The premise behind ESG investing is that companies that properly integrate ESG criteria into the fabric of their business processes and practices will see a positive impact.

Environmental, Social and Governance (ESG) indicators, an extension of the Socially Responsible Investing (SRI) movement that has been around for a number of years, we believe are becoming increasingly important factors people are considering when they are researching potential investments.

The premise behind ESG investing is that companies that properly integrate ESG criteria into the fabric of their business processes and practices will see a positive impact. We believe the implications for investors are that these companies can potentially produce more positive returns compared to companies not integrating ESG into their business. At the same time, companies with an ESG commitment give investors an opportunity to make investment decisions based on their own values and beliefs.

WHAT IS ESG?
Our research suggests that ESG investing, sometimes referred to sustainable investing or impact investing, and may be one of the fastest growing segments of the investing industry.

The acronym “ESG” has three components:

- Environmental
- Social
- Governance
**Environmental** focuses on the company’s environmental disclosures, waste management policies, water management procedures and their use of environmental resources. Efforts to reduce pollution and carbon emissions are key components here as well. What are the company’s policies on conserving natural resources and the treatment of animals? Are there potential environmental risks facing the company based on its normal business activities? How do the company’s business practices and policies mitigate these risks to reduce their financial exposure? These are some questions investors may wish to ask regarding the environmental practices of companies in which they are considering investing.

**Social** refers to a company’s approach to work-place issues like diversity, management, and human rights. It also refers to the company’s relationships within the community. Does the company encourage volunteering among employees? Does the company do business with suppliers and partners that share its values?

**Governance** covers areas such as compensation, shareholder rights, and the relationship between management and shareholders. Does the company use clear and transparent accounting practices? Is it careful to avoid conflicts of interest when choosing board members? Does the company avoid investments in companies that engage in illegal or questionable activities? Does the board insist that shareholders be allowed to vote on important issues?

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**ATTRACTING A WIDER SPECTRUM OF INVESTORS**

We believe ETFs and funds using ESG criteria as an investment screen are in line to gather assets from investors who share these values. The same can be said for companies looking to attract investors or funding from venture capitalists or institutional investors.

For example, a survey conducted by the Forum for Sustainable and Responsible Investment indicated that 58% of high net worth investors and 85% of millennial investors surveyed indicated that they, “Agree Social or Environmental Impact is Important to Investment Decisions.” Ten percent of all High Net Worth (HNW) and Ultra High Net Worth (UHNW) adults surveyed currently own or employ social impact investments while 22 percent are interested in them. Yet among wealthy millennials, 17 percent currently own such investments and 43 percent are interested.¹

Morningstar has established sustainability ratings for funds and ETFs that allow investors to compare various funds they may be considering on these metrics. In addition to assigning an ESG score for the portfolio, the Morningstar rankings deduct for a poor portfolio controversy ranking, defined as ESG-related incidents. These might include pollution-related occurrences or a discrimination-related controversy.²

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WHAT DOES A POTENTIAL ESG INVESTOR LOOK LIKE?

<table>
<thead>
<tr>
<th>Overall demographic profile of a strong ESG target</th>
</tr>
</thead>
<tbody>
<tr>
<td>58% of affluent investors indicated that they believe social or environmental impact is important to investment decisions</td>
</tr>
<tr>
<td>Only 10% of High Net Worth adults currently own social impact investments</td>
</tr>
<tr>
<td>43% of wealthy millennial investors are interested in employing social impact investments</td>
</tr>
</tbody>
</table>

Forum for Sustainable and Responsible Investment, Feb 2016

<table>
<thead>
<tr>
<th>Wealth transfer characteristics of High Net Worth investors</th>
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</thead>
<tbody>
<tr>
<td>The majority of High Net Worth investors believe social responsibility is a consideration in estate planning</td>
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<tr>
<td>92% of High Net Worth investors expect their children to have similar or more interest in ESG investing than they do</td>
</tr>
</tbody>
</table>

Naissance, June 2016

<table>
<thead>
<tr>
<th>Personal demographics of potential ESG interested clients</th>
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</thead>
<tbody>
<tr>
<td>Female, Younger than 40 years-old</td>
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<tr>
<td>Active in charities and / or social or environmental causes</td>
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<tr>
<td>Located in large cities, specifically on the east or west coasts</td>
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</tbody>
</table>

TIAA, May 2016

ESG AND THE POTENTIAL FOR ALPHA GENERATION

According to a Calvert study, companies who undertake ESG strategies in their business have been shown to generate positive impacts on their costs, revenues, and cost of capital. The study cites the potential for alpha generation because the impact of ESG is slow to be reflected in a company’s stock. Investors who understand the potential benefits to companies who incorporate ESG strategies into their business may have the opportunity to invest prior to the general market recognizing the impact, thus potentially providing an opportunity to invest before the benefits of ESG become reflected in the stock’s price.

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Even as far back as 2011, a study of 180 companies, 90 of which the study’s authors classified as high sustainability firms and 90 of which they classified as low sustainability companies,\(^4\) recognized a potential correlation. The study looked at results for this sample of companies over an 18-year period. Over this period, the companies rated as high for sustainability outperformed those rated as low both in terms of their stock’s performance and in terms of accounting measures. The study also underscored that the positive impact of high sustainability was a potential long-term benefit, concluding that incorporating ESG and sustainability into the organization’s strategy and operations was not a way to ensure short-term outperformance.

**ESG AND STRATEGIC BETA**

The diligent screening process used to implement a meaningful ESG strategy into the creation of an index follows a rules-based approach which may be similar to the way other indexes incorporate factors that constitute the portfolio design of other strategic beta ETFs. ESG is based on screening for and weighting certain Key Performance Indicators (KPIs) tied to the environmental, social, and governance efforts of the companies included in the ETF’s benchmark. KPIs are quantitative and qualitative metrics that demonstrate how effectively a company is achieving its business objectives, which often include environmental, social or governance considerations. These KPIs are screened and the companies meeting the selected criteria are included in the index and determine which securities are in the ETF’s portfolio. This process is repeated at the set intervals that the index is rebalanced/reconstituted.

This is very similar to the process used by most strategic beta funds, both those utilizing a single factor and those using a multi-factor approach. ETFs using both strategic beta strategies and ESG strategies have seen significant growth in assets, and some industry experts speculate that funds using a combination of the two approaches will experience growth as well.\(^5\)

**OUR APPROACH TO ESG INVESTING**

FlexShares offers two ESG-based ETFs based upon the STOXX\(^®\) Global 1800 Index, which includes an investable universe of about 1,800 companies. These ETFs are:

- **FlexShares STOXX\(^®\) US ESG Impact Index Fund (ESG)**, which falls into Morningstar’s\(^®\) large blend category and is about 99% invested in U.S. stocks. The fund tracks the STOXX\(^®\) USA ESG Impact Index. The fund is designed to serve as a core portfolio holding that strives to enhance risk-adjusted returns via the incorporation of ESG exposure into the fund’s stock selection process.

- **FlexShares STOXX\(^®\) Global ESG Impact Index Fund (ESGG)**, which falls into Morningstar’s\(^®\) world large stock category. The fund tracks the STOXX\(^®\) Global ESG Impact Index. The fund’s holdings include about 55% in U.S. stocks and about 44% in non-U.S. stocks.

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We believe that these above and other KPIs have been shown to have the most influence on a stock’s risk and return. The portfolio is tilted in favor of companies with higher aggregate ESG scores in an effort to optimize risk-adjusted return. Sector, security, and country constraints are employed to minimize concentration risk.

We believe that our approach to measuring the impact of key ESG KPIs on performance as part of a diversified investing approach helps ensure that companies with both positive share-price performance and sustainable business models are included in the fund portfolios.

SUMMARY

Our research indicates that investors increasingly want to invest in companies that reflect their values. This investor pool isn’t limited to millennials, the next large generation of investors, but also includes today’s high net worth investors.

Studies have shown that companies with a good record in ESG issues often prove to be solid investments as well. Money managers and financial advisors may want to consider being well-versed in this aspect of investing to serve the needs of investors, especially millennial investors, that we believe value the benefits of ESG investing.

TO LEARN MORE

To learn more about FlexShares, please contact our team at 1-855-FlexETF (1-855-353-9383) or visit flexshares.com.

Alpha is a measure of risk-adjusted return and is the excess return of an investment over and above its benchmark.

Written in conjunction with Roger Wohlner utilizing Contently. Roger is an experienced financial writer whose work has appeared on Investopedia, US News, Morningstar Magazine and MSN Money.

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IMPORTANT INFORMATION

Before investing, carefully consider the FlexShares investment objectives, risks, charges and expenses. This and other information is in the prospectus and a summary prospectus, copies of which may be obtained by visiting www.flexshares.com. Read the prospectus carefully before you invest. Foreside Fund Services, LLC, distributor.

An investment in FlexShares is subject to numerous risks, including possible loss of principal. Fund returns may not match the return of the respective indexes. The Funds are subject to the following principal risks: asset class; commodity; concentration; counterparty; currency; derivatives; dividend; emerging markets; equity securities; fluctuation of yield; foreign securities; geographic; income; industry concentration; inflation-protected securities; infrastructure-related companies; interest rate / maturity risk; issuer; large cap; management; market; market trading; mid cap stock; MLP; momentum; natural resources; new funds; non-diversification; passive investment; privatization; small cap stock; tracking error; value investing; and volatility risk. A full description of risks is in the prospectus.

FlexShares STOXX® US ESG Impact Index Fund (ESG) and the FlexShares STOXX® Global ESG Impact Index Fund (ESGG) are passively managed and use a representative sampling strategy to track their underlying index respectively. Use of a representative sampling strategy creates tracking risk where the Fund’s performance could vary substantially from the performance of the underlying index. The Funds are subject to environmental, social and governance (ESG) Investment Risk, which is the risk that because the methodology of the Underlying Indices selects and assigns weights to securities of issuers for non-financial reasons, the Funds may underperform the broader equity market or other funds that do not utilize ESG criteria when selecting investments. The Funds are also at increased risk of industry concentration, where it may be more than 25% invested in the assets of a single industry. For ESGG, investments in foreign market securities involve certain risks such as currency volatility, political and social instability and reduced market liquidity. The Funds may also invest in derivative instruments. Changes in the value of the derivative may not correlate with the underlying asset, rate or index and the Funds could lose more than the principal amount invested. The STOXX® USA ESG Impact Index and the STOXX® Global ESG Impact Index are the intellectual property (including registered trademarks) of STOXX® Limited, Zurich, Switzerland and/or its licensors (“Licensors”), which is used under license. The securities based on the Index are in no way sponsored, endorsed, sold or promoted by STOXX® and its Licensors and neither of the Licensors shall have any liability with respect thereto.

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CONTACT US

FINANCIAL PROFESSIONALS

By Phone Consult
Consultants are available
Monday - Friday: 9 AM to 5 PM ET
1-855-FlexETF (1-855-353-9383)

By Mail/Overnight Delivery
FlexShares ETFs
c/o Foreside Fund Services, LLC
3 Canal Plaza Suite 100
Portland, ME 04101

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