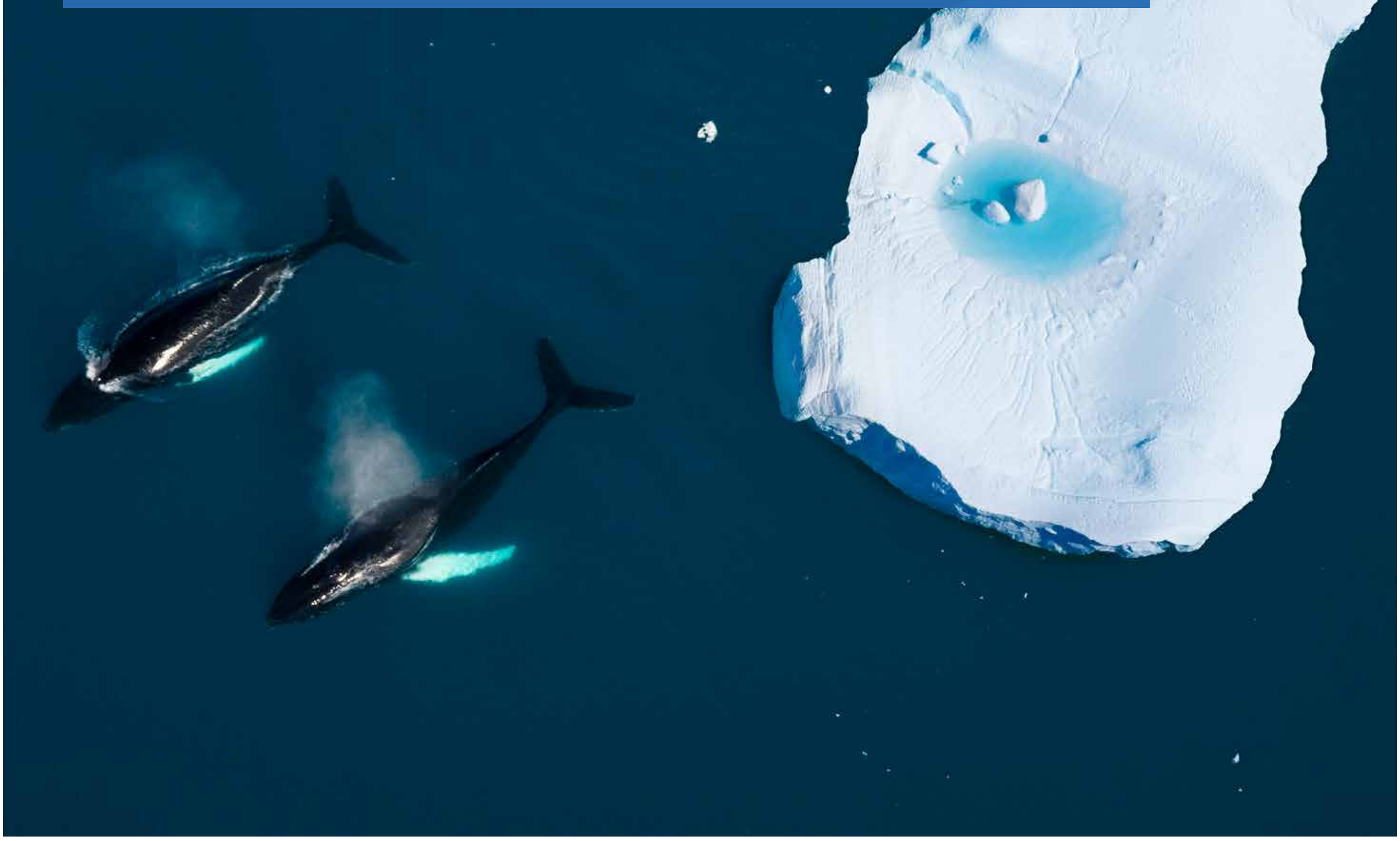
Renewing our Climate Impact Pledge

To spur net-zero carbon emissions, we are making our targeted engagement programme even more ambitious



Legal & General
INVESTMENT MANAGEMENT

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Meryam Omi
Head of Sustainability and Responsible Investment Strategy

Iancu Daramus
Senior Sustainability Analyst

Yasmine Svan
Senior Sustainability Analyst

A global consensus on climate change has taken shape in just a few years, as wildfires have devastated entire regions, millions have taken to the streets to demand action and COVID-19 has underscored the importance of averting looming threats before it is too late.

In recognition of this dramatic shift, we are renewing our Climate Impact Pledge, a programme of targeted engagement with about 80 companies that we launched in 2016 to hasten the transition to a low-carbon economy.

We will broaden the pledge's reach to include hundreds more companies, with the ultimate goal of aiming to achieve net-zero carbon emissions globally by 2050 – an objective of critical importance to our clients and society as a whole. Our engagement will continue to carry meaningful consequences, both through our voting activity and through our capital allocation.

In this document, we outline what the pledge has achieved so far, how we are redoubling our efforts to meet its objectives and why now, more than ever before, we believe the world needs to take action to avert a climate emergency.

Naming and faming

Under our original pledge, we focused on the largest companies in sectors crucial to accelerating or halting the energy transition (energy, transport, financials) and deforestation and land use change (food retail). We then assessed and ranked them against a wide range of indicators – from governance structures to business targets and lobbying activities – to gain a well-rounded view of their exposure to climate risks and opportunities.

In our dialogue with companies, we sought to help them disclose more, form robust strategies and commit to meaningful targets. [See our previous rankings.]

When companies failed to demonstrate sufficient action, we voted against the chair of their boards, using the voting rights granted by LGIM's entire equity book, and divested from them within some of our funds.[i]

Crucially, when we took these steps, we named the companies targeted – just as we highlighted those worthy of praise. So far, we have sanctioned 13 companies, including **ExxonMobil***, **MetLife*** and **China Construction Bank***.

2018 LGIM's Climate Impact Pledge: The results so far

For Investment Professionals

LGIM's Climate Impact Pledge: The results so far

We are publicising the global corporate leaders and laggards on climate change.

Meryam Omi is responsible for engaging on sustainability themes globally and the development of responsible investment solutions.

A year ago, we had a clear message for the companies in which we invest: ignoring climate change is a financial risk. We would use our rights as major shareholders to put pressure on them to help accelerate the transition to a low-carbon economy.

We called this our Climate Impact Pledge – a commitment to engage with 84 of the world's largest companies, alongside analysing, scoring and ranking them against their peers to improve their strategies to address this challenge.

As part of the process, we also said LGIM would make public the names of some of the best and worst performers, alongside examples of best practices that we would like to see adopted more widely.

One year later, we are seeing many companies taking positive steps. From banks to oil and gas producers, businesses are responding to our demands and embracing the advantages of sustainability. This reinforces our belief in the value of engagement, which is core to our role as a steward of our clients' assets.

In this piece, we are 'naming and faming' those companies that are indeed excelling in taking real, positive action to meet one of the defining challenges of our era; we also highlight those where there is significant room for improvement.

NO 'TRUMP BUMP' FOR CLIMATE PROGRESS

Since we began the engagement process in April 2017, our scores for US companies have improved, dispelling concerns over the knock-on effects of President Donald Trump's decision to withdraw from the Paris climate accord.

Average Japanese, Australian and South Korean companies have also climbed in our rankings; by contrast, average French, UK and German companies declined. These trends reflect a broader increase in Asia, and a slowdown in Europe, in clean energy investments last year[1].

Back in 2017, more companies' scores were towards the bottom than the top of our initial ranking; one year later, however, we have seen improvements in the scores of entire sectors. This was true of oil and gas companies, utilities and auto manufacturers. These sectors are on the front line of the energy transition, as companies react to the plunging costs of renewables and the rapid rise of electric vehicles.

TIME FOR ACTION

The energy transition is fast becoming a sustainability revolution, which we believe can transform all areas of the economy, from food retail to banks. Through the 2015 Paris Agreement on climate change, countries around the world have set themselves the target of keeping the average rise in global temperatures to "well below" 2°C above pre-industrial levels. The companies covered by the pledge are in sectors that we believe will be crucial to meeting this target.

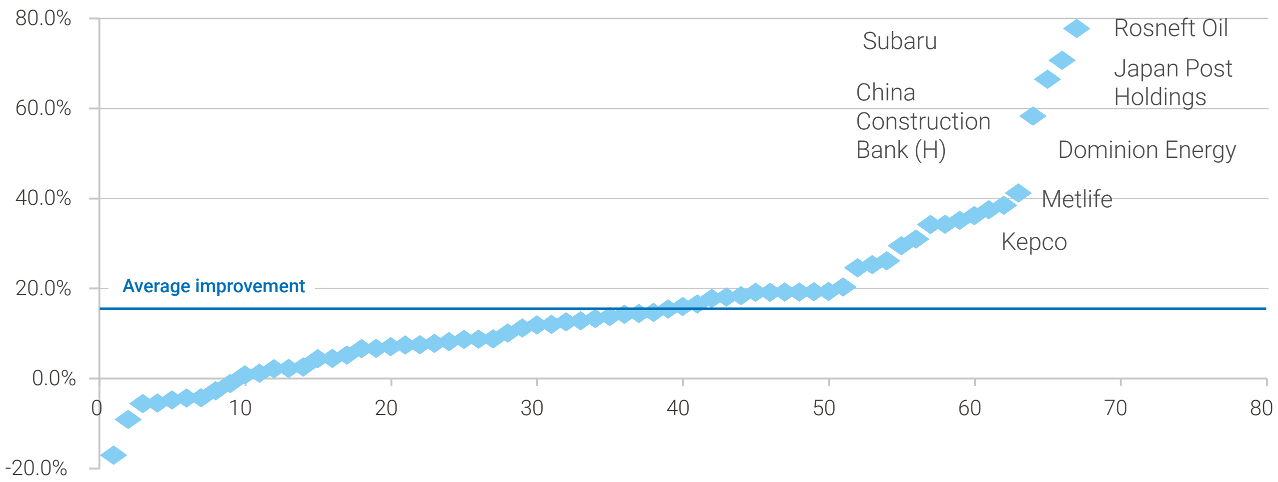
1 BNEF Clean Energy Investment Trends, 2017

We often found that our public sanctions elevated our conversations with companies, motivating them to address our concerns. In 2019, we were pleased to see two divested companies reinstated in our funds, following improvements. In 2020, one of that pair – **Dominion Energy*** – has gone even further by adopting a target for net-zero emissions.

We are also pleased to announce this year that we have reinstated Japanese automaker **Subaru*** following significant improvements in emission targets and climate disclosures.

Moreover, seven of the ten companies that have registered the largest improvements since last year were those we had named as 'laggards' in previous years.

Company score improvements (%)



Source: LGIM, as at September 2020

*Reference to a particular security is for illustrative purposes only, is on a historic basis and does not mean that the security is currently held or will be held within an LGIM portfolio. The above information does not constitute a recommendation to buy or sell any security.

Taking stock

As 'cleantech' passes new milestones, fossil fuel resources or infrastructure at risk in a low-carbon future are now commonly seen as "stranded assets".

Responses by clients and other stakeholders to our initiative have been overwhelmingly positive in the years since we launched the pledge, during which the market has changed significantly.[ii]

Access to climate data, both from companies' own disclosures and from specialist data providers, has grown significantly, supported by favourable regulation and growing investor pressure. Collaboration is also on the rise, as seen in the activity of investor networks, such as Climate Action 100, the Institutional Investors Group on Climate Change, the One Planet Asset Manager initiative and the Transitions Pathway Initiative; and of policy experts like the Aldersgate Group.

As policymakers translate the seminal Paris accord of 2015 into local policies and regulations, almost half of global GDP is now covered by net-zero targets, while banks, insurance companies and investors are required to consider and disclose risks stemming from climate change.[iii] And as 'cleantech' passes new milestones,[1] fossil fuel resources or infrastructure at risk in a low-carbon future are now commonly seen as "stranded assets".

The dangers we face have also become more apparent. In a landmark 2018 report, scientists convened by the UN warned that limiting global warming to 2°C above pre-industrial times, which had previously been seen as a 'safe' target, still represented a significant threat. According to the report, holding warming to 1.5°C instead of 2°C could reduce "risks to health, livelihoods, food security, water supply, human security, and economic growth".

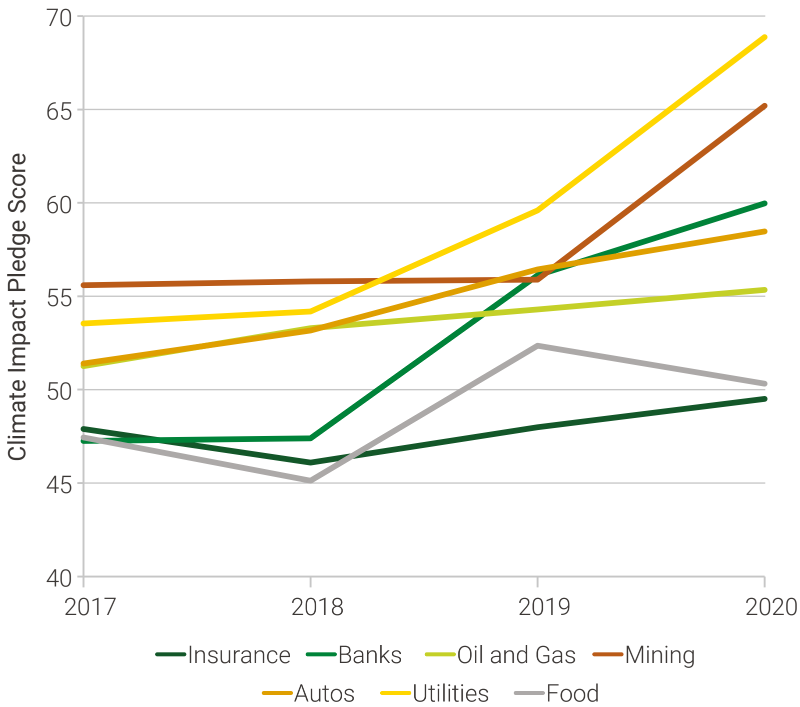
Consensus is now rapidly building around reaching net-zero carbon emissions globally by 2050 as the safest way to meet the 1.5°C goal.[iv]

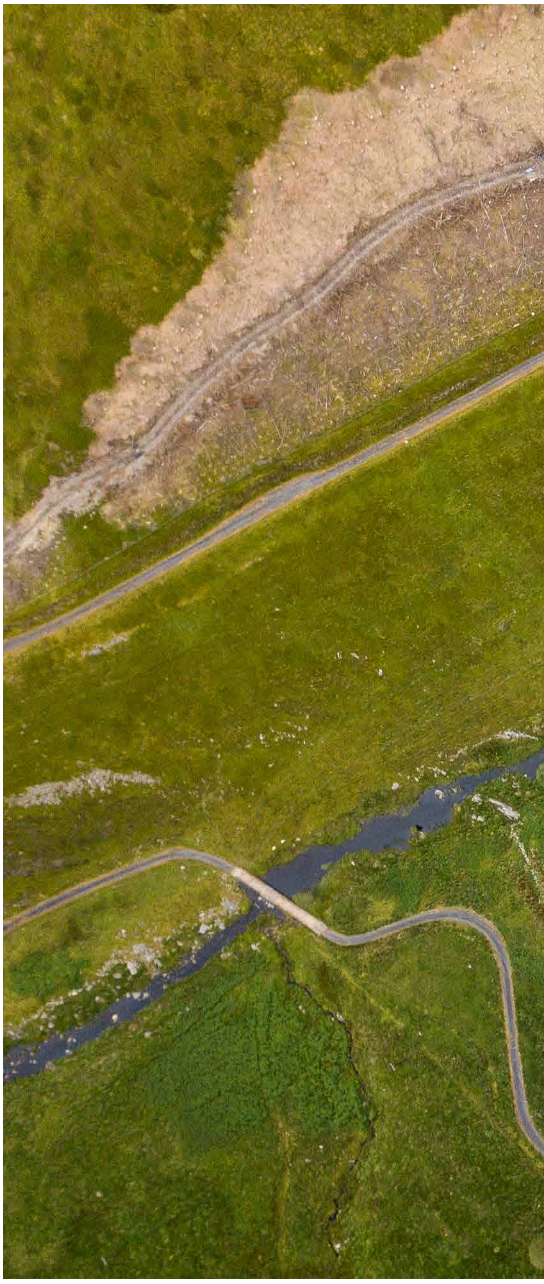
1. Including the costs of solar power and battery storage more than halving since 2016, and an electric vehicle manufacturer becoming the world's most valuable auto company. There is no guarantee that any forecasts made will come to pass.

Progress since 2019

Since 2019, the scores under our original approach have increased across most sectors, while those for all sectors have improved since the start of our pledge. This trend is all the more notable given that we have raised some of our minimum standards as companies began to meet them.

Climate scores rising across sectors





Changes

	2017-2020 cumulative	2017 - 2020 average	2019 - 2020 change
Insurance	3.4%	0.8%	3.2%
Banks	26.9%	6.1%	6.9%
Oil and Gas	8.0%	1.9%	1.9%
Mining	17.3%	4.1%	16.7%
Autos	13.8%	3.3%	3.6%
Utilities	28.6%	6.5%	15.6%
Food	6.1%	1.5%	-3.9%

Source: LGIM, as at September 2020

Reflecting the relentless progress of renewable energy, **utilities** have retained the top spot. The charge to phase out coal – led by progressive European utilities such as **Enel*** – is now reverberating in markets that had previously resisted change. Regulated utilities in the US – which do not face the pressures of competitive power markets – have begun adopting net-zero targets. Even utilities in coal-reliant Asia, such as Hong Kong's **CLP Holdings***, are calling time on their coal plants.[v]

As the development of electric vehicles continues apace, there is a growing awareness that they require significant extraction of minerals to support their growth, not least copper, cobalt, zinc, lithium – as will renewables, too.[vi] The **mining sector** has thus supplanted automakers in second place, with **BHP*** making a notable move to set carbon goals for its clients.[vii]

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“We listened and we learned”

Bernard Looney
CEO, BP

Divergence among energy companies

In the **oil and gas** sector, all European oil majors have announced net-zero emissions targets. These include not just their operations, but also the use of their products (by far the largest source of emissions for the industry), with **BP*** planning to curb oil and gas production significantly, broadly in line with global climate targets. Such moves indicate a remarkable shift for an industry that only a few years ago was resolutely opposed to setting carbon targets.[viii]

"We listened and we learned," said Bernard Looney, BP CEO, reflecting on shareholder engagement co-led by LGIM, as part of the Climate Action 100+ investor coalition.[ix]

However, the sector's overall performance has been roughly static, as US oil majors continue to trail their European peers.

Financials - no longer laggards

Initially climate 'laggards' when we began our assessment in 2017, banks have since played catch up, retaining third place since last year. Notable commitments include **Commonwealth Bank of Australia's*** vow to halt coal financing,[x] and **Lloyds Banking Group's*** plans to halve the carbon it finances over the next decade.[xi]

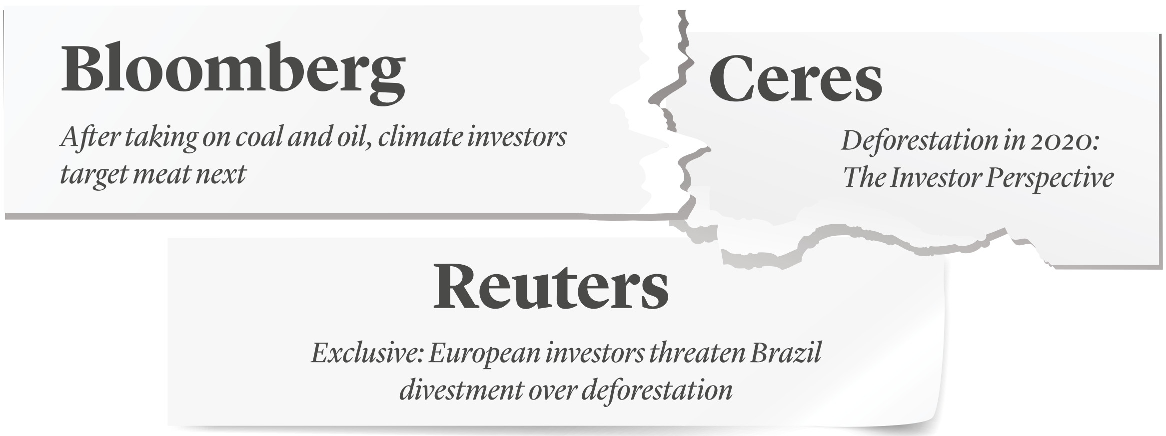
Insurers, too, have been making inroads; while the modelling of natural catastrophes is established practice within property and casualty (re)insurance, life insurers have begun to reckon with the carbon footprint of their assets and liabilities. **AIG*** has released its first climate report, whilst **Chubb*** has become the first major US insurer to call a halt to investing in (and insuring) coal projects.[xii]

Regression by food retail

The only sector to have declined year-on-year, **food retail** remains an area of concern, as its scores for verification of greenhouse gas (GHG) data, governance and targets have declined.

Over the past year, we have devoted significant efforts to engaging with food companies about the role of deforestation in their supply chain – a major cause of climate change – and the transition of product portfolios towards lower-impact alternatives.

However, we also recognise that there are a variety of approaches taken in the industry, with companies such as **Nestlé*** modelling the impact of a changing climate on their coffee, cereals and dairy production[xiii] and **General Mills*** bringing regenerative, carbon-storing agriculture techniques in its supply chain.[xiv]



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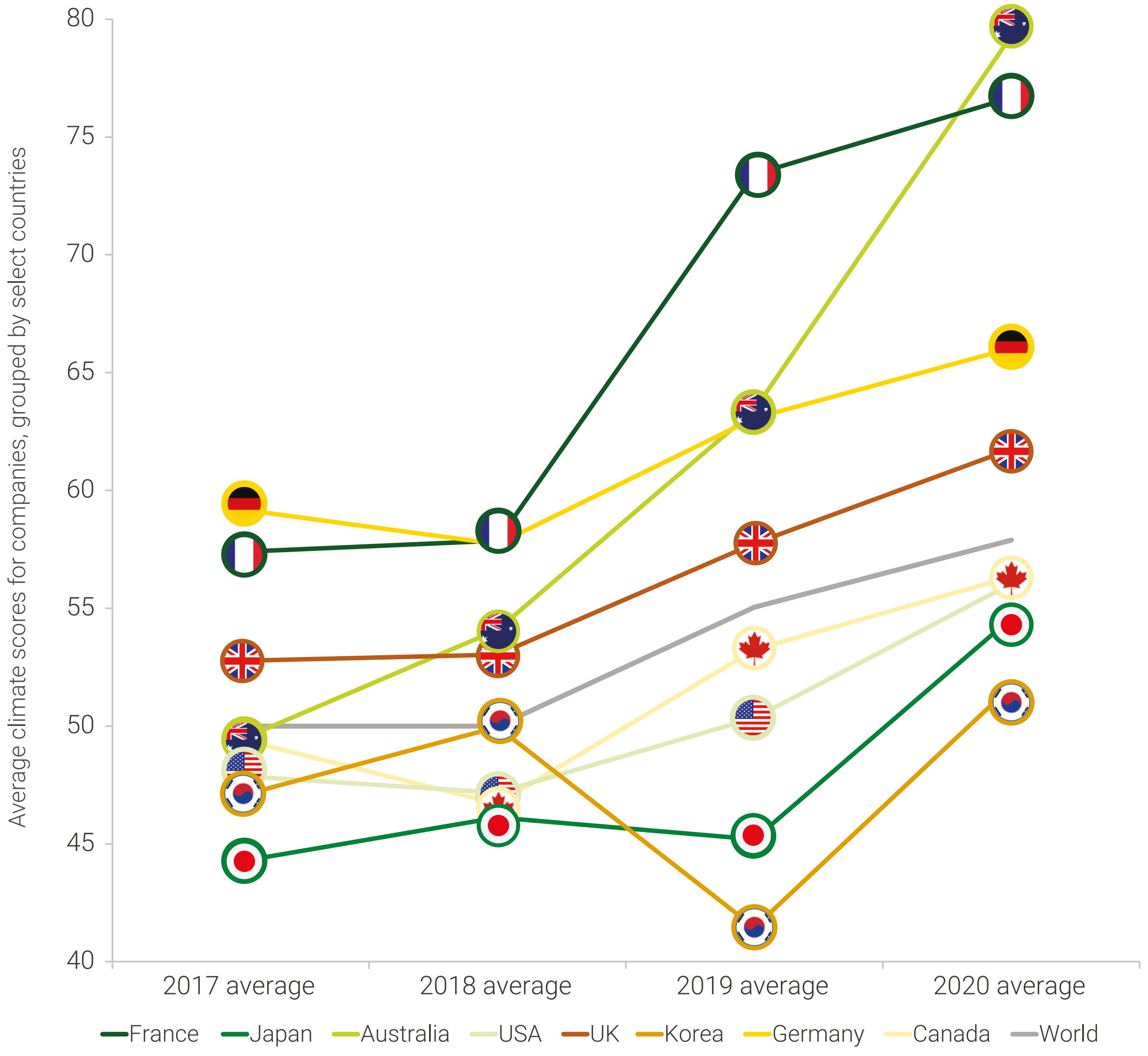
East Side Story

We have seen overall progress in the average scores of most countries, with some of the highest year-on-year improvements in Australia, Japan and South Korea. This echoes research that found some Asian countries have been adopting climate disclosure standards at a faster rate than European counterparts.[xvi]



Source: LGIM, as at September 2020

According to our metrics, the number of companies expressing public support for the Paris Agreement on climate has grown by 94% since 2017. And although US plans to withdraw from the agreement, announced in 2017 by President Donald Trump, were reflected in fewer explicit discussions of climate by North American companies from that year, this trend has now gone into reverse.

'Greenwashing' risk

We are encouraged to see companies adopt notable goals:

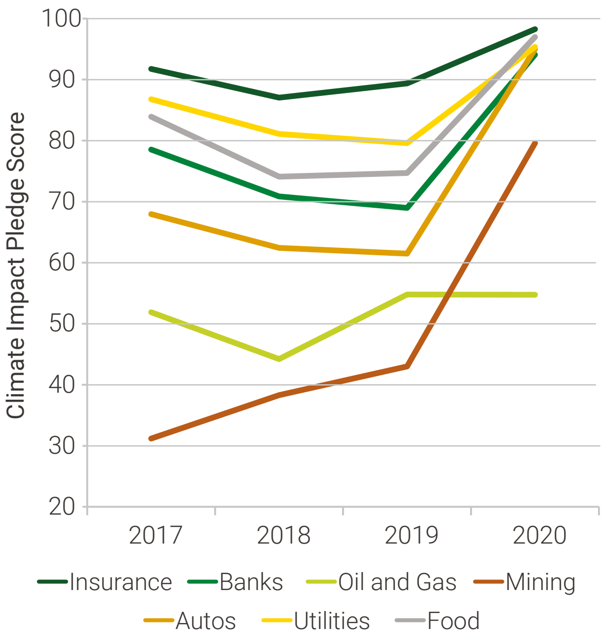
- Targets for procuring 100% clean power (18% of Climate Impact Pledge companies)
- Net zero/Science-Based Targets for their operations (13%)
- Emissions targets that include their products or supply chains[2] (16%)

However, we note that according to our metrics, progress on governance and accountability has been uneven. Without sufficient clarity as to board oversight and responsibility, companies may struggle to achieve the goals they have set.

Indeed, as companies claim climate credentials, they open themselves up to accusations of 'greenwashing'. We see this reflected in our scores for reputational risk, which use machine learning to track company mentions in various media – with the most pronounced increase in the mining sector, followed by automakers and banks.

One source of reputational risk comes from lobbying, when companies' messages to governments (privately, or through trade associations) are at odds with their official stance. Our lobbying metrics have highlighted concerns in the mining and food industry – which we have expressed through our voting and engagement.

Reputational risks on the rise



Source: Reprisk, as at at September 2020

That said, a number of oil majors have left lobby groups due to differences over climate, and our metrics show improvements in the auto industry, which appears to be heeding the lessons of the Dieselgate scandal.

We, too, have learned from our engagement with companies; having seen the progress made, we now turn towards the key changes in our scoring and engagement approach.

2. 'Scope 3' emissions

Strengthening our pledge

Under our new approach, in order to meet the challenge of net zero, we are expanding the number of companies and sectors covered by the pledge; shifting the way in which we engage; and updating our scoring methodology.

This means we will be systematically holding more companies accountable – through tangible voting and investment sanctions.

Updated ratings

We have updated the underlying methodology behind our climate ratings. Our initial list of about 100 indicators was, in certain cases, trying to assess qualitatively what can now be more precisely measured by access to more and better data.

We have thus streamlined the list to around 40 indicators, including:

- Climate governance
- Disclosure in line with the Task Force on Climate-related Financial Disclosures (TCFD)
- Company policies and participation in relevant sector initiatives and standards
- Climate lobbying
- Climate value-at-risk and temperature alignment (drawing on LGIM's climate modelling capabilities[3]) as well as green opportunities
- Historical and forward-looking carbon performance

Increased coverage and transparency

We will continue to sanction companies that fall short of our standards, through voting against them across our entire book and divesting from their securities within some of our funds.

But we will be holding many more companies systematically accountable: climate ratings for about 1,000 companies will be publicly available on our website, under a 'traffic light' system, alongside the methodology for their assessment. This represents a more than ten-fold increase in coverage under the pledge.

Therefore, companies and their stakeholders will be able to verify their progress in a transparent process. In addition, we will encourage companies to provide feedback to our data providers, thereby improving the accuracy of climate data for the entire market.

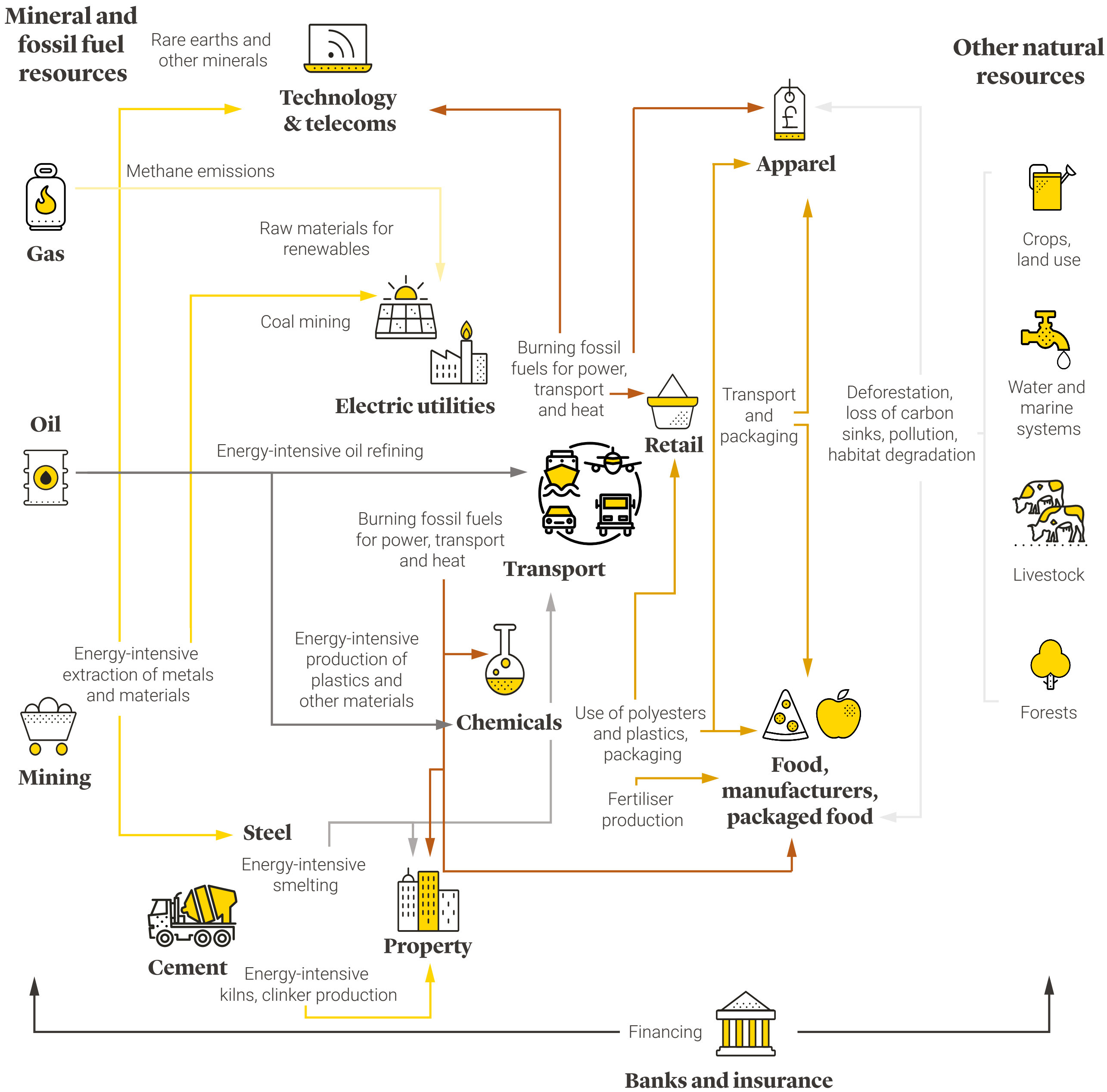
Meanwhile, in order to better tackle the interconnected economic system driving global emissions, we are adding to and augmenting the group of sectors we cover, which under the original pledge comprised utilities, mining, food, oil & gas, financials and automakers. The sectors now added are as follows:

- Cement
- Steel
- Chemicals
- Technology and telecoms (T&T)
- Apparel
- Property (real estate investment trusts or REITs)
- Transport (adding marine, air and heavy-duty transport alongside automakers)
- Food (adding food manufacturers to food retailers)

We are monitoring heavy-emitting sectors that make possible the production of basic materials, the transportation and housing of goods and people. But we are also covering those that have a high indirect impact through their supply chain (food, apparel); energy use (T&T); or finance.

3. See more: https://www.lgimblog.com/categories/esg-and-long-term-themes/why-the-climate-emergency-can-t-be-postponed/

We are targeting sectors that are key to reducing global emissions



Source: LGIM. Text on arrows shows major sources of emissions in sector.

Enhanced engagement

We have upgraded our engagement model to focus on net-zero impacts, recognising both that all companies need to change if we are to rise collectively to the challenge; but also that some companies have much further to go. That is why we have divided the engagement universe in two:

Broader engagement

A more rules-based and data-driven approach, where about **500 companies** with red 'traffic lights' (where we have a large holding) will automatically receive a letter highlighting their rating and any potential sanctions.

Deeper engagement

A more tailored, 'hands-on' approach, focused on about **50 companies**, which are pivotal to the transition. For these companies, we have developed a more in-depth assessment framework to understand their strategy, and we will engage in direct dialogue to help remove roadblocks and encourage progress.

As a result, we will devote more of our time to key companies, where the most effort is needed, while leveraging data to encourage 'easier' wins.

In keeping with our constructive approach to engagement, for both groups we have given **sector-specific guidance** as to transition pathways and key milestones; technologies that require development; and policies that need to be implemented.

Please see our Climate Impact Pledge website to access our guides.

Inaction is not an option

Even though COVID-19 is set to trigger the largest recorded fall in global annual emissions in history,[xvii] reaching net-zero emissions will require reductions of a similar magnitude every year for the next decade.[xviii]

Investors and policymakers are increasingly aware that in the face of climate catastrophe, inaction is not an option. Among others, Mark Carney, the former Bank of England governor, has warned that if companies and industries fail to adjust to this new world, "they will fail to exist".[xix]

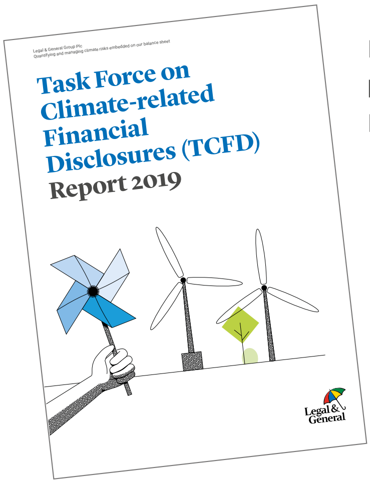
So we are laser-focused on meeting the challenge of net zero, by helping companies to succeed in this radical but necessary transition – by taking action to reduce (not just offset) their emissions – and calling on governments to create a baseline of ambitious policies upon which businesses can build sustainable strategies.

We will continue to play our part as a responsible investor, by supporting with our capital allocation those companies that are aligned to this direction of travel, and withdrawing financing from those that are not – and are most critical to the energy transition. And we are increasingly able to bring data and complex modelling to support our stance.

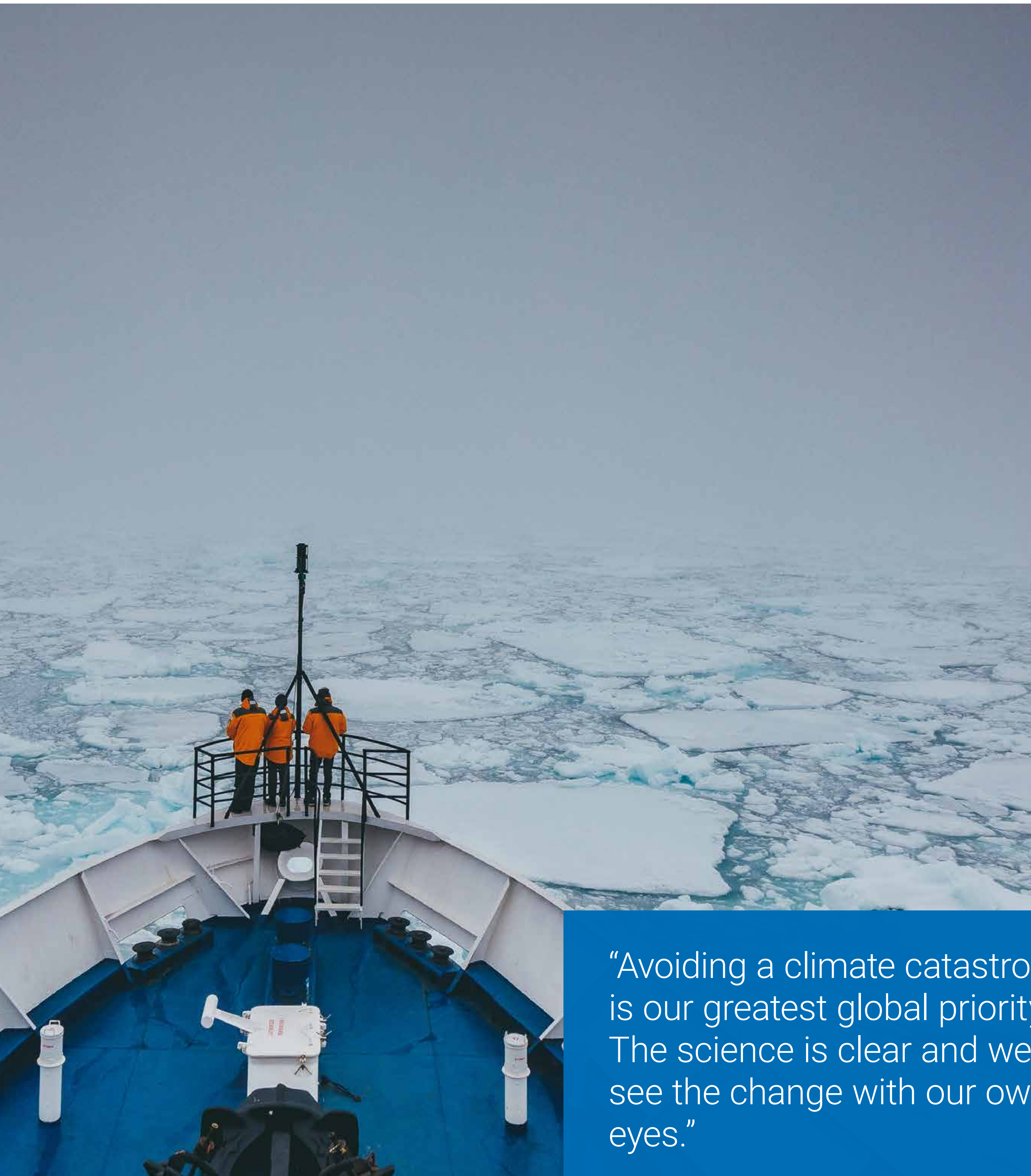
As part of a strategic partnership with Baringa Partners formed in 2018, we have developed a model to analyse the energy transition, and assess the associated risks across the capital structure. We also aim to offer our clients end-to-end climate solutions to measure and manage carbon exposure; identify and mitigate underlying climate risks; and seek temperature alignment.

Zeroing in on 2050

As we renew our Climate Impact Pledge, we will support efforts to achieve net-zero emissions by 2050 with energy and determination – through our engagements, voting, capital allocation and the way we partner with our clients. We are proud that our parent company, L&G Group, has set a strong example by pledging to align its business with the 1.5°C temperature goal of the Paris Agreement.



In the years since we launched the pledge, we have seen that investor pressure can help steer companies towards sustainability. By making our climate engagement programme even more ambitious, we believe we can truly help transform the world. The goal of net zero is possible – and we are committed to achieving it.



"Avoiding a climate catastrophe is our greatest global priority... The science is clear and we can see the change with our own eyes."

Nigel Wilson
CEO of Legal & General

[i] The Future World fund range.

[ii] "Legal and General exhibited best practice […] through its Climate Impact Pledge," according to InfluenceMap https://influencemap.org/report/FinanceMap-Launch-Report-f80b653f6a631cec947a07e44ae4a4a7. ShareAction ranked LGIM as number 1 among the world's asset managers for our approach to climate change, in its review of the world's 75 largest asset managers' approach to responsible investment: https://shareaction.org/research-resources/point-of-no-returns/#ranking-heatmap (sort descending by 'Climate change' column)

[iii] https://eciu.net/news-and-events/press-releases/2020/almost-half-of-global-gdp-under-actual-or-intended-net-zero-emissions-targets

[iv] The IPCC (2018) finds that "In model pathways with no or limited overshoot of 1.5°C, global net anthropogenic CO2 emissions decline by about 45% from 2010 levels by 2030 […] reaching net zero around 2050" https://www.ipcc.ch/sr15/

The timing of net zero emissions will depend on modelling assumptions - the scale up of carbon capture technologies, and the potential for reductions in non-CO2 greenhouse gases globally. Recognising the urgency, we support policy efforts to peak emissions as early as possible, but we have explored 1.5°C-aligned pathways for the global energy system which see net zero CO2 emissions post-2050.

[v] https://www.reuters.com/article/us-hongkong-coal-investments/hong-kongs-clp-holdings-to-end-investing-in-new-coal-fired-power-idUSKBN1YL0NO

[vi] https://www.iea.org/articles/clean-energy-progress-after-the-covid-19-crisis-will-need-reliable-supplies-of-critical-minerals

[vii] https://www.bhp.com/-/media/documents/investors/annual-reports/2020/200910_bhpclimatechangereport2020.pdf

[viii] Some exclude emissions from sold oil and gas which companies did not extract; others include all emissions in the value chain. There is relative consistency regarding commitments to net-zero operational emissions.

[ix] https://www.bp.com/en/global/corporate/news-and-insights/speeches/2020-annual-general-meeting-group-chief-executive.html

[x] https://uk.reuters.com/article/us-climatechange-cba/cba-joins-global-push-to-limit-emissions-by-cutting-coal-exposure-by-2030-idUKKCN1UX0NW

[xi] https://www.lloydsbankinggroup.com/media/press-releases/2020-press-releases/lloyds-banking-group/lloyds-banking-group-pledges-to-cut-carbon-by-more-than-50-in-the-next-decade-to-help-finance-a-green-future/

[xii] https://uk.reuters.com/article/us-climatechange-cba/cba-joins-global-push-to-limit-emissions-by-cutting-coal-exposure-by-2030-idUKKCN1UX0NW

[xiii] https://www.nestle.com/media/news/nestle-climate-related-financial-disclosures

[xiv] https://www.generalmills.com/en/Responsibility/Sustainability/Regenerative-agriculture

[xv] https://www.reuters.com/article/us-brazil-environment-divestment-exclusi/exclusive-european-investors-threaten-brazil-divestment-over-deforestation-idUSKBN23Q1MU?_sm_byp=iVVskqJ6tPSHJRnp;
https://www.ceres.org/resources/webinars/deforestation-2020-investor-perspective?_sm_byp=iVVskqJ6tPSHJRnp;
https://www.bloomberg.com/news/articles/2019-12-13/after-taking-on-coal-and-oil-climate-investors-target-meat-next

[xvi] https://www.ft.com/content/727862e4-d760-11e9-8f9b-77216ebe1f17

[xvii] https://www.iea.org/reports/global-energy-review-2020/global-energy-and-co2-emissions-in-2020

[xviii] https://www.carbonbrief.org/iea-coronavirus-impact-on-co2-emissions-six-times-larger-than-financial-crisis?_sm_byp=iVVksFq0srsSHZTq

[xix] https://www.bankofengland.co.uk/news/2019/april/open-letter-on-climate-related-financial-risks

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