Net zero engagement

Addressing climate change is one of the most complex challenges we have ever faced[1]. As investors, we all have a role to play achieving net zero, but the path is not simple or straightforward. This year, as part of the Net Zero Asset Managers Initiative (NZAMI): initial target disclosure report, Royal London Asset Management (RLAM) has initially committed 71%[2] of our total assets under management to be managed in line with net zero. To this end, we have established and are applying a net zero engagement framework. As an initial step, by 2030 we are targeting a 50% reduction of tonnes of carbon dioxide emitted per million dollars invested (tCO_2e/$mn) from a 2020 baseline.

Our objective is to evaluate and/or influence through engagement, companies representing 70% of RLAM's corporate financed emissions — this allows us to prioritise and focus our engagement on companies with the largest emissions and where we have an opportunity / responsibility to influence change. We will be seeking companies to adopt emissions reductions targets and climate transition plans linked to science-based and sector-specific methodologies, such as those set by the Science Based Targets initiative (SBTi) or other similar initiatives.

Net zero engagement is about using engagement as a tool to drive us towards net zero. By focussing on engagement, we seek to influence companies' behaviour and drive the transition to net zero, providing better low-carbon alternatives and shifting demand - we are making the choice to tackle climate change rather than avoid it (see our latest net zero webinar for the latest update from our team).

RLAM engagement process & activity, 2021

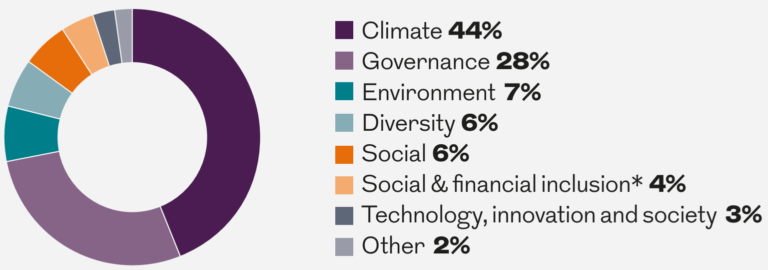
We continuously improve our engagement framework to focus more time and effort on examining the credibility and progress of companies' climate transition strategies (see our Stewardship and responsible investment 2022 report for more information).

Companies must set targets which aim to limit global warming to no more than 1.5°C and act now to reduce real-world emissions.

Our engagement on climate spans multiple sectors. To prioritise companies, we used backward and forward-looking information assessing historic carbon emissions. We also assess the future 'warming' trajectory of a company, and their strategies to adjust their business models for reducing emissions and achieving net zero. In 2021, we spoke to 70 companies in depth on climate mitigation and adaptation, and contacted 19 companies specifically to ask them to implement a net zero engagement framework (adjacent).

Our engagement team, in collaboration with our investment teams, is agile across industries and economic activities, and in 2021 we engaged on net zero across a range of sectors, including energy utilities, oil & gas, semiconductors, mining, banks, chemicals, and food & packaging. However, not all sectors are equal when it comes to climate, and when it comes to

RLAM engagements by theme, 2021



*Includes engagement in support for a 'Just Transition'. Source: RLAM

[1] Our climate targets are based on the expectation that governments and policy-makers will deliver on commitments to achieve the 1.5°C temperature goal of the Paris Agreement, and that the actions we take do not contravene RLAM's fiduciary duties.

[2] This commitment represents pooled funds owned/controlled by RLAM or segregated mandates with clear net zero signal from clients.

engagement it is those with higher direct and indirect emissions which offer greater potential for real world decarbonisation. The energy utilities and banking sectors are a major focus for RLAM as a result, and are a major focus of our engagement efforts for 2022, alongside the oil & gas sector.

Net zero engagement framework

There are three key things we want companies to do:

1. **Set emission reduction targets aligned with the 1.5°C ambition**: we expect companies to reach net zero emissions by 2050 or earlier on all scopes of emissions, and to offset only residual emissions following net zero-aligned offsetting principles.
2. **Bring others to net zero**: we expect companies to commit to scaling-up technology and solutions, lobbying for policy that accelerates the transition to net zero, and engaging fully with the entire business value chain – including communities and workers – to ensure a Just Transition. We also expect them to invest in adaptation measures to ensure resilience against the physical impacts of climate change.
3. **Demonstrate action now**: we expect companies to set ambitious short-term targets, and for boardroom, management and employee incentives to be aligned to achieving net zero targets. Companies should develop an action plan with specific operational implications and any necessary business model transformation required to become a net zero business. Companies should also align their capital and operational expenditures, accounting practices and infrastructure plans with the Paris goals, disclose transparently and consult on their plans with stakeholders.

Engagement with the utilities sector

With current technologies it is not possible to decarbonise large sections of the economy without the decarbonisation of the electricity sector first. So, while the sector is itself the largest emitter of carbon, it also has a key role to play in enabling other sectors to transition to net zero. Decarbonising electricity not only reduces the sector's own carbon intensity, but it will also enable other sectors to transition to sustainable business processes. This means utility companies are pivotal in reaching the Paris Agreement, and should be achieving net zero much sooner than the broader global target of 2050 – by 2040 globally, and 2035 in advanced economies.

So how should we engage with utilities companies? Well, in October 2021, we contributed to the Climate Action 100+ (CA100+) initiative's report: *Net zero in the power sector: what it looks like and how investors can accelerate and track progress*. Co-authored by RLAM, the report provides detailed guidance for investors on how to engage with the sector, and provides the basis for engagement for more than 615 investor signatories to CA100+ who manage $65 trillion in assets globally – a significant collective force for engagement.

The report provides the following specifics for investors engagement with power companies:

- Set a net zero target of 2040 for electricity generation globally, and 2035 in advanced economies. More than 50% of decarbonisation should be achieved by 2030.
- Detail a clear decarbonisation strategy that minimises reliance on carbon capture, utilisation and storage (CCUS), avoiding carbon offsets for electricity generation emissions, and setting a date for phasing out unabated coal generation.
- Align capital expenditure with 1.5°C pathways, including an immediate halt to investments in new coal generation. New natural gas generation should be net zero by 2040 globally, and by 2035 in advanced economies.
- Set a net zero target for all sold or distributed energy, with a focus on removing the use of natural gas for heating.
- Commit to a just transition, setting out in a board-level report how the wider societal impact of the net zero transition will be managed, and who will be responsible for implementation.

Engaging for a Just Transition

The concept of the Just Transition involves the inclusion of social issues considerations when moving to a low carbon economy. Rapid climate action that limits global warming to below 1.5°C prevents the worst human and economic costs of climate change, particularly in the long run; a Just Transition ensures that this climate action also supports an inclusive economy and avoids exacerbating existing injustices or creating new ones, particularly in the short run. Just Transition is a key element of RLAM's engagement – find out more via our 'Just Transition engagement report 2021'.

Net Zero and the banking sector

In 2021, we prioritised engagement with the banking sector, specifically banks with high Scope 3 (estimated) emissions.

Up until recently, we found banks have not been very focused on the emissions profile of their lending books, and many of the banks in our portfolios had high estimated Scope 3 emissions as a result of lending and financing activity. This changed in the run up to COP26 in 2021, when banks started to think more seriously about the impacts of their lending on carbon emissions, and making new commitments to address this part of their business activity.

We adapted our 'net zero engagement framework' for the banking sector, to make it more targeted. For banks some of our asks include:

- Reach net zero financed emissions at the earliest feasible timeframe, with 2050 as the backstop date
- Include all financing activities across different asset classes and sectors within their plans
- Avoid using offsetting for financed emissions
- Commit to scaling-up finance for solutions required to achieve net zero; and

- Engage with clients to implement net zero commitments, and over time, phase out finance for clients that are not able or willing to transition
- Consider halting financing for new fossil fuel projects

During the second half of 2021, we had constructive conversations with Nationwide, HSBC, The Co-operative Bank, NatWest and Virgin Money UK. Each embraced our recommendation to focus some of their climate work on Just Transition alignment, and to progress with the decarbonisation of their lending. We discussed the data in detail, reporting and target-setting challenges for financed emissions, and the challenges faced by different banks. In 2022, we have engaged with banks further through speaking at their AGMs to build further awareness of Just and net zero transition at their Boards. You can read about our net zero engagement in practise via our case study with HSBC.

Engagement – a strategic tool for reaching net zero

Although it may be far quicker and easier to divest from carbon intensive companies and sectors, divesting heightens the risk that assets will fall under the stewardship of less responsible owners – divestment strategies can therefore have very little real-world impact on emissions when there is still demand for fossil fuels. RLAM choses to tackle climate change rather than avoid it. We believe, through cooperation and accountability, it is still possible to prevent the worst effects of global warming.

For more information, please see our Stewardship and responsible investment 2022 report; furthermore, our second annual Task-force for Climate Related Financial Disclosures (TCFD) Report will be published this year.

Contact us

For more information about our range of products and services, please contact us.

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