

VANGUARD ESG FUNDS Q&A



Vanguard ESG Developed World All Cap Equity Index Fund
Vanguard ESG Emerging Markets All Cap Equity Index Fund

1 Why is Vanguard launching ESG funds?

Vanguard believes ESG (environmental, social, governance) investing matters and it will continue to be an enduring trend. We appreciate our investors have a wide variety of humanitarian, ethical, environmental and social concerns, and many want to see these beliefs reflected in their investments.

This demand from investors combined with our commitment to social responsibility means we've offered ESG-screened products globally since 2000. Our ESG funds are designed to offer investors greater choice, while maintaining broad diversification at low cost.

2 What is Vanguard's approach to developing ESG products?

We are dedicated to developing and curating a low-cost, high-quality global product line-up for current and future investors and employ a rigorous, disciplined process for vetting product proposals. We continuously look at our offerings and ask: "Are we serving Vanguard investors in the right way?" That means applying discipline and focus to our product line-up and service offerings and prioritising those things that will bring the most value to our investors. If we believe that the addition of an investment strategy offers an enduring investment case and a cost-effective way to implement it, we will consider it.

Vanguard continues to seek ways to deliver long-term ESG strategies to investors. We'll remain focused on delivering broadly diversified, low-cost funds that either screen for certain investor preferences or, if they are active funds, seek to own securities in companies that the managers believe could translate ESG practice leadership into outperformance. Incorporating preferences alongside financial goals remains top of mind for ESG investors, and we will continue to seek ways to deliver on that.

Our product development process is informed by our product design principles, through which we ask, among other things:

- Is there enduring investment merit? We maintain our commitment to investors' success by ensuring that an academically supported and intuitive argument exists for why the investment could appreciate in value over time.
- Does it meet an unmet need for investors? We work to ensure we're designing investments for the long-term needs of investors.
- Can Vanguard be world class? We ensure there are no constraints to prevent us from achieving our aim of putting forward the best fund in the marketplace.

All potential Vanguard investment products must ultimately obtain the approval of our Global Investment Committee and UCITS Investment Committee, which asks the fundamental question: "How will this benefit investors?" Vanguard's chief executive officer leads the Global Investment Committee, which includes the chief investment officer and senior leaders from the Portfolio Review Department, Investment Management Group, Risk Management Group, and Investment Strategy Group.

3 How does Vanguard approach ESG integration?

Vanguard approaches ESG integration through our evolving offer of investment products, our integration of ESG considerations throughout our investment processes, and the investment stewardship activities across our active and passive equity and fixed income funds.

4 How do you assess ESG risks and opportunities within your investment processes?

As an investor-first organisation, Vanguard assesses ESG risks and opportunities in the context of their potential to affect long-term value for shareholders in our funds. We look to the managers of our active funds to assess companies' ESG risks on a case-by-case basis.

Our approach necessarily differs for our active funds managed in-house, our active funds managed externally and our index funds.

5 How do ESG considerations work with index funds?

Through our Investment Stewardship team, Vanguard engages with the constituent companies of equity indexes. Our dialogue with the management and boards of funds' portfolio companies is a year-round process that goes beyond proxy voting at a company's annual meeting. Because our index funds are essentially permanent owners of portfolio companies, we aim to understand how corporate boards of directors govern long-term strategy, protect shareholder rights and oversee key risks to long-term value—including environmental and societal risks. Vanguard's investment stewardship team addresses these critical corporate governance matters through public advocacy, direct meetings with company boards and leaders and proxy voting.

Vanguard does not seek to influence company strategy, but we raise concerns with relevant parties when we feel the economic interests of our shareholders may be in jeopardy. If a company's business practices or products put people's health, safety or dignity at risk, they present long-term financial risks to investors, too. We take positions on these matters because they are tied to the long-term economic value of funds' investments.

The majority of our global equity and fixed income funds seek to track the performance of an index. Our investors expect the funds in which they invest to meet the specific objective set forth for that investment and, as such, they expect our index funds to follow their benchmark with minimal tracking error.

Many indexes aim to reflect entire markets, often irrespective of ESG consideration, and funds based on these indexes will hold the same broader set of securities. As stewards of shareholders' assets, Vanguard uses, whenever possible, a full replication strategy (i.e. owning all stocks in the benchmark) to provide investment results that track the performance of the index as closely as possible. While Vanguard engages with index providers to understand their methodologies, those providers are independent and have autonomy in constructing an index. We have a fiduciary obligation to act in our investors' best interest with respect to their investments and will continue to adhere to these strategies.

Index providers determine the securities in the benchmark and may not take ESG information into account when selecting them. Different indexes may be constructed so that the weight of a given company is substantially different in one index compared with another. As such, we seek to mitigate ESG risks through our investment stewardship activities and engaging directly with portfolio companies to enhance a company's approach to ESG practices that impact long-term value creation.

The Investment Stewardship commentary *What we do. How we do it. Why it matters* provides further context on our ESG and company engagement efforts.

Vanguard's ESG index funds incorporate sets of screens applied by index providers to enable investors to express their personal values, while they pursue their financial goals through a broadly diversified investment option.

6 How should investors use these funds?

The funds, which each track an ESG index, can play a role in a global, diversified, portfolio, depending on an investor's objectives, preferences, constraints and tolerance for risk. For investors with a long-term investment horizon and a policy requirement or a humanitarian, religious, political, ethical or environmental preference to avoid investing directly or indirectly in companies that engage in certain business activities, the funds can serve as core equity building blocks. Although the funds will be market-cap-weighted following the application of the ESG screens, investors should be prepared for performance that may vary materially from conventional total market index funds over certain periods as a result of differences in holdings and all-in costs.

7 What is the investment strategy of the funds?

The funds will employ an indexing investment strategy designed to track the performance of the relevant indexes.

To the extent practicable, the funds use a full replication strategy, so that they invest in all, or substantially all, of the constituents of the relevant tracked index, making the weight of such investments approximate to those of the index. When not practicable to fully replicate, the funds use a sampling process to invest in a portfolio of securities that consists of a representative sample of the component securities of the relevant index. Under normal circumstances, the funds are expected to maintain broad risk characteristics consistent with that of the relevant indexes.

8 What is the market capitalisation coverage of the funds?

The funds will have all-cap coverage, providing investors with the benefits of broad market exposure and diversification of large-, mid-, and small-cap stocks.

Vanguard ESG Developed World All Cap Equity Index Fund

9 What is the benchmark of the Vanguard ESG Developed World All Cap Equity Index Fund?

The Vanguard ESG Developed World All Cap Equity Index Fund (the fund) tracks the FTSE Developed All Cap ex Controversies/Non-Renewable Energy/Vice Products/Weapons Index. The index is constructed from the FTSE Developed All Cap Index (the "Developed Parent Index") which is then screened for certain environmental, social, and corporate governance criteria by the sponsor of the Index, which is independent of Vanguard.

10 What are some comparison data between the ESG-screened index and non-ESG screened parent index, including performance?

It is important to note that the fund, which tracks an ESG-screened index, will inevitably have different risk/return characteristics to the non-ESG screened Developed Parent Index, and will as such perform differently. Nonetheless the fund has been designed according to Vanguard's core investment principles: to help ESG conscious, long-term investors put together balanced, diversified equity portfolios to help them meet their investment goals, at a low cost.

		FTSE Developed All Cap ex Controversies/Non-Renewable Energy/Vice Products/Weapons Index^{1^}	FTSE Developed All Cap Index¹
Number of constituents		4,770	5,640
Number of exclusions		870	-
Dividend Yield %		2.3%	2.6%
Net MCap (GBP)		28.2 trillion	34.8 trillion
Top 10 Holdings (% Index MCap)		17.1%	14.1%
1YR Return	Cumulative Performance	2.9%	-1.5%
3YR Return*		25.4%	18.1%
5YR Return*		68.6%	56.3%
2015	Annualised Performance	-	5.4%
2016		27.3%	29.6%
2017		14.3%	12.9%
2018		-2.2%	-3.5%
2019		25.4%	24.7%

Past performance is not a reliable indicator of future results. Simulated past performance is not a reliable indicator of future results. *Compound annual returns over 3 and 5 years, respectively.

1 Source: FTSE Russell. Data as at 30 April 2020. [^]Returns shown prior to index launch (19 February 2020) represent hypothetical, historical data.

11 What are the available share classes and the corresponding ongoing charges figures ("OCF") and investment minimums?

Share class	OCF	ISIN	Minimum Investment
"Pound Sterling" Accumulation Shares	0.20%	IE00B76VTN11	£100,000
"Pound Sterling" Income Shares	0.20%	IE00B76VTM04	£100,000
Institutional Plus GBP Accumulation Shares	0.13%	IE00BPT2BN12	£200,000,000
Institutional "U.S. Dollar" Shares	0.20%	IE00B505V954	\$100,000
Investor "Euro" Shares	0.20%	IE00B54FFW20	€ 100,000
Institutional "Euro" Shares	0.20%	IE00B5456744	€ 5,000,000
Institutional Plus "Euro" Shares	0.13%	IE00BFPM9S65	€ 200,000,000

Vanguard ESG Emerging Markets All Cap Equity Index Fund

12 What is the benchmark of the Vanguard ESG Emerging Markets All Cap Equity Index Fund?

The Vanguard ESG Emerging Markets All Cap Equity Index Fund (the fund) tracks the FTSE Emerging All Cap ex Controversies/Non-Renewable Energy/Vice Products/Weapons Index. The index is constructed from the FTSE Emerging All Cap Index (the "Emerging Parent Index") which is then screened for certain environmental, social, and corporate governance criteria by the sponsor of the index, which is independent of Vanguard.

13 What are some comparison data between the ESG-screened index and non-ESG screened parent index, including performance?

It is important to note that the fund, which tracks an ESG-screened index, will inevitably have different risk/return characteristics to the non-ESG screened Emerging Parent Index, and will as such perform differently. Nonetheless the fund has been designed according to Vanguard's core investment principles: to help ESG conscious, long-term investors put together global, diversified equity portfolios to help them meet their investment goals, at a low cost.

		FTSE Emerging All Cap ex Controversies/ Non-Renewable Energy/Vice Products/ Weapons Index ^{2^}	FTSE Emerging All Cap Index²
Number of constituents		2,456	3,273
Number of exclusions		817	-
Dividend Yield %		2.7%	3.3%
Net MCap (GBP)		4.3 trillion	5.1 trillion
Top 10 Holdings (% Index MCap)		30.1%	25.9%
1YR Return	Cumulative Performance	-9.7%	-11.7%
3YR Return*		2.0%	1.3%
5YR Return*		0.1%	0.0%
2015	Annualised Performance	-	-14.7%
2016		10.4%	12.9%
2017		33.8%	32.5%
2018		-15.7%	-13.6%
2019		21.7%	20.3%

Past performance is not a reliable indicator of future results. Simulated past performance is not a reliable indicator of future results.*Compound annual returns over 3 and 5 years, respectively.

² Source: FTSE Russell. Data as at 30 April 2020. [^]Returns shown prior to index launch (19 February 2020) represent hypothetical, historical data.

14 What share classes are available at launch, what are the corresponding ongoing charges figures ("OCF") and investment minimums?

Share class	OCF	ISIN	Minimum Investment
"Pound Sterling" Accumulation Shares	0.25%	IE00BKV0VZ05	£100,000
"Pound Sterling" Income Shares	0.25%	IE00BKV0W029	£100,000
Institutional Plus GBP Income	0.18%	IE00BKV0W136	£200,000,000
Investor "Euro" Shares	0.25%	IE00BKV0W243	€100,000
Investor "U.S. Dollar" Shares	0.25%	IE00BKV0W359	US \$100,000

15 Why have you chosen the FTSE Global Choice Index Series?

Vanguard has chosen FTSE Global Choice Index Series for several reasons:

- The FTSE Global Choice Index Series is transparent and simple to understand, an important consideration for our investors.
- FTSE's exclusionary screens are most closely aligned to Vanguard's approach to exclusionary index investing. Specifically, the FTSE Global Choice Index Series methodology provides a comprehensive set of product and conduct screens which are rules based. This means that the standard for exclusions are determined based on certain criteria and applied across the entire index consistently. Conversely, a ratings-based approach, another common method for exclusionary and inclusionary screens, uses a myriad of factors including disclosure data and third-party rating sources. However, we do not yet have confidence in ratings-based approaches due to significant inconsistencies in the inputs.

16 What is the exclusionary screening methodology of the index?

The FTSE Global Choice Index Series is a market capitalisation weighted index series with a rules-based methodology for defining how the products and conduct of a company impact society and the environment. The result is a framework for applying robust and customisable values-based exclusions to a broad market index. The index applies screens to exclude companies engaged or involved in the following activities:

- **Controversies** i.e. companies which do not meet the labour, human rights, environmental and anti-corruption standards, as defined by the United Nations Global Compact Principles ³;
- **Non-renewable energy** i.e. (i) companies that own proved or probable reserves in coal, oil or gas; (ii) companies with primary business activity defined as the production, or supporting products and services, of coal, oil or gas; and (iii) companies that generate revenues from nuclear power production or related activities (including equipment, construction and uranium);
- **Vice products** i.e. (i) companies that produce adult entertainment; (ii) companies that produce alcoholic beverages; (iii) companies that produce tobacco products; and (iv) companies that provide gambling services; and

- **Weapons** i.e. (i) companies that produce or produce specific and critical parts or services for nuclear weapon systems, chemical or biological weapons, cluster munitions and anti-personnel mines; (ii) companies that produce other weapons for military use; and (iii) companies that produce firearms or ammunition for non-military use.

17 What are the risks to consider when implementing ESG investing?

A central question for investors considering ESG funds is whether they will deliver risk-adjusted returns consistently different to the market. ESG-screened equity funds should be expected to have stock holdings and weightings that diverge from an investor's existing conventional index strategies, and therefore should be expected to perform differently.

- Performance dimension (relative risk)⁴:
 - ▶ Our research into the return characteristics of ESG equity funds found that both index and active funds produce mixed and quite dispersed risk and return results versus the broad market.
 - ▶ These observations were often explained by differences in factor and/or industry exposures or owing to fund-specific elements.
 - ▶ We do not find that ESG funds collectively outperform nor do they collectively underperform.
- ESG dimension:
 - ▶ Defining ESG can be highly individual and requires due diligence. Steps may include:
 - ▶ Identifying those issues that matter most to the investor and may be addressed through a wide range of options.
 - ▶ Linking each issue to selected objectives.
- Product dimension:
 - ▶ Model risk: ESG elements may be interpreted differently among ESG product and/or research providers. This can lead to differences even among products with presumably identical ESG elements.
 - ▶ Cost differential: ESG products may have different costs compared to non-ESG equivalents.

3 <https://www.unglobalcompact.org/what-is-gc/mission/principles>

4 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.

Past performance is not a reliable indicator of future results.

Simulated past performance is not a reliable indicator of future results.

Some funds invest in emerging markets which can be more volatile than more established markets. As a result the value of your investment may rise or fall.

The funds may use derivatives in order to reduce risk or cost and/or generate extra income or growth. The use of derivatives could increase or reduce exposure to underlying assets and result in greater fluctuations of the funds' net asset value. A derivative is a financial contract whose value is based on the value of a financial asset (such as a share, bond, or currency) or a market index.

Some funds invest in securities which are denominated in different currencies. Movements in currency exchange rates can affect the return of investments.

For further information on risks please see the "Risk Factors" section of the prospectus on our website at <https://global.vanguard.com>.

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For further information on the fund's investment policy, please refer to the Key Investor Information Document ("KIID").

The KIIDs for these funds are available in local languages, alongside the prospectus via Vanguard's website <https://global.vanguard.com/>.

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