physical risks of climate change

We conduct top-down research to analyse long-term ESG trends and their implications for the markets in which we operate. These research findings are used to inform our views on sector allocation and asset selection. Bottom-up research relates to ESG assessment of individual assets. This stage involves analysis of material ESG factors specific to the transaction in order to flag and address potential risks and highlight opportunities.

This approach is exemplified by our analysis of climate transition and physical risks. For example, we use carbon taxes as one of the main tools for modelling climate change risks.² This includes direct impacts on fossil fuel producers and consumers (e.g. oil & gas exploration, power generators and shipping companies), and indirect impacts in industries which themselves are relatively low-carbon, but play a key role in the fossil-fuel value chain (e.g. airports, chemicals, energy infrastructure).

In driving a consistent responsible investment approach across our platform, we are looking to ensure greater standardisation, which means a constant quest for improved data quality and transparency. To that end, we are a member of several industry initiatives seeking to drive improvements in this area.

1.3 Governance, Roles and Responsibilities

1.3.1 Board-level governance

LGIMRA Private Credit’s strategic responsible investment decisions are governed by the **Private Credit Management Committee**, which is chaired by the Head of Real Assets. This board level committee governs all the ESG activities, processes and approach to regulatory compliance. The committee reports into the LGIM Real Asset Limited Board.

LGIMRA’s responsible investment strategy and policies are aligned with both Legal & General (L&G) Group’s policies and management, and with LGIM’s responsible investment policies that are supported by the LGIM Responsible Investment Group (RIG).

At L&G Group level, the Group Board Nominations and Corporate Governance Committee are responsible for ensuring compliance with the principles of good corporate governance. Its purpose is to approve and oversee the group strategy and policies in relation to groupwide ESG risks and opportunities, including climate change and the Diversity and Inclusion council. The Group Board, through the Group Risk Committee and Executive Risk Committee has delegated oversight of the management of the risks associated with climate change to the Group Environment Committee (GEC), which is chaired by the Group Risk Officer to ensure a consistent group-wide approach. LGIM RA director of Strategy & ESG is an observer at the GEC. Under the governance of the GEC, there are relevant subcommittees, where the LGIM RA ESG Team members are represented:

- i. Climate Risk Subcommittee;
- ii. Environment Subcommittee; and
- iii. Climate Risk Working Groups

In terms of governance at LGIM level, the **Responsible Investment Group (RIG)** advises the LGIM Executive Committee in setting global, cross-asset strategy, principles and positioning across the entire business. The Head of LGIMRA is part of the RIG committee and therefore ensures that LGIMRA’s responsible investment strategy and policies are aligned across the broader LGIM platform.

1.3.2 LGIMRA ESG Team

LGIMRA has a dedicated ESG team, led by the Head of

ESG who reports into the Director of Strategy & ESG. They are jointly responsible for setting the ESG strategy and framework across the business. These are approved by the LGIMRA Private Credit Management Committee who has oversight of ESG integration and implementation across the private credit platform. The ESG team works closely with the investment, asset management and portfolio management teams throughout the investment process – from origination to post-investment.

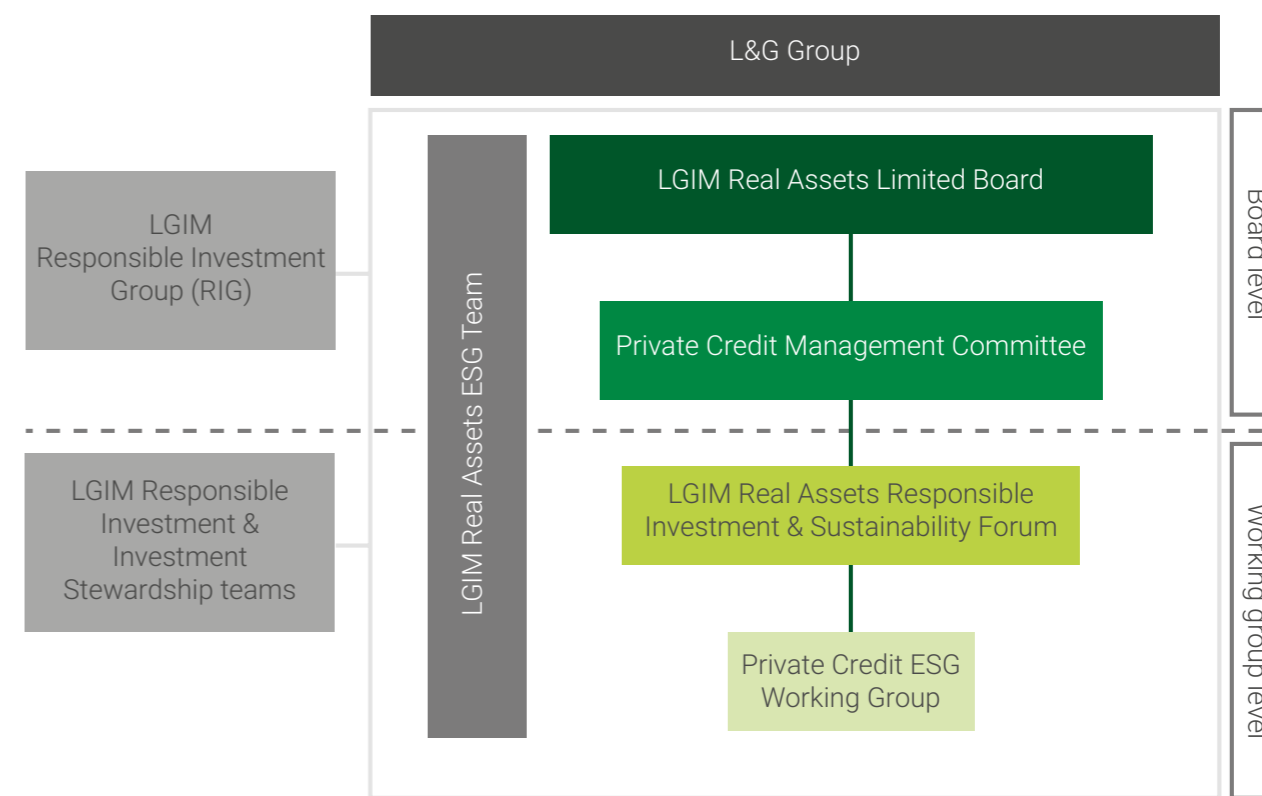
Our Private Credit ESG Working Group has representation across all relevant investment teams – corporate and alternatives, infrastructure and real estate debt - and portfolio management. This group is co-chaired by the Head of ESG and Head of Infrastructure Debt (Europe). Some of the areas that this dedicated group focuses on include:

- Driving ESG development and integration across the private credit platform
- Development of policy and guidelines, generating ideas and providing feedback, communicate and implement changes based on ESG best practices across the platform
- A platform for knowledge sharing and supporting ESG learning and development.
- As ESG and climate change have become an increasing priority for LGIM and L&G Group, a Responsible Investment & Sustainability Forum was established to support the overarching Responsible Investment beliefs and purpose of the Real Assets platform. This forum has representation from all relevant business areas within LGIMRA, along with representation from ESG teams at LGIM.

The forum’s primary role is to strengthen ESG strategy and integration across the business, and to ensure that it is aligned with the wider responsible investment approach at LGIM and Group level. The following are some of its key objectives:

- A platform for knowledge sharing of relevant responsible investment topics and market trends both within Real Assets and across LGIM
- Facilitate LGIMRA internal implementation and integration efforts via working groups
- Guide and prioritise ESG relevant topics and decision-making
- Inform and guide firm-wide communications on ESG for LGIMRA

Figure 2: LGIM Real Assets responsible investment governance structure for private credit





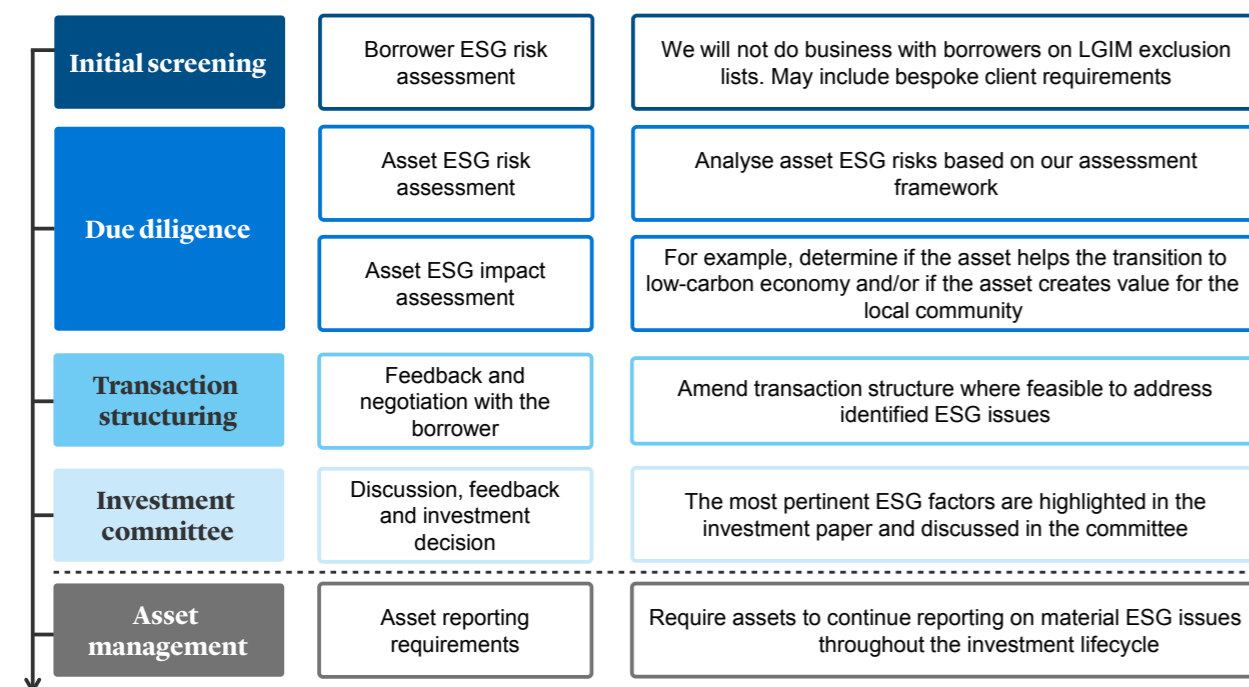
2. ESG Integration

2.1 Overview

We are committed to integrating ESG into our investment process to ensure the assets we finance are of the highest possible quality. We integrate ESG considerations into all our investment decision-making by identifying and managing the issues that are, in our view, the most material to our assets across the investment lifecycle.

ESG implementation is essentially part of the responsibility of the investment, asset management and portfolio management teams, working closely with the ESG team to ensure that it is fully integrated throughout the investment process – from origination to post-investment.

Figure 3: Building blocks of our ESG integration approach



Our ESG assessment methodology will be tailored according to the type of investment as some transactions have unique negotiated structures. As a debt investor, we can exert the most influence in the pre-investment stage, while terms and structure are being negotiated. In this stage, we can discuss and address ESG issues with the borrower and structure the transaction to minimise risks and provide regular ESG reporting and transparency.

2.2 Initial ESG screening

Due to the longer-dated and often illiquid nature of assets in our private credit portfolio, initial ESG screening is a key stage in the pre-investment process.

Across Legal & General, we have identified borrowers whose business practices and products are incompatible with our beliefs and purpose as a responsible investor. After a thorough research and due diligence process, these companies are put on an exclusion list. Therefore, our ESG management approach incorporates an initial ESG screening process to ensure the asset (company or project) is not in our exclusion list.

Our approach in the early stages of assessing a potential investment opportunity is also informed by our long-term sector views. While this aspect of our screening approach is less prescriptive and involves a deal of analytical judgement and discussion, it can lead to us declining the transaction. We may, for example, decline to proceed if we believe that the asset in question has a negative impact on the local community, is incompatible with our climate change goals, or is putting an undue burden on the public sector.

³Our LGIM Active ESG View tool forms an essential component of the overall active research process. The tool brings together granular quantitative and qualitative inputs in order to reflect a full picture of the ESG risks and opportunities embedded within each company. ESG risks vary across sectors and therefore the proprietary tool we have developed evaluates sector-specific ESG factors, spanning 64 specific sectors /sub-sectors.

2.2.1 Exclusion list

We will not provide funding to businesses that have failed in their duty to act as responsible corporate citizens. These entities include:

- a. Controversial weapons' manufacturer
- b. Companies whose chief commercial activity is coal mining

We will also assess if the entity has an ESG score from our internal proprietary **LGIM Active Universe ESG View³** which applies primarily to listed companies.

The findings from the initial ESG screening directly inform investment decision making, and in some instances, may terminate an investment. The decision to pursue a potential investment is based on an assessment of ESG issues and risks, and whether LGIMRA can effectively manage these ESG issues.

This analysis feeds into our decision-making prior to making a commitment. Situations may arise where an existing asset, which passed the initial ESG screening, transitions onto an exclusion list post-investment e.g. if a company breaches the UN Global Compact. These assets will be reviewed on a case-by-case basis. Liquidity, valuation and other factors will need to be balanced against the ESG considerations to ensure the best possible outcome.

2.3 ESG due diligence

Once the asset has passed the initial screening process, we will undertake an ESG assessment, taking into consideration industry (or sub-industry) views and a more detailed assessment at company/project level.

As part of the due diligence process, senior management of the prospective borrower or transaction sponsor is engaged to provide disclosure of ESG risks through an internal ESG Due Diligence Questionnaire (DDQ). We have adapted several industry frameworks such as the Sustainability Accounting Standards Board (SASB) framework and materiality map to highlight the most material ESG issues for consideration, as well as the GRESB Infrastructure framework (specific to infrastructure debt). The ESG factors will vary in terms of priority (weighting) depending on the nature of the project or sector.

Primary responsibility for ESG assessment rests with the investment manager working on a potential transaction. Investment managers will be supported by the ESG team and investment research teams across the business, to undertake an in-depth ESG assessment of the asset to be financed, factoring in evolving ESG considerations across different sectors. In tackling ESG analysis, private credit teams also leverage the expertise of other LGIM businesses, such as the LGIM Stewardship team.

LGIM's traded fixed income and equity teams are a source of valuable expertise in assessing ESG risks in infrastructure and corporate private debt, while the ESG framework adopted in the LGIMRA real estate equity funds serves to inform our ESG analysis of real estate debt transactions.

2.3.1 ESG framework

Our ESG framework consists of top-down research of long-term trends, which also informs our bottom-up analysis of individual issuers and their implications for the way we allocate capital. Climate change is one of the key long-term topics where research findings are being fed into our sector allocation and asset selection. An illustration of our climate research projects is below.

Our bottom-up ESG framework is designed to capture material ESG risks and impacts relevant to each sector, ranging from carbon emissions avoided in renewables to employee and contractor health and safety, community development, board composition, and bribery and corruption. Information sources during the due diligence phase can come from a variety of sources including sell-side research, legal and technical due diligence reports and equity sponsor materials, including in-house research and ESG analysis (from the public markets). We also work closely with our credit team in order to incorporate any ESG considerations that may have an impact on the future cash flows or credit risk of the business in question.

Table 1: Illustration of climate change research projects

Climate change – key sectors covered

Energy	Transport
Key topics covered	
<ol style="list-style-type: none"> How will the energy mix need to evolve in order for Paris Agreement targets to be met? What types of assets support (or do not hinder) the achievement of Paris objectives? What role will gas-fired energy play in the energy mix over the next decade? What is the risk of assets becoming stranded? How will renewable asset investments evolve over time? To what extent can we support the development of merchant renewables? What new technologies will need to be rolled out or scaled up? How can we support these? 	<ol style="list-style-type: none"> What are the most feasible paths to transport sector decarbonisation in line with Paris Agreement commitments? What types of assets are at risk of becoming stranded? What is the timeline for these risks materialising? Can the aviation sector continue to grow while decarbonising? How can the shipping industry implement and fund decarbonisation measures over the next decade?

Figure 4: ESG process throughout the investment life

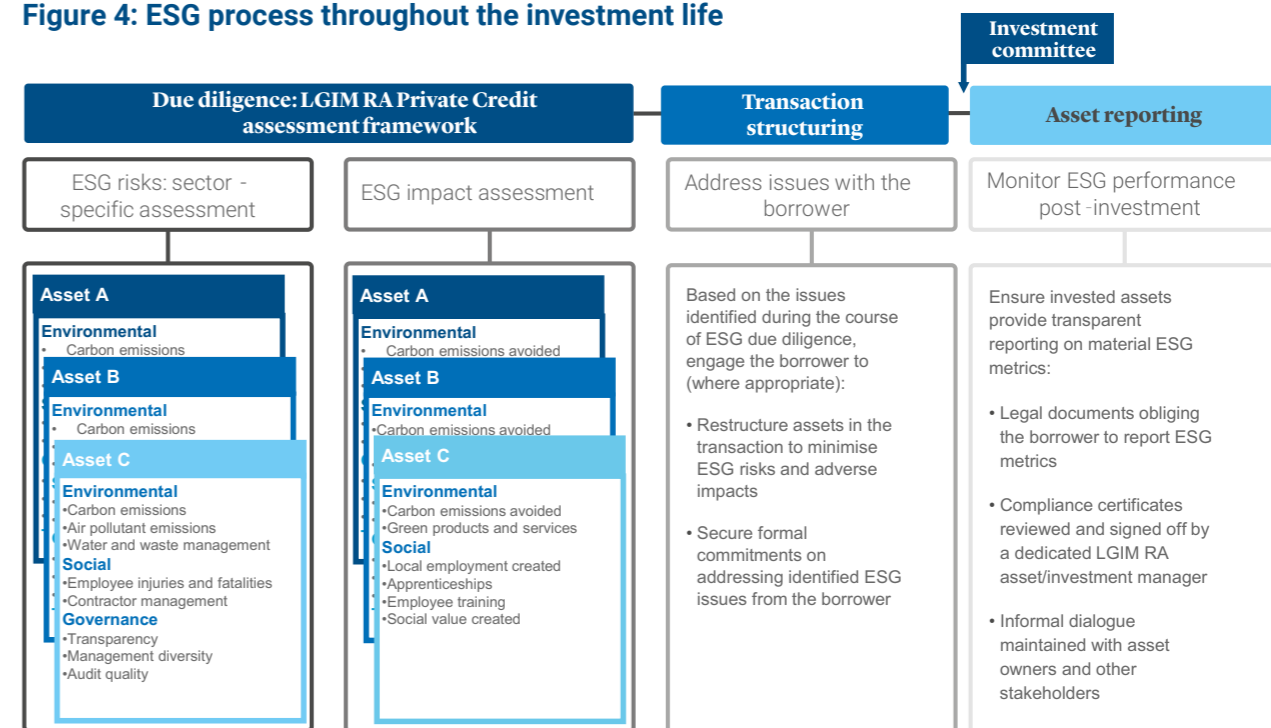


Figure 5: Examples of top-down research reports



Table 2: LGIMRA ESG risk assessment key indicators

Dimension	ESG Indicators
Environment & climate change	- Compliance with local and national environmental laws
	- Environmental risk assessment and management
	- Environmental policy
	- GHG emissions
	- Water usage & water pollution
	- Air quality
	- Noise pollution
	- Waste management
Social: internal	- Biodiversity
	- Employee health & safety
	- Employee engagement, diversity & inclusion
	- Labour practices
	- Whistle-blower policy
Social: external	- Supply chain labour management
	- Data security
	- Social benefits
	- Community relationship
	- Product quality & safety
	- Bribery and corruption
	- Conflicts of interest
- Political involvement policy	
Governance: board robustness	- Procurement policy
	- Board independence
	- Chairman is not a former executive (independence)
Governance: ESG oversight	- Board diversity
	- Senior decision-maker accountable for ESG issues
	- Individual responsible for implementing ESG objectives
	- ESG factors in personnel performance targets
	- Critical incident risk management
	- Governance risk assessment

Table 2 includes the most common examples of material ESG risk indicators that are factored into our ESG assessment. Not all these indicators, however, will be relevant for every transaction - our due diligence focuses on the key risks most material for the particular asset, based on its business model and sector. ESG factors will differ depending on the type of debt transaction – corporate, alternative, infrastructure or real estate debt. We generally take into account historical ESG performance with respect to best practices and industry peers. We also assess the future performance trajectory, looking at management commitments, governance structure including ESG links to remuneration for executive staff, capex, and transition plans. Ultimately, these factors are weighted based on which criteria are reasonably likely to impact the financial or operating performance of a company, project or industry, and are therefore the most important from an investment perspective.

⁴Information undertakings are determined within the document negotiation process with the borrower prior to financial close. A Maintenance Information Undertaking, whereby the borrower is bound to continuously provide detail on ESG performance, is generally a stronger covenant than an Occurrence Information Undertaking, where a borrower is obliged to report only when there is a significant change to their ESG performance. The exact type of information undertaking LGIMRA is able to negotiate may vary from asset to asset.

2.4 Transaction structuring and borrower engagement

ESG issues flagged during the due diligence process are discussed with the borrower. Where we identify material ESG risks that we believe have not been sufficiently factored into the borrower’s financial forecasts, we may seek higher financial coverage ratios or liquidity reserves to mitigating the elevated transition or asset obsolescence risk.

Where material risks are identified, we may ask the borrower to report to us on ESG metrics throughout the asset’s lifecycle. An update on these risks will form part of the regular dialogue we have with borrowers on the risks and challenges, both operational and financial, that they face over time.

Finally, we share expertise on ESG matters with borrowers, co-lenders and/ or equity sponsors in order to manage specific risk exposures.



2.5 Investment committee process

Our ESG due diligence findings, which identify material risks and opportunities, are summarised in the Private Credit Investment Committee (“PCIC” or “Investment Committee”) memorandum alongside other important considerations for Investment Committee decision-making, such as, amongst others) the borrower’s credit terms and credit rating, rationale for the investment, value from a portfolio perspective. The ESG summary provides a snapshot of the key ESG risks and opportunities assessed for the individual investment case including, in some cases, specific ESG considerations highlighted by the Investment and ESG teams.

In the event the investment does not meet the ESG due diligence criteria or significantly deviates from our responsible investment beliefs and purpose, the investment would be declined at an earlier stage before going to the Investment Committee.

ESG summary for the PCIC includes:

- A brief summary of the due diligence process;
- ESG risk assessment findings, highlighting the most material ESG risks; and
- Identification of the risks/gaps that need to be addressed, which may be which may be a condition required to obtain approval, subject to the company fulfilling ESG conditions prior to investment

Decisions taken at PCIC on ESG matters will be recorded. Where the PCIC has granted conditional approval, the Investment and ESG teams will engage with the borrower to ensure that conditions or outstanding actions and/or documentation have been completed or attained and reviewed prior to drawdown.

Any longer term ESG considerations that are deemed material to the PCIC over the life of the financing will be recorded and incorporated as part of the post-investment monitoring and reporting process.

2.6 Post-investment

2.6.1 Monitoring and reporting

Ongoing monitoring after a transaction has been completed is an essential part of all our investments. During the due diligence phase, we identify any material ESG issues that we believe should be monitored during the lifecycle of the investment and consider emerging issues on an ongoing basis. This typically involves our own research whereby we monitor for ESG incidents and identify growing exposure to ESG risks, changes in management, and so forth.

Additionally, we rely on regular communication with the borrowers to ensure an in-depth understanding of an asset's performance over the duration of the investments, which includes ESG. This communication can take place via regular meetings with the management, ad hoc meetings to address key market (including ESG) developments and regular reports that the borrowers send to us on a quarterly basis.

We have a dedicated asset management team in charge of coordinating communication with existing borrowers. Asset managers work together with investment and ESG teams in order to maintain close dialogue with our borrowers, including on ESG issues. Where applicable, as a responsible lender we will engage with the borrower on their ongoing compliance with relevant standards.

2.6.2 Exit

Exits from private debt investments are typically driven by the refinancing of existing loans, a change-of-control event or the completion of loan terms. It is, therefore, in a borrower's interest to maintain strong relationships with lenders, particularly when it is looking to refinance. This may provide us with further opportunities to influence how a borrower addresses specific ESG issues.

In the case of refinancing because of business growth, we rely on insights gleaned from the previous deal cycle and apply those to additional ESG due diligence or reporting requirements. The borrower may be open to more demanding ESG requirements in order to secure refinancing under mutually improved credit conditions.



Case study

The Private Credit team declined an opportunity to lend to a large OECD-country rolling stock company in H1 2019. The company scored poorly on exposure to climate change regulatory risk as the deal involved financing a rolling stock fleet where a considerable proportion of trains were diesel-fuelled.

The team understood diesel trains are necessary on certain lines where electrification is not commercially feasible. However, they were concerned about the elevated long-term risk of regulatory action on diesel trains due to climate change and air pollution. The investment manager engaged with the borrower, who was not willing to implement ESG risk management provisions relating to long-term diesel exposure in the proposed debt covenants as its strategy was in part predicated on seeing economic value in additional diesel train procurements. As a result, we declined this opportunity as we believed the issuer needed to set a clear strategy for managing this risk, including future targets for the proportion of diesel trains in its overall fleet.

⁴Information undertakings are determined within the document negotiation process with the borrower prior to financial close. A Maintenance Information Undertaking, whereby the borrower is bound to continuously provide detail on ESG performance, is generally a stronger covenant than an Occurrence Information Undertaking, where a borrower is obliged to report only when there is a significant change to their ESG performance. The exact type of information undertaking LGIMRA is able to negotiate may vary from asset to asset.

3. Future direction and development

3.1 Improving ESG data quality

In the private markets, there is increasing evidence that ESG integration can have a positive impact on financial performance in the medium to long term despite the challenges around data quality and consistency. Investors are also beginning to gain a deeper insight into ESG considerations, as well as the impact their investments are having on the environment, employees, stakeholders and local communities. Due to the diverse nature of the private credit asset class, there is currently no market standard in terms of ESG management and disclosure. ESG analysis and assessments are formed using a combination of quantitative and qualitative data. We are continually working to strengthen our own ESG approach and in collaboration with other industry leaders to promote ESG disclosure, transparency and better standards.

We also intend to start including vital ESG information into formal borrower reporting requirements. This means that we intend to, where appropriate, work with the borrowers to agree on material ESG metrics which will be included within compliance certificates or other regular reports borrowers send to us as lenders.

3.2 Promoting industry standards and guidelines

We are committed to industry guidelines and reporting frameworks that promote responsible investment practices.

UN Principles of Responsible Investment (UNPRI)

LGIM has been a signatory to the UN PRI since 2010 and has achieved an A+ rating for overall Strategy & Governance and A rating for our Property module in 2019.



The UN PRI has six key principles with which its signatories are required to align:

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

GRESB

We also participate in the GRESB Infrastructure Debt Working Group, which is an industry initiative led by GRESB to set standards and ESG best practice in the infrastructure debt sector.

Climate and financing the low-carbon transition

Paris agreement on climate change

A global landmark agreement to combat climate change and to accelerate and intensify the actions and investments needed for a sustainable low carbon future, keeping temperatures well below 2°C above pre-industrial levels, and ideally below 1.5°C.



Taskforce on climate related financial disclosure

Voluntary disclosure of material financial transition and physical risks. Forward-looking scenario analysis is critical in real assets, particularly regarding physical risks.



UK Net Zero 2050

The UK Government's commitment to achieve net zero carbon emission contribution in line with the Paris targets by 2050. LGIMRA has committed to net zero under the Better Building Partnerships (BPP).



Social capital & sustainable development

Social value

Allows organisations to calculate their financial contribution across a full range of social metrics. LGIMRA helped to facilitate the launch of this initiative, utilising the framework to measure and inform social value across its real estate equity portfolio.



UN sustainable development goals

SDGs are increasingly being used as a global framework to define impact and purpose by governments, companies and the investment sector.



Just transition

Understanding where the impact of policies will be felt - reflecting the growing realisation that the immense scale and speed of the economic transformation necessitates an active social dimension. "Leave no one behind."



EU Taxonomy

The EU Taxonomy aims to provide a common framework for sustainable activities in support of the transition to a low-carbon economy. We continue to closely monitor the development of this framework and to understand where it can be incorporated into our investment practice.

UN Sustainable Development Goals (SDGs)

Adopted in December 2015 by all 193-member states of the United Nations, the 17 UN Sustainable Development Goals provide a universal framework to guide global actions for governments and companies across countries and sectors to coordinate and address some of the world's most pressing social and environmental challenges. At LGIMRA, we believe the principles of the SDGs underpin our overarching beliefs and purpose, in line with L&G's vision of inclusive capitalism.

ESG framework for UK social housing

Another example of promoting greater disclosure and more ambitious ESG standards is the development of an industry wide ESG framework⁵ for the UK social housing sector, which we were actively involved in developing as part of our commitment to ESG in the corporate debt sector. The objective of this initiative was to build a sector standard approach for ESG reporting and disclosure. The Sustainability Reporting Standard for the social housing sector was published in November 2020 and is based on twelve core themes, including affordability, building safety, resident voice and climate change, among others. The standard can be found [here](#).

3.3 Climate risk

Climate change is a key consideration for all businesses within Legal & General Group (L&G). L&G published its first TCFD report in 2018. The report highlights how we are embedding climate considerations in our investment decisions.

For example, we have implemented additional governance and controls around investments in carbon-intensive assets. This includes controls to comply with new guidelines that apply to the funding of new coal facilities. We have exclusions for certain carbon-intensive assets written into the investment management agreements for all relevant asset classes we manage.

In addition, we have set carbon intensity targets to monitor alignment with the Paris objective and are funding the development and roll-out of key technologies which have the potential to accelerate the transition to net zero carbon. We have undertaken a strategic review of our carbon risks and opportunities and we actively manage and report on our carbon emissions.

At Legal & General Investment Management (LGIM), we understand that our scale brings the responsibility to act decisively on climate change. We are currently working with a specialist consultant to produce a financial model, which will assess physical and transition climate change risks to our portfolio. This work aims to build a standardised and transparent framework for analysing climate change impacts on financial portfolios. Our ultimate goal is to quantify climate change impacts and integrate them in a systematic, consistent and transparent manner into capital allocation and portfolio construction process, both for our own and managed assets.

From a private credit perspective, standardisation of climate impact assessments is particularly important, given the long-dated and illiquid nature of our investments. A standardised, data-driven approach will allow us to further refine our approach to climate risk and enhance our existing portfolio construction and management tools.

We understand that our scale brings the responsibility to act decisively on climate change.



⁵ESG Social Housing White Paper, Nov 2020 (https://esgsocialhousing.co.uk/wp-content/uploads/2020/11/SRS_final-report-2.pdf)

Contact us

For further information about LGIM Real Assets, please visit www.lgim.com/realassets or email contactrealassets@lgim.com



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