Climate Impact Pledge: Tackling the climate emergency

The second annual results of our Climate Impact Pledge showcase the corporate leaders and laggards on climate action; we are encouraged by improvements across sectors but will continue to press companies to meet this era-defining challenge.

Meryam Omi

Head of Sustainability and Responsible Investment Strategy

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

Public concern about the danger posed by climate change has reached unprecedented levels. More than a million students have walked out of classes worldwide, while protests have been held across dozens of countries, to call for swift action from governments[1].

This is no fad. The world is truly in the midst of a *climate emergency*, which could have drastic consequences for markets, companies and, therefore, our clients' assets.

With the UN warning that there is little over a decade in which global emissions must start to decline significantly, the window for action is closing fast[2]. That is why we have ratcheted up the pressure on companies globally, demanding to know how they will hasten the transition to a low-carbon economy.

We have done so as part of our **Climate Impact Pledge**, under which we assess and score over 80 of the world's largest companies, engaging with them to improve their strategies to address this era-defining challenge. And to underscore our seriousness, we divest within our **Future World funds** from those companies that fail to demonstrate sufficient action and vote against the re-election of their board chairs across all funds where we hold voting rights.

In our second annual review of the process, we report encouraging signs of progress, even though a vast amount of work remains to be done.

Sectors stepping up

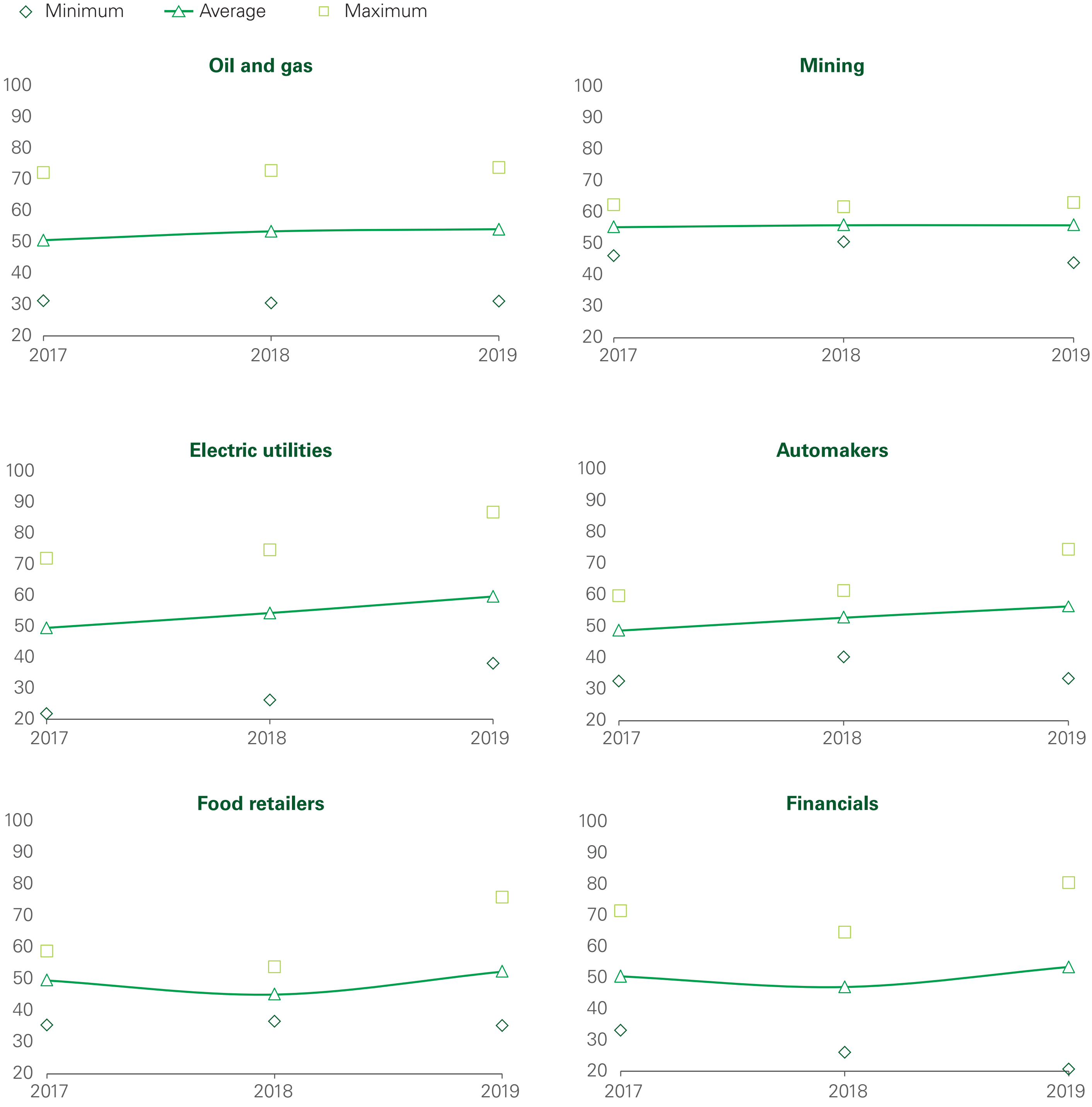
Our assessment takes into account a wide range of indicators – from governance structures to business strategy, targets and lobbying activities – in order to gain a well-rounded view of companies' exposure to climate risks and opportunities[3].

We have chosen companies that, due to their scale and public profile, have the potential to influence entire industries and markets. The stocks covered account for about half of the market value of six key sectors: oil and gas; mining; electric utilities; automakers; food retail; and financials.

Since last year's results, there has been an increase in the average scores across each of these sectors. In addition, previously high-scoring companies scored even higher, while others are clearly working to catch up.

Legal & General
INVESTMENT MANAGEMENT

Average Climate Impact Pledge scores (0-100) 2017-2019

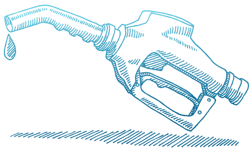


Source: LGIM calculations

We are also pleased to report that all eight companies we cited last year as candidates for divestment have engaged with us on our concerns, with some making sufficient progress to warrant reinvestment.

Other companies that scored low last year have significantly improved, as a result of our efforts and those of our peers. But we are also adding five new companies as candidates for divestment, which are detailed below, largely due to a lack of sufficient strategic awareness of climate change.

Oil and gas:
a transatlantic ambition gap



The oil and gas sector is under significant investor and public pressure to outline how it is taking into account the impact of climate change into its business plans.

We want to see stress-tests against a wide range of scenarios, recognising potential disruptions from renewable energy, electric vehicles, carbon taxes and constraints on plastic usage. The results of such tests should be made public, in our view, so they can be judged against targets set under the Paris Agreement to limit global temperature increases to 'well below' two degrees Celsius above pre-industrial levels.

We grant the highest scores for transparency on carbon emissions from operations and products, as well as for stringent targets. We also emphasise the need for companies to align lobbying activities to their official stances on climate change. Overall, the sector has improved on our metrics of disclosure and transparency, partly reflecting industry experience in modelling complex oil demand pathways, compared to sectors like food retail or financials, where such concepts are new.

- **Equinor** and **BP** have agreed to provide more details around how new, material investments in oil and gas exploration are consistent with the Paris Agreement. BP's decision followed a shareholder resolution put forward by LGIM and other investors.

- In an industry first, **Royal Dutch Shell** has adopted comprehensive emission targets, linked to executive pay, which include not just emissions from Shell's operations, but also from the burning of its oil and gas products. The company has also left a US trade lobbying group due to differences over climate policy.

We will continue to put pressure on oil and gas companies to alter 'business-as-usual' strategies, and close a transatlantic gap in ambition as our top-ranking producers are currently all European. Achieving a low-carbon economy requires a shift in mindset for the sector, with incentive structures no longer focused on continued growth in fossil fuel reserves. However, it does not necessarily mean such companies should reinvent themselves as renewable energy companies. We would welcome a strategy of disciplined capital allocation that is suited to the ex-growth era.

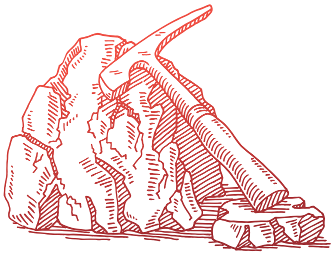
Exclusion/reinvestment candidates

- Reinstated after improvements: **Occidental Petroleum** has shown a step-change in engagement, backed by tangible actions. Recognising the importance of the issue to investors, the company now measures and discloses its total carbon emissions (including from the use of products), and is set to announce targets for the carbon and methane emissions from its operations and energy use (Scope 1 and 2) by the end of 2019. The company has committed to regularly assess its portfolio against climate risks, and its reporting is informed by the Task Force on Climate-related Financial Disclosures (TCFD) which LGIM supports. We look forward to further progress from the company over the coming year.

- New exclusion candidate: **ExxonMobil Corporation** has not met our key minimum requirements, including on emissions reporting and targets. The company stated that it will not disclose its total carbon emissions (to include scope 3, which many other oil companies are starting to disclose) and will not commit to setting company-wide targets for the carbon emissions under its more direct control (Scope 1 and 2)[4]. We appreciate the opportunity we have had to engage with Exxon and recognise the consideration of the TCFD in the company's reporting on climate. Yet we believe the lack of action in a number of areas, not least in what we see as basic, fundamental disclosures, leaves the company trailing its peers.

- Continuing exclusion candidate: We note improved responsiveness and disclosure from Russia's **Rosneft Oil,** but believe there are still important areas of improvement for a company of this scale.

Catherine Ogden
Manager, Sustainability and Responsible Investment
Leads the Pledge engagements with the oil and gas sector



Mining:
digging for the future

The mining industry wants to reposition itself as the indispensable supplier for a low-carbon future. Company narratives are rapidly evolving around the metals needed to satiate the world's appetite for electric vehicles and batteries, such as copper, lithium and cobalt; by contrast, the supposed benefits of coal-burning receive fewer mentions.

We expect the industry to follow through by phasing out thermal coal, but recognise this will require government support, not least for the displaced workers[5].

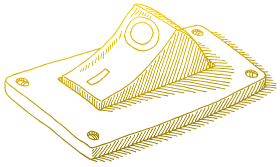
As all companies covered within this sector remain committed to positive engagements, and we expect further shifts in corporate strategies, we are not divesting from any of them. However, we would like to cite the world's two largest miners for commendation:

- **Rio Tinto** in 2018 became the first major miner to own no coal assets. The company has also signalled it will exit trade bodies that make public statements which are inconsistent with the goals of the Paris Agreement or seek to undermine the 'valuable contribution' of renewable energy. The move followed pressure by shareholders, including LGIM, for better lobbying disclosure.

- **BHP Billiton** has indicated that coal is to be 'phased out, possibly sooner than expected', with the company having 'no appetite for growth in energy coal regardless of asset attractiveness'.

Beyond the issue of coal, we expect companies to provide details around water scarcity risks, as well as full disclosure and targets for emissions. Following recent disasters in Brazil, which led to catastrophic loss of life, we have also joined an investor coalition to press for more clarity from miners around the safety of tailings dams.

Iancu Daramus
Sustainability Analyst
Leads the Pledge engagements with the mining sector



Electric utilities:
clean power struggles

Utilities were among the first companies to witness the investment implications of climate change, given the need to build grids resilient to extreme weather while withstanding disruption from renewable energy, digitalisation and decentralisation.

Following unprecedented wildfires, Californian utility **PG&E Corp**. – one of the companies covered by the Pledge – has regrettably filed for bankruptcy. Described by the Wall Street Journal as 'the first climate-change bankruptcy, probably not the last,' PG&E offers a stark warning of the challenges ahead.

In light of declining renewable energy prices, as well as a growing policy push for cleantech, we expect utilities to outline plans to decarbonise their generation mix, including a detailed breakdown of capital expenditure and research and development on cleantech. We also expect to see clear targets for emissions of carbon dioxide, methane and other pollutants.

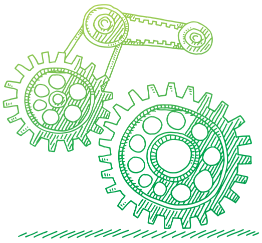
A growing number of companies are realising that their regulated status does not offer indefinite protection, as market shifts make it less likely that politicians and the public will continue subsidising coal. In the US, **Xcel Energy** is the first major utility to announce plans to go 100% carbon-free, pledging to close its last coal plants a decade ahead of schedule.

Exclusion/reinvestment candidates

- Reinstated after improvements: **Dominion Energy** has shown a very positive response to our engagement. Since 2018, the company has published its first climate change report, improved carbon disclosure via the Carbon Disclosure Project and established a sustainability committee with board oversight. It has also publicly supported the Paris Agreement and adopted voluntary targets to halve methane emissions in the next decade, while its CEO has joined a coalition of fellow business leaders to push for federal climate action.

- New exclusion candidate: **Korean Electric Power Corporation** (KEPCO) is the lowest-scoring company in its sector, particularly on measures of strategy and board composition. The company has also failed to engage with us on our concerns.

Clare Payn
Head of Corporate Governance, North America
Leads the Pledge engagements with the utilities sector



Automakers:
the road to net zero emissions

The auto sector is facing significant upheaval, as electric vehicles are likely to be soon cheaper as well as cleaner and, for quite a few drivers, cooler, than their gas-powered counterparts.

We expect companies to outline robust plans to reach net zero emissions, with due consideration to potential risks, including fines. **Renault** provides a good model for risk disclosures, in our analysis. Elsewhere, we commend **Daimler** for its commitment to making its new Mercedes-Benz passenger car fleet carbon-neutral by 2039, a target that covers key elements of manufacture, use and end-of-life for cars.

We also note improved engagements with **Tesla Motors**. Despite its sole focus on electric vehicles, the company last year failed to score high on transparency and governance metrics. Tesla has since published its first impact report and also separated the roles of CEO and chair, which we consider best practice.

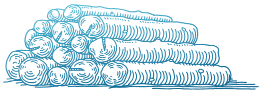
Still, we are still concerned to see automakers support the Paris Agreement while remaining members of trade groups that, through their lobbying, seek to downplay the health and environmental impact of emissions. We have therefore supported resolutions calling for transparency on political lobbying at **Ford** and **GM**.

Exclusion/reinvestment candidates

- Continuing exclusion candidate: **Subaru** has shown a willingness to engage. Since last year, we have interacted with the company repeatedly, with the board formally committing to the Paris accord, but there are still areas for improvement.

Marion Plouhinec
Corporate Governance Analyst
Leads the Pledge engagements with the automakers sector

Food retailers:



appetite for innovation

Even though almost a quarter of the world's emissions derive from agriculture, land use and deforestation, the food retail sector has received comparably little public attention in relation to the role it plays in solving climate issues[6].

With only a handful of 'forest risk commodities' – palm oil, soy, cattle, timber and rubber – being the leading cause of deforestation worldwide, we want to understand how the sector is mitigating and managing the threats they pose.

We want companies to demonstrate high standards not just in their operations, but in their entire supply chain – down to disclosure and targets for all associated emissions (including Scope 3) as well a strategy to reduce food and non-food waste. We commend **General Mills** and **Danone** for adopting comprehensive emission targets.

While many companies are investing in agricultural innovation, we remain concerned that the sector overall does not show strategic awareness of climate risks, which is why food retailers make up a significant proportion of our divestment candidates.

Exclusion/reinvestment candidates

- New exclusion candidate: US-based **Hormel Foods** received the lowest scores of its sector, particularly on strategy and governance. It has displayed insufficient transparency around deforestation risk and its supply chain, lacks robust and ambitious targets for emissions and forest risk commodities. In addition, Hormel lacks independent verification of its emissions, timely engagement, and has poor supply chain traceability.

- New exclusion candidate: **Kroger**, the US retailer, scored poorly in the same areas. The company is insufficiently transparent around emissions, deforestation risk and supply chain. It has also displayed a lack of engagement.

- Continuing exclusion candidate: US food distributor **Sysco** has made some improvements in verifying operational emissions. But we would still like to see full reporting of emissions (Scope 3), and expect the company to set more ambitious targets. We remain concerned with the lack of a deforestation or environmental policy; Sysco also needs to discuss climate risks and opportunities in public reporting.

- Continuing exclusion candidate: **Loblaw**, the Canadian grocery chain, has made improvements in its governance, appointing a Lead Independent Director to ensure a counter-balancing voice to the Chair/CEO role. But we believe there are still a number of necessary steps for companies of such scale, and look forward to continuing engagement and support for substantive changes in the future.

Angeli Benham
Corporate Governance Manager
Leads the Pledge engagements with the food sector

Financials:
preparing for the climate test

The financial sector is directly responsible for a small proportion of the world's emissions. But its lending, corporate facilitation, insurance and asset management activities are key to speeding up or delaying the low-carbon economy.

We expect companies to consider climate change in their business strategies, with particular regard to the risks it poses. As a result, we believe climate change 'stress-tests' are an essential component for prudent risk management; a growing number of regulators agree and are pushing forward new measures in this area[7]. We note several banks are piloting climate scenario analysis, including **Westpac**, **Citigroup**, **Commonwealth Bank of Australia**, **BNP Paribas**.

BNP Paribas, HSBC and Commonwealth Bank of Australia disclose a breakdown of their exposure to emissions-intensive clients, with a notable reduction in coal exposure for the latter. A number of institutions, including **HSBC**, **Citi**, **US Bancorp** and **Lloyds Bank**, are also introducing restrictions on their financing of the most-polluting fossil fuels such as coal. Overall, though, we approach the climate policies adopted by the sector with caution, given the existence of worrisome loopholes.

Among insurers, European companies rank highest. **AXA** and **Allianz** are conducting climate scenario analysis on assets and have introduced stringent restrictions on coal investments and insurance. Allianz is exploring means to set a science-based target for its asset portfolio[8] to drive climate action, while AXA has a target to grow 'green' investments to €12 billion by 2020.

Chubb stands out as an American insurer that discusses climate risks and opportunities quite extensively, especially the impact of changing weather on its catastrophe losses, and the green/renewable business opportunities it is pursuing.

Looking ahead, we would like more companies to improve reporting on green revenues, so investors can assess the extent to which they represent a meaningful departure from a business-as-usual trajectory. Similarly, we would benefit from more clarity around the extent to which the outputs of scenario analysis are used to inform company strategy. Lastly, we remain concerned that most financial companies still do not disclose, let alone have targets for, their total emissions.

Exclusion/reinvestment candidates

- New exclusion candidate: **Metlife** has not responded to our attempts to engage and has scored poorly across most categories of assessment, including strategy and governance. The US insurer lacks robust climate governance, with oversight relegated just to the 'corporate social responsibility' committee; has poor risk disclosures; and offers limited visibility over climate-related opportunities, despite having a property and casualty insurance division.

- Continuing exclusion candidate: **China Construction Bank** has engaged with us productively over the past year and improved areas of its reporting, particularly around green opportunities. We note a commitment to report in line with the TCFD, but remain concerned that requests for other basic disclosures remain unmet. These include changes in absolute, not relative exposure to high-carbon sectors and more details on sector lending policies.

- Continuing exclusion candidate: **Japan Post Holdings** has also shown increased responsiveness to our engagements, but its public reporting is yet to reflect substantial changes on climate change risks and opportunities, as well as the full disclosure of emissions. In our view, this still falls short of the high standard expected for a financial services provider of it size in Japan.

Yasmine Svan
Sustainability Analyst

James Malone
Corporate Governance ESG Analyst

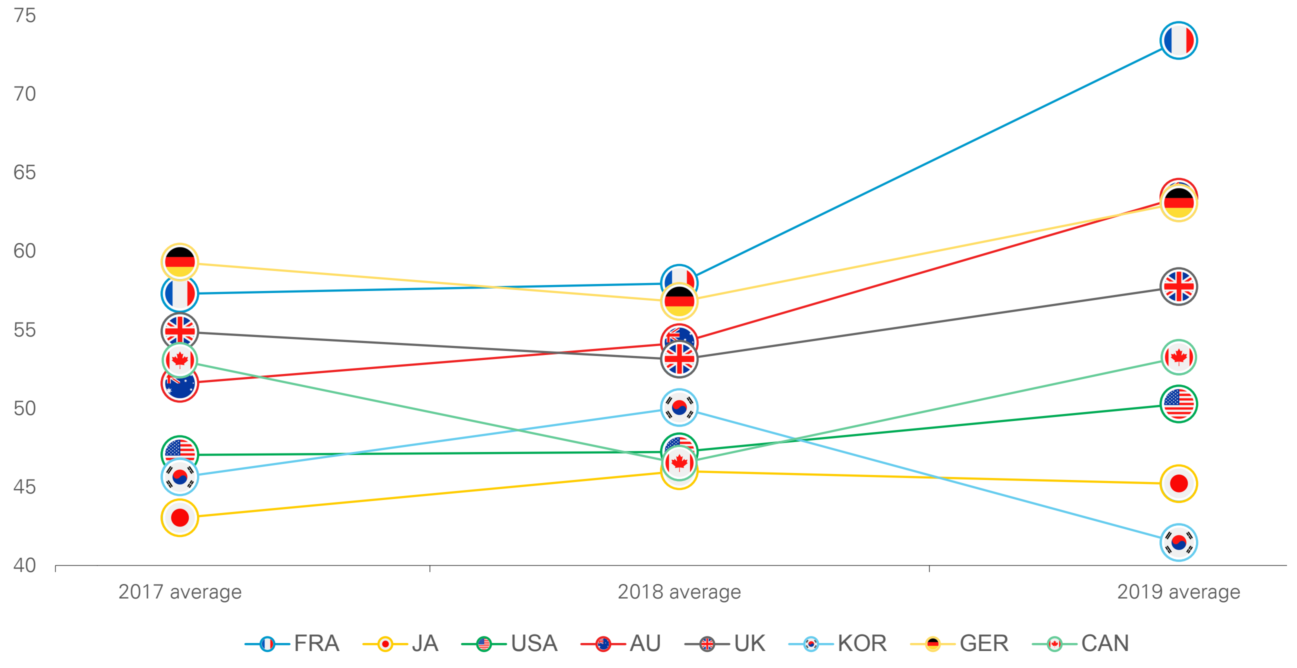
Yasmine and James lead the Pledge engagements with the financials sector

We'll always have Paris

International ambition has not subsided, with every country in the world now having passed legislation in support of the Paris Agreement and a cleaner energy system[9].

In terms of regions, there has been an increase in average company scores across all those we analyse – North America, UK, Europe and Asia-Pacific. The same is true at a country level, with the exception of Japan and Korea, where there is regrettably a downward trend.

Average country Climate Impact Pledge scores (0-100) 2017-2019



Source: LGIM calculations

A question still remains around the US, where President Donald Trump's stated aim of withdrawing from the accord contrasts with the positive state- and city-level support embodied by the #WeAreStillIn movement.

This division is reflected in our scores, as average US company scores are on the rise, even though there was a disproportionate number of companies from the world's biggest economy among the lowest-scoring companies, too.

However, the continued growth in global emissions since 2018 means decisive action and implementation remains critical.

Sacha Sadan
Director of Corporate Governance

Averting the climate catastrophe

In our latest Corporate Governance annual report, for 2019, we spoke about the risks of a climate catastrophe facing the world – and the millions of people whose retirement savings and investments we manage.

Indeed, so urgent is the need for action, we developed the Climate Impact Pledge to create positive change where it can have the greatest impact. But as genuinely 'active owners', who seek to raise standards across companies and entire markets, we are also stepping up the pressure on all companies to meet the climate challenge, regardless of sector.

In our interactions with peers, regulators and policy makers, we are advocating strongly in support of the aim of the Paris Agreement. And through our Future World funds, we are providing investors with the opportunity to express a conviction on environmental, social and governance themes such as climate change, across a broad range of asset classes.

We are encouraged that our pragmatic approach of engagement with consequences is starting to yield tangible results. But we recognise that because climate change is a truly global problem, it requires a global solution – with everyone playing a part in securing a prosperous, healthy and vibrant economy for the 21st century and beyond.

Notes

1. https://www.theguardian.com/environment/2019/mar/19/school-climate-strikes-more-than-1-million-took-part-say-campaigners-greta-thunberg

2. https://www.ipcc.ch/sr15

3. For more details see: http://www.lgim.com/uk/en/insights/our-thinking/market-insights/lgims-climate-impact-pledge-the-results-so-far.html

4. See more details around LGIM's modelling work on the energy transition: https://www.legalandgeneralgroup.com/media-centre/press-releases/lgim-research-into-the-energy-transition-reveals-trillion-dollar-investment-opportunity/

5.See LGIM and other investors' joint statement to policymakers: https://www.iigcc.org/resource/global-investor-statement-to-governments-on-climate-change/

6. Source: IPCC

7. See the work done by a key coalition of central banks and supervisors: https://www.banque-france.fr/en/communique-de-presse/ngfs-calls-action-central-banks-supervisors-and-all-relevant-stakeholders-greening-financial-system

8. Our parent company, Legal & General, is also looking at the adoption of Science-Based Targets and has committed to phase out its exposure to thermal coal. More information is available here: https://www.legalandgeneralgroup.com/csr/our-approach/climate-change-the-environment/tcfd-reports/

9. Source: http://www.lse.ac.uk/GranthamInstitute/news/new-study-reveals-all-countries-that-have-signed-or-ratified-the-paris-agreement-have-at-least-one-national-law-or-policy-on-climate-change/

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