

Climate change engagement: **a framework for the future**



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“Investors have a critical role in tackling climate change and achieving the aims of the Paris climate agreement.”

Introducing our engagement framework

BMO Global Asset Management has engaged with companies for over a decade with the aim of preventing the unmanageable effects of climate change. Since the Paris climate agreement, we have supported the ambition of limiting global warming to well below 2 degrees Celsius compared to the pre-industrial emissions baseline, and pursuing efforts to limit the temperature increase even further to 1.5 degrees Celsius.

Here we set out our climate change engagement framework, and how we translate the ambition of the Paris Agreement into expectations of companies. This engagement forms a key part of our overall response to climate change, which also includes integration into investment analysis, public policy activities and providing specialist investment products.



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The value of investments and any income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

Aiming for alignment

Achieving the aims of the Paris climate agreement will mean making fundamental changes to the global economy. Investors and companies both need to play their part.

The basis of our climate change engagement framework

Investors have a critical role in tackling climate change and achieving the aims of the Paris climate agreement. Climate action is also essential to pursuing the Sustainable Development Goals (SDGs)¹. As well as SDG 13 – Climate Action, unabated climate change presents challenges to almost every other one of the Goals through its impacts on food, energy, living standards and health. We also recognize that there is a social angle to the energy transition, as local communities and existing workforces adapt to the changes ahead.

Achieving the Paris goals is essential, but not easy. Greenhouse gas emissions will have to be net zero by 2070 to limit increased global temperatures to 2 degrees Celsius, or by 2050 to keep the increase to 1.5 degrees, with similar reductions required in other greenhouse gases².

This will require a complete transformation of the way the world produces and consumes energy, as well as radical measures to cut emissions from transport, land use and agriculture, also key sources of emissions.

Structural change of this scale presents serious financial risks to some sectors and companies, as well as opportunities for others. As such, climate change not only represents a moral duty for investors as stewards and allocators of capital, but also an issue that has implications for the way we understand and manage investment risk.



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What do we expect of companies?

Our expectations draw on both our own engagement experience, as well as best practice standards set by key industry organizations and initiatives.

We expect companies in climate-exposed sectors to follow a clear trajectory of action, progressing through the steps below:

- The first step is for companies to show **Basic Awareness** of the issue of climate change and how it relates to their business activities, including disclosure of greenhouse gas emissions.
- Through **Active Emissions Management**, we expect concrete action to reduce the emissions for which the company is directly responsible. This includes setting targets and investing in efficiency projects.
- Taking a **Strategic Approach** means making the critical shift to seeing climate change as a core business issue. We expect companies to consider at Board level, the range of risks and opportunities that climate change presents to their strategy, informed by scenario analysis. This includes consideration of emissions across the whole value chain, not just direct operations.
- **Alignment** is where we expect companies to ultimately aim. This step goes beyond considering the impact of climate change on the business, and looks at the impact of the business on climate change. We look to companies to actively contribute to tackling climate change through aligning their own business objectives with the Paris goals. Adopting such goals is a proactive move that should also position companies to be financially robust to the changing environment ahead.

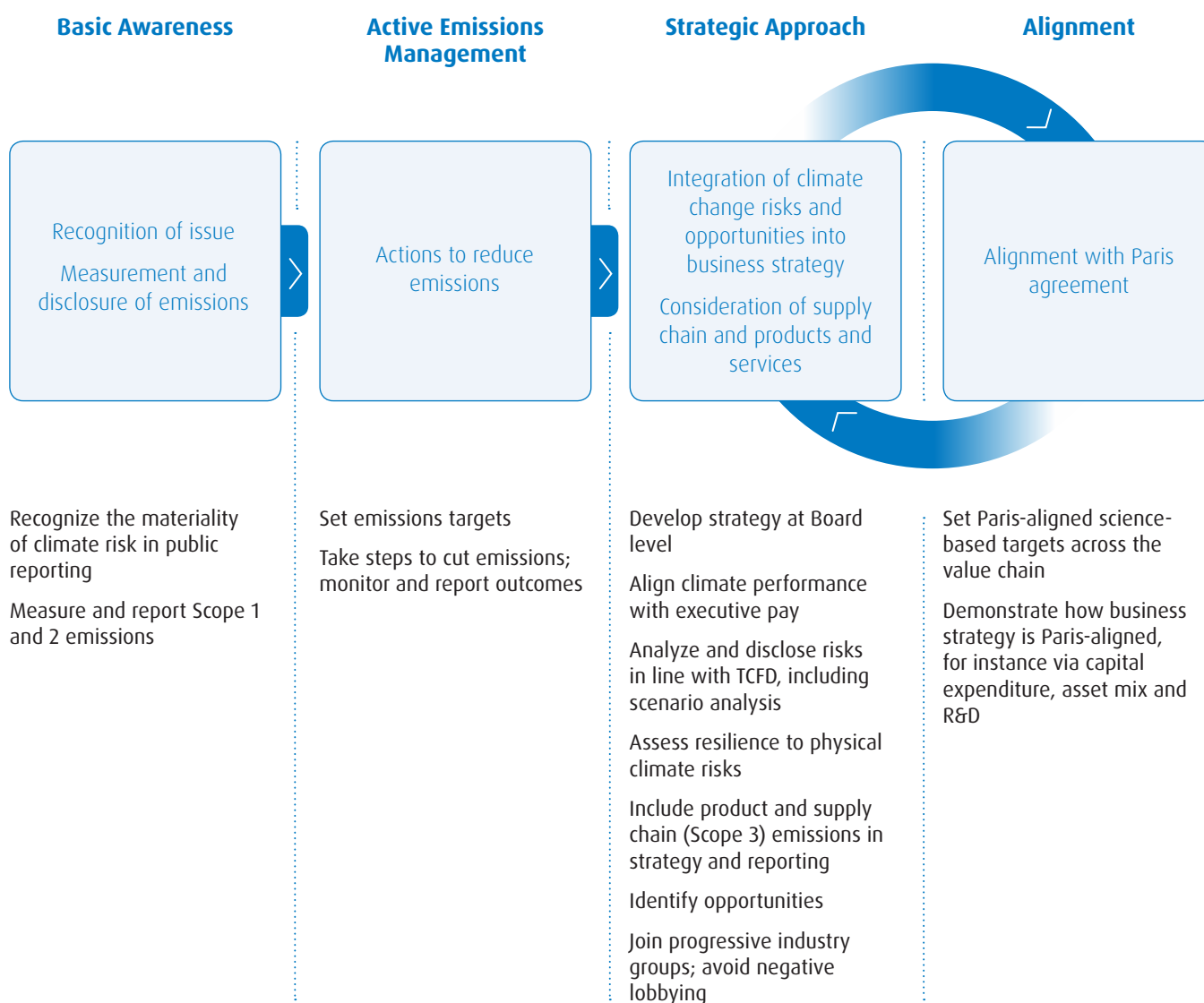
Figure 1 shows some of the concrete policies and actions we consider as best practice as companies progress through these stages. Where a company commits to align its business strategy with the Paris Agreement, this is not the end of the process; we would then anticipate a continuous feedback loop as the company sets its strategy on this basis, monitors progress and adjusts over time.

¹ <https://www.bmogam.com/gb-en/intermediary/news-and-insights/advancing-sdgs-through-engagement/>

² Special Report: Global Warming of 1.5°C, Intergovernmental Panel on Climate Change (2018)



Figure 1: Our engagement expectations



TCFD = Task Force on Climate-related Financial Disclosures



Selected climate change organizations and initiatives

Our views on best practice in engagement have been informed by initiatives including:

- 1 Carbon Disclosure Project (CDP)**
Global disclosure system for environmental performance
- 2 Climate Action 100+**
A US\$35 trillion³ investor collaboration asking companies to take action on governance, emissions reduction and disclosure (see page 10)
- 3 Institutional Investors Group on Climate Change (IIGCC)**
This European investor network's work has included developing sector-specific expectations guidance
- 4 Investing in a Just Transition Project**
Provides research and recommendations around the social impacts of the energy transition
- 5 Science Based Targets Initiative**
Produces guidance and assessments for corporations on science-based target setting
- 6 Task Force on Climate-related Financial Disclosures (TCFD)**
Sets out a framework for consistent climate-related financial risk disclosures, including specific measures for high-risk sectors
- 7 Transition Pathway Initiative**
Systematically assesses companies' preparedness for the transition to a low-carbon economy

³ As at 31 August 2019



What does alignment mean?

With a growing number of companies now claiming to be ‘aligned’ with the Paris climate agreement, how do we judge the validity of these claims and distinguish between ambitious action and greenwash?

The first question is – aligned with what? The Paris Agreement calls for action to keep the global temperature rise “well below 2 degrees Celsius above pre-industrial levels, and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius”. Most companies so far have calibrated their efforts against a 2 degrees trajectory, but a few are starting to make reference to the much more ambitious 1.5 degrees goal.

The second question is how a company in a particular sector or region relates its own business targets to this high-level, global goal. Organizations such as the International Energy Agency have set out emissions pathways for specific sectors that can be used to guide action, recognizing that some sectors will need to implement more rapid reductions than others. However, the choice of scenario is critical. Choosing a scenario which is overly flattering to the sector in question – such as a utility company assuming early, wide-scale adoption of carbon capture technologies, for instance – may undermine the credibility of the commitment.

At a regional level, some companies have aligned themselves with their own government’s Paris commitments (Nationally Determined Contributions, or NDCs). Although this is often a very positive signal that the companies are embracing their responsibilities, it raises the problem that the current set of NDCs fall far short, in aggregate, of the overall Paris goal.

In sectors such as Electric Utilities, Transportation and Industrials, we are seeing net zero carbon goals emerge as best practice.

Here we expect to see genuine commitment to cut emissions as far as possible, avoiding excessive reliance on offsets.

The third question is then how the company translates this long-term ambition into its business strategy. We expect to see a clear account of how the company’s decisions in areas such as capital expenditure and R&D support their goals, combined with ongoing monitoring of progress. We are skeptical of companies that have set distant 2040 or 2050 goals with no interim targets to back this up.

It is vital that companies are transparent about the choices and assumptions they make in setting and implementing their alignment strategies. Where possible, we encourage companies to have their claims independently verified by an organization such as the Science Based Targets Initiative, which now works with over 600 companies taking action to align their strategies.

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How our expectations vary **by sector**

Our expectations are universal, but the specific recommendations we make to companies will be shaped by the circumstances of the company, sector and region.

Our sector leads determine which areas to focus on, which may vary over time as our priorities change. Below are some of the sector-specific engagement expectations we have developed for sectors we are currently prioritizing in our climate engagement program.

Figure 2: Current climate engagement focus areas by sector

Sector	Sector-specific engagement priorities
Oil & Gas	<ul style="list-style-type: none">• CO2 emission reduction targets for the value chain (including production and use of energy products)• Assess resilience of business plans against challenging climate scenarios, including a well below 2 degrees Celsius scenario
Mining	<ul style="list-style-type: none">• Commodity-specific capex investment plan• Operational emission reduction plan• Timescale for phase-out of thermal coal production• Collaborative programs with downstream smelters on energy efficiency
Electric Utilities	<ul style="list-style-type: none">• Phase-out of coal-fired power by 2030 (for OECD countries) or 2050 (for non-OECD)• Planning for social and community impacts of power plant closures
Energy-intensive industries	<ul style="list-style-type: none">• Reduction of operational emissions, utilizing renewable energy credits or onsite generation• Technology implementation plan for carbon reduction
Transportation	<ul style="list-style-type: none">• Management of Scope 3 emissions: upstream on steel and aluminium procurement; downstream on fleet emissions (Automotives)• Lobbying practices (Automotives)• Timeframe for reaching net zero CO2 emissions
Food producers and traders, consumer goods	<ul style="list-style-type: none">• Deforestation policy for key commodities such as palm oil, soy, timber, and dairy/cattle• Assessment of physical impacts of climate change across supply chains
Financials	<ul style="list-style-type: none">• Environmental stress testing / scenario analysis• Integration of climate risk in lending and underwriting policies and procedures

BMO engagement action and outcomes

Since the Paris Agreement was adopted on December 12 2015, we have conducted 1,075 engagement activities with 629 companies on climate change.

Our engagement activities included 7 dedicated engagement projects, targeting climate management strategies of carbon-intensive companies in the utilities, Oil and Gas, Mining, Automobiles, Chemicals, Industrials and Construction Materials industries.

Tracking the results of our engagement, we have identified 236 milestones or instances of change following engagement.

This engagement has been split across sectors as shown in Figure 3.

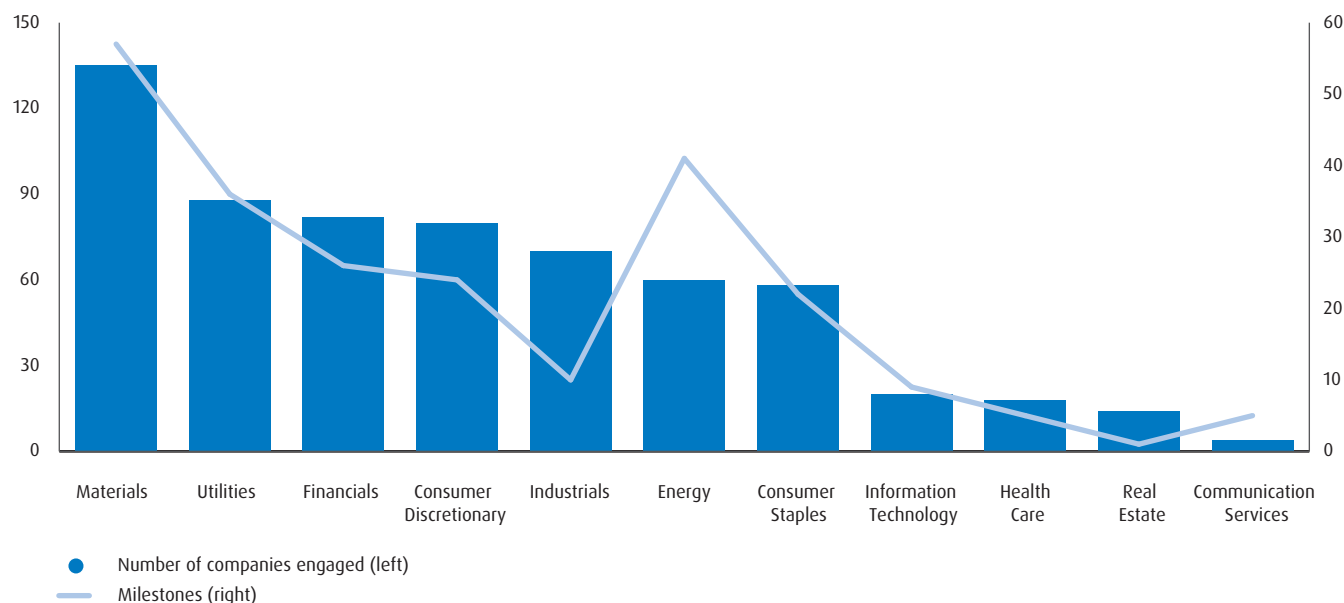
To date, we have seen the greatest number of engagement outcomes in the Energy and Materials sector. We believe this is reflective of the fact that the extractives industries (Oil, Gas and Coal Mining) were the earliest to be targeted by investor engagement. However, engagement now ranges far wider than this, recognizing that systemic change across sectors is needed.

We have used both one-to-one and collaborative approaches, with the Climate Action 100+ initiative being a central part of our approach. However, there are many important companies and sectors that are not part of this initiative, so our direct engagement remains important.

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“We have used both one-to-one and collaborative approaches, with the Climate Action 100+ initiative being a central part of our approach.”

Figure 3: Engagement split across sectors



Source: BMO Global Asset Management, as at September 2019



Climate Action 100+ – a \$35 trillion force for change

Climate Action 100+ is a global collaborative investor engagement initiative, launched in December 2017.

It co-ordinates engagement with 100 'systemically important' companies accounting for two-thirds of annual industrial greenhouse gas emissions, as well as over 60 others with the opportunity to drive the low-carbon transition. The main sectors covered are cumulative Utilities, Materials (Mining, Steel, Chemicals), Energy and Automobiles. Investors with assets under management of over US\$35 trillion have so far signed up to the initiative, making this probably the largest ever global investor engagement collaboration.

Engagement objectives

The initiative asks companies to take action in different areas:

- **Governance:** Implement a strong governance framework that clearly articulates the Board's accountability and oversight of physical and transitional climate change risks and opportunities; ensure sufficient Board competence to oversee climate change risk; implement climate change related targets into remuneration.
- **Emissions management:** Take action and set targets to reduce greenhouse gas emissions across their value chain, consistent with the Paris Agreement's goal of limiting the global average temperature increase to well below 2 degrees Celsius.
- **Disclosure:** Provide enhanced corporate disclosure in line with the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and, when applicable, sector-specific guidance; explain the level of consistency of the strategy with the goal of the Paris Agreement as well as resilience to transition-related risks.

Climate Action 100+ increasingly uses a range of alternative approaches, often in combination. In 2018, a statement was made at the Annual General Meeting of nearly half of the companies targeted. In 2019, this was followed by the first shareholder proposals being filed under the name of the initiative. Other escalation strategies resulted in public letters to companies, and joint public statements by investors and target companies.

In 2019, transparency of corporate lobbying was added as an engagement objective to several high-impact companies in the Automobiles, Energy and Mining sectors, with the aim of aligning lobbying by trade organizations with the public positions of companies.

BMO Global Asset Management has been an active participant in Climate Action 100+ since the start, acting as (co-)lead in 6 company engagements (Vistra, Fiat Chrysler, POSCO, Suncor, GM and VW), and participating in engagements with a further 17 companies in different sectors and regions. To date, we have conducted over 30 Climate Action 100+ engagement activities with these companies, including speaking at the AGM of Fiat Chrysler.

Reporting on progress

Climate Action 100+ will produce a report annually to evaluate corporate progress toward the goals of the initiative. Companies may be removed from the focus list if they have made enough progress to meet the goals of the initiative.



Integrating climate change into proxy voting

For listed companies, the use of voting is a powerful tool that can be used in combination with engagement to signal the importance of climate change action to companies.

Investors are increasingly active in using the vote to press for progress. This is reflected in the high number of climate change shareholder resolutions filed in recent years – which would have been higher still, had many not been withdrawn in light of progress achieved by companies⁴. We have supported shareholder resolutions on climate change such as those put forward by the Aiming for A coalition.

An important development has been the willingness of investors to express concerns about climate change not only through dedicated shareholder resolutions, but also by voting on various management resolutions.

Our own Corporate Governance Guidelines⁵ make it clear that where companies in high-impact sectors fail to provide investment-relevant climate disclosure, we may not support management resolutions, including the report and accounts or the election of directors.

For instance, at the AGM of ExxonMobil, we voted against the re-election of incumbent Board members as a result of the company being insufficiently responsive to investors seeking to engage as part of the Climate Action 100+, combined with our assessment that there had been a lack of

Board oversight evident by the company's public and strategic response to climate change lagging its peers.

We expect to continue to use this approach in 2020. More generally across the market we expect the integration of climate change into core voting policies to accelerate, driven by increased concerns about materiality of risk as well as alignment with an increasing level of ambition by both asset owners and managers.



“An important development has been the willingness of investors to express concerns about climate change not only through dedicated shareholder resolutions, but also by voting on various management resolutions.”

⁴ At the time of writing, 60 resolutions had been filed on climate change in the US, but only 15 went to a vote, mainly due to the resolutions being withdrawn following progress made.

⁵ <https://www.bmogam.com/gb-en/intermediary/wp-content/uploads/2018/10/corporate-governance-guidelines-cgg.pdf>



Engagement in practice: Case studies

Concerted investor engagement is putting unprecedented pressure on companies to act, and we are seeing significant progress by leaders, with a gap opening up with laggards.



Fiat Chrysler

Background: Fiat Chrysler Automobiles (FCA) was established in October 2014 by merging Fiat and Chrysler into a new holding company and now sells its

vehicles in more than 135 countries. We have engaged over several years with the company and are now leading the Climate Action 100+ engagement.

Engagement approach: We made a statement at the 2018 AGM on behalf of the Climate Action 100+ initiative and set out its core expectations, asking in particular about alignment of the company's strategy with the goals of the Paris Agreement. Since the AGM, we had several calls with the company, with a particular focus on electric vehicle strategy, but progress was limited; perhaps partly due to the disruption following merger attempts.

Outcome: Unlike some European auto companies that recently set longer-term decarbonization aspirations with medium-term targets, FCA only provides insight into its effort to comply with shorter-term regulation, with very limited insight into the trajectory of technology development and application. We will continue to challenge FCA on these issues.



POSCO

Background: POSCO is one of the world's largest steelmakers, and ranks as one of the 100 most carbon-intensive companies globally. Despite this, it lags its global peers

in its climate strategy and targets. BMO GAM is co-leading engagement with POSCO through the Climate Action 100+ initiative.

Engagement approach: Although POSCO does have a 2020 emissions target, it met this three years early and has yet to set out its longer-term ambitions. We had two meetings under the Climate Action 100+ initiative, calling for a more strategic approach. While the first meeting lacked detail, the company gave us access to one of its operational specialists for the second, allowing us to go into greater depth. We called for long-term targets aligned with the Paris Agreement, with Board-level oversight and improved disclosure.

Outcome: The company explained that it has performed climate scenario analysis, but has not disclosed any results. It has also pledged to establish a 2030 target. We will review this new target when it is disclosed and compare with industry best practice, such as Arcelor Mittal's Climate Action plan. However, we remain concerned that the company has yet to take a proactive approach led at Board level.

“We expect companies in climate-exposed sectors to follow a clear trajectory of action”.



Duke Energy

Background: One of the largest electricity producers in the US, Duke Energy has 51 megawatts of capacity serving almost 8 million customers. Despite decommissioning

several coal plants, coal still accounts for one-third of total generation capacity, with gas and oil a further 42%.

Engagement approach: We started engaging Duke Energy on climate change in 2016, holding several detailed one-on-one calls, and since then have joined the Climate Action 100+ investor group. We asked for the company to conduct scenario analysis and give clarity on its long-term decarbonization strategy.

Outcome: Duke Energy was the first major US utility to publish a climate scenarios report in early 2018. After further shareholder dialogue, in September 2019 it announced an ambition to achieve net-zero carbon emissions in 2050, with an interim goal of 50% by 2030. We see this as a major step forward and will be encouraging other US utilities to follow their lead.



Bank Mandiri

Background: Bank Mandiri is Indonesia's largest bank, and also is one of the largest lenders to the country's palm oil industry, which accounts for approximately 9% of its

loan portfolio. Serious ongoing concerns about the sustainability of the industry presents risks to these assets.

Engagement approach: We have met the company several times – including a meeting with the CEO – to encourage it to take a more strategic approach to the risks of palm oil lending, and to consider the adoption of a No Deforestation, No Peat and No Exploitation (NDPE) policy. This would require the Bank's palm oil clients to end all deforestation, protect high conservation value areas and implement best plantation management practices.

Outcome: In August 2019 the Bank published a new Sustainable Finance Action Plan, with palm oil being one of four priority sectors it has committed to address. We are encouraged that the company has made this top-level commitment to a more sustainable way of operating, and will press for the adoption of NDPE as it moves forward to implementation.



Vistra Energy

Background: Vistra is a US electric utility, which listed in 2017 and whose assets have come from predecessor firms TXU, Luminant and Dynegy. Around one-third of its generation

is from coal. We first spoke with the company in 2018, and are now co-leading the Climate Action 100+ engagement.

Engagement approach: As a relatively new company, strategy and disclosure on ESG issues, including climate change was very limited. We asked for the company to conduct scenario analysis; provide clarity on the future timescale for coal-fired power retirements; and set medium and long-term emissions targets. We also recommended the company respond to the CDP and support the TCFD.

Outcome: The company has responded well to our engagement. It has held climate scenario workshops and is now working on 2030 and 2050 targets, with the Paris Agreement, a key reference point. It plans to publish these new targets later in 2019.



Royal Dutch Shell

Background: Shell has shown leadership within the energy sector by including use of its energy products in its longer-term CO2 reduction ambition. In 2017, the company

introduced the concept of the Net Carbon Footprint (NCF) of its energy products and set an ambition to halve that footprint in 2050, with 20% reduction in 2035 as an interim step.

Engagement approach: The NCF ambition is sector-leading – but questions remained about implementation. We asked for more clarity around the variety of potential tools Shell plans to use to achieve the necessary reduction over time.

Outcome: Our ongoing engagement contributed to a joint statement published by Shell and Climate Action 100+ investors in which the company committed to developing public short-term NCF targets, and linking these to executive remuneration. In addition, Shell will publish annual updates on progress towards its NCF targets and ambition.

How BMO Global Asset Management can help you

BMO Global Asset Management incorporates material ESG issues into its investment processes across asset classes. We also offer our Responsible Funds range, which invests in companies operating sustainably and excludes those not meeting our ethical and ESG criteria, and our **reo®** engagement service, through which we provide engagement and voting services covering global equities and credit.

Best ESG Research Team 2018



Key risks

The value of investments and any income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

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Viewpoints

We regularly produce research on responsible investment and engagement throughout the year, with past topics ranging from ocean plastics to modern slavery. Click on the thumbnails below to read our most recent viewpoints.



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