M&G Investments' Approach to Climate Change

Principles and implementation

April 2020

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Introduction

Climate change presents immediate and material systemic risks to the financial stability of the global economy, the long-term environmental health of the planet, and ultimately the cohesive functioning of society. The impacts of rising global temperatures are already being felt, with increasing threats on every continent to natural habitats, human populations and the economy. We recognise that there is no safe level of global heating, but the current trajectory of emissions implies that global average temperatures could rise in excess of 4°C by the end of this century[1].

To limit the global average temperature rise to well below 2°C above pre-industrial levels, in line with the Paris Agreement, will require no further greenhouse gas (GHG) emissions, i.e. net zero GHG emissions, from 2050. Achieving this will only be possible with material changes in behaviour, as well as investment to transition to a low-carbon economy.

As a FTSE100 company and as a long-term asset owner and asset manager, M&G plc has a responsibility to our customers and to wider society to invest in ways which ensure a sustainable future, including tackling climate change and enabling a transition to a low carbon economy.

In March 2020, M&G plc announced two new commitments to focus and accelerate our efforts, and those of our partners and investees, to address climate change.

- As an asset owner and asset manager, we have committed to reach net zero carbon emissions on our total book of assets under management and administration by 2050, in line with the Paris Agreement and the UK Government's target. **This includes all investments made by M&G Investments, the asset manager within M&G plc.**
- As a company, we have committed to reduce our own carbon emissions to net zero by 2030[2].

This document explains how M&G Investments is approaching the first goal: the ambitious but vitally important target of net zero carbon emissions across our investment portfolios by 2050. In doing so, we look to embody the care and integrity that enable our business to operate sustainably over the long term, while growing our customers' wealth.

As long-term investors, we believe that environmental, social and governance factors should be a core part of our analysis alongside more traditional financial metrics, and this is especially important in tackling climate change. To meet our net zero goals and continue to deliver long-term returns for our investors, we need to understand how all M&G's investments impact – and are impacted by – the risks and opportunities associated with climate change. This is a huge and complex task across the many and diverse asset classes and markets in which we invest, yet is essential if we are to use our influence appropriately and fulfil our responsibilities as long-term stewards of our customers' money. As the Bank of England has made clear, every professional financial decision will need to take climate change into account, and every company, bank, insurer and investor will need to adjust their business models for a low carbon world.

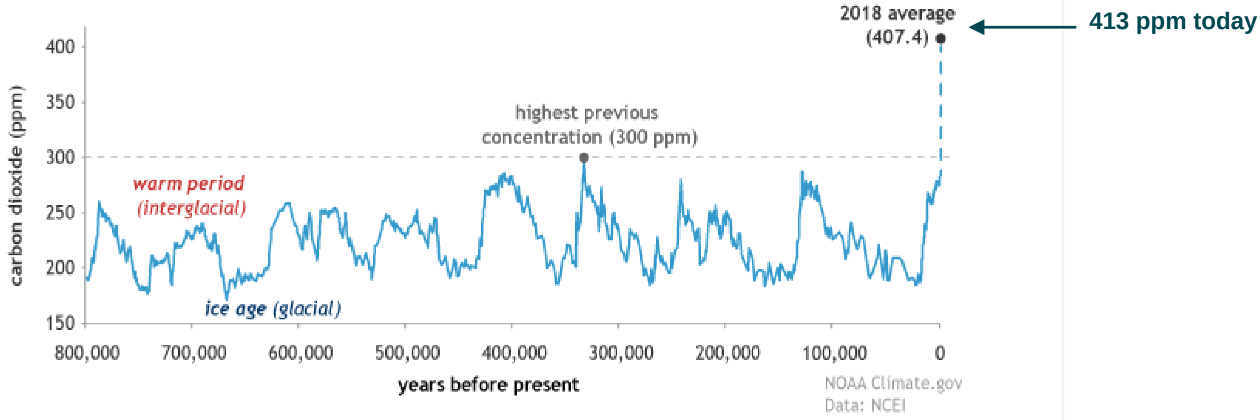
The climate science on which we are basing our approach

Scientific evidence suggests that the climate is changing faster than at almost any point in history, and the increase of CO_2 and other GHGs in the Earth's atmosphere can be largely attributed to human activity. This results from the burning of fossil fuels for energy in particular, but also from transportation, tropical deforestation from land-use change and intensive agricultural practices, and various other industrial processes. This current period of warming, which has resulted in more frequent and extreme weather

[1] Source: Climate Action Tracker
[2] Includes Greenhouse Gas Protocol Scope 1 and 2 emissions and a minimum of 66% of upstream Scope 3 emissions (categories 1 to 8).

events, has shifted the world out of the relatively stable Holocene into a new geological era often termed the Anthropocene[3]. Most of the observed warming of the last 50 years is likely to have been due to the increase in atmospheric GHG concentrations occurring at a rate 10 times faster than at any period during the past 800,000 years.

CO_2 during ice ages and warm periods for the past 800,000 years



Source: National Oceanic and Atmospheric Administration (NOAA) Earth System Laboratory

In 2015, world governments met under the United Nations Framework Convention on Climate Change and signed the Paris Agreement[4], a global response to climate change. The Paris Agreement includes a two-headed temperature goal to hold an increase in global average temperature to well below 2°C above pre-industrial levels by 2100, and pursue efforts to limit temperature increase to 1.5°C. The signatories also agreed to adopt and implement nationally determined contributions (NDCs) that set out the actions they would take to reduce greenhouse gas (GHG) emissions, and to strengthen these efforts in the years ahead. The more granular responsibility for these reductions falls on industries, companies and individuals, with the bulk needing to come from high carbon-emitting industries (in particular oil and gas, power utilities and transportation).

In 2018, the Intergovernmental Panel on Climate Change (IPCC) Special Report on Global Warming[5] stated that meeting a 1.5°C target would require deep emission reductions and rapid, far-reaching and unprecedented changes in all aspects of society. Limiting global warming to 1.5°C compared with 2°C would reduce challenging impacts on natural ecosystems, human health and well-being. By comparison, and among other impacts, a 2°C temperature increase would exacerbate extreme weather, rising sea levels, diminishing Arctic sea ice, coral bleaching, and loss of ecosystems. At current estimates, the world is already at approximately 1°C of warming above pre-industrial levels.

The IPCC report states that adaptation and mitigation efforts are already occurring and that future climate-related risks could be reduced by accelerating far-reaching, cross-sectoral climate mitigation strategies. Further scientific evidence has highlighted that staying within a 1.5°C warming limit would substantially

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[3] The Anthropocene is a proposed geological epoch from the commencement of significant human impact on the Earth's geology and ecosystems, including, but not limited to, anthropogenic climate change.

[4] https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

[5] https://www.ipcc.ch/sr15/

reduce the impact of climate change, while a further half a degree increase would result in various extreme weather outcomes[6].

Overview of M&G's approach

M&G Investments' approach to climate change sets us on track to achieve our 2050 net zero carbon emissions goal and alignment with the Paris Agreement, while also reflecting regulatory advances, shifting client expectations and an increasingly clear investment imperative. It is grounded both in academic rigour and fundamental analysis. It is forward looking, cross-sectoral and informed by the latest scientific evidence on mitigating the effects of climate change.

This approach has two objectives.

The first is a structured process for understanding and managing the climate-related risks to our investments across asset classes, incorporating a climate risk management programme that focuses on the largest emitters. This is derived from a mapping of high-carbon sectors and our holdings within them, based on portfolio carbon footprinting and elements of climate change scenario analysis.

The second broad outcome is the identification of investment opportunities that offer solutions to tackling climate change.

We believe companies that clearly understand the risks to their business – and have put in place measures to mitigate and adapt to these risks, as well as capitalising on long-term opportunities – will be better positioned to deliver stronger, long-term investment outcomes.

Our analysis provides the basis for a risk and opportunity evaluation and structured engagement programme, which prioritises greater transparency in corporate disclosures and a clearer demonstration of corporate decarbonisation plans. In this way, we will use our position as an investor to encourage the transition to a low carbon economy. To build on this analysis and engagement activity, we are developing a voting approach that integrates an assessment of climate performance more structurally into our voting decisions for all companies.

We also recognise the importance of a measured and equitable transition to a low-carbon economy, which addresses environmental issues such as pollution and climate change, while also recognising the importance of socio-economic factors such as energy security, the development gap between richer and poorer economies, and the importance of protecting workers' rights and affected communities through the transition.

Collaboration

M&G Investments participates with other investors and stakeholders to push for improved climate-related disclosures and risk management and to encourage positive change. We collaborate with the Institutional Investors Group on Climate Change (IIGCC) and we were a founding signatory of Climate Action 100+ (CA100+), a collaborative engagement initiative focusing on supporting low carbon transition of the highest GHG emitters globally. We are also members of the IIGCC Paris Aligned Investor Initiative, which seeks to identify the critical metrics to assess Paris alignment across asset classes.

We will continue our participation in other industry-led collective engagement groups and climate change initiatives to help accelerate progress in investment approaches and wider policy direction.

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[6] Schleussner, C. F., Lissner, T. K., Fischer, E. M., Wohland, J., Perrette, M., Golly, A., … Schaeffer, M. (2016). Differential climate impacts for policy-relevant limits to global warming: The case of 1.5 °c and 2 °c. Earth System Dynamics, 7(2), 327–351.

Supporting a stable and consistent policy environment

As well as encouraging individual companies, collaborative engagement can also help to accelerate the implementation of appropriate policies by governments, which will be an important enabler of climate action. We recognise the role that carbon-intensive sectors continue to play in supporting energy security for a significant proportion of the world's energy needs. However, we are acutely aware that policy developments and technological advances are driving change at a rapid pace, influencing the long-term outlook for the global energy supply mix.

We believe that a robust and stable government policy framework – realised via a transparent carbon pricing mechanism, for example – will be necessary to provide the right basis for long-term investment in a well-diversified and sustainable energy future. We are, however, mindful that a global carbon market faces numerous challenges to progress. This is an area where we and other investors are playing an active role, engaging in dialogue with policy makers via direct engagements, consultations and through our membership of industry associations.

We share the concerns of many investors that corporate lobbying, while representing a valid engagement lever for companies and industry bodies, can sometimes have a detrimental impact on positive climate policy, counteracting otherwise encouraging momentum in this area. We push for greater transparency around corporate lobbying activities and look for companies' industry association memberships to demonstrate alignment with those companies' stated climate ambitions.

Governance and transparency

M&G Investments has publicly supported the recommendations of the Financial Stability Board's Task Force on Climate Related Financial Disclosures (TCFD) since December 2017. Following its listing on the London Stock Exchange as an independent business in 2019, our parent company M&G plc has continued this support. At plc level, we have prepared an initial plan to enable us to meet our regulatory requirements and implement the TCFD recommendations. This roadmap comprises the following workstreams:

- **Philosophy and strategy** – defining a climate change philosophy and strategy, covering our role as asset owner, asset manager and corporate entity
- **Governance** – embedding consideration of the opportunities and risks from climate change in our governance arrangements
- **Investment integration** – implementing climate change philosophy and principles across our investment process
- **Scenario analysis and risk modelling** – using scenario analysis and risk modelling to inform strategy, risk assessment and identification
- **Risk management** – incorporating the risks from climate change into existing risk management practice; and
- **Disclosure** – developing a holistic approach to disclosure on the opportunities and risks from climate change.

ESG at M&G plc is governed by a subcommittee of the M&G Executive Committee (the 'ESG Subco'), which is chaired by M&G's Chief Investment Officer. Its members are drawn from M&G's Executive Committee and senior leadership team.

The ESG Subco will oversee the delivery of the M&G climate risk management plan, with appropriate risk and internal audit oversight, over the anticipated implementation by the end of 2021.

M&G Investments’ climate change implementation plan

Introduction

This climate change implementation plan is designed to support M&G Investments’ approach to climate change and sets out in greater detail how the approach will be implemented in practice.

Climate change in our investment process

We believe that ESG factors, including climate change, need to be systematically integrated into our investment decision-making process to support the identification and management of risks and opportunities. Issues such as a company’s sustainability and environmental strategy, how it is impacted by climate change, its corporate governance, how it motivates and manages its employees and how it engages with communities are all critical factors in determining its long-term chances of success. We are currently working towards the full integration of ESG considerations across our investment portfolio.

Within our listed equity and fixed income portfolios, we look to assess climate-related risks and opportunities, by assessing the carbon emissions linked to our portfolios and analysing the transition plans of the companies in which we invest, using third-party carbon analytics tools. As well as providing company-specific insights, this work enables us to establish a baseline for the carbon footprint of our investment portfolio and identify areas for development in our analysis of certain asset classes, following which we aim to develop a long-term and impactful strategy to reduce the carbon intensity of our assets.

For real estate, we are in the process of developing fund level net zero carbon strategies to deliver our target of net zero carbon across our global real estate portfolio. These will include interim targets and metrics to measure progress against and report progress to investors. We are also integrating net zero considerations into investment processes and investment strategy. Alongside this we are trialling transition and physical risk modelling tools to allow us to roll out across our portfolio, to enable us to provide TCFD-aligned reporting to our investors from 2021.

In addition to carbon footprinting, we are carrying out analysis of company exposure to physical and transition risks across a range of climate scenarios. This work has been supported by our involvement in the UN Environment Programme Finance Initiative (UNEP FI) pilot scheme to develop scenarios, models and metrics to enable forward-looking assessments and disclosures of climate-related risks and opportunities. While this analysis is in the early stages of development, and is yet to cover certain elements of our investment universe, it provides a more holistic evaluation of the risks and complements the footprinting approach. We are developing a climate risk assessment methodology for our investments, which combines a number of factors to assess, overall, whether a company is aligned with the Paris Agreement. This is so we can both engage appropriately with the company on its direction of travel, and also track our progress towards carbon net zero across our total assets under management by 2050. This will necessarily be an iterative process, recognising that data, tools and methodologies are developing rapidly.

Climate stewardship

Engagement

We are long-term stewards of the assets we manage and take the responsibilities that come with this role seriously, informed by the belief that long-term success is dependent on effective stewardship and governance oversight. We consider it one of our core responsibilities to engage with the companies in which we invest on important strategic topics.

For M&G’s stewardship and investment teams, climate is a central pillar of our engagements across sectors and asset classes. Through meetings with company directors, we gain valuable insights into the climate-related risks and opportunities faced by our investments. We engage with companies to gain a deeper understanding of their performance as it relates to climate change, as well as to assess progress towards targets the company may have set. We believe it is vital to fully understand how companies are dealing with these challenges, and feel it is our duty to hold the boards of our investee companies to account.

Our proprietary ESG databank features climate-specific questions that assist our equity analysts, credit analysts and fund managers with their company engagements across asset classes. The ESG engagement framework helps us understand corporate performance and progress on issues such as climate-related disclosures, board oversight and ownership, incentivisation in relation to climate governance, scenario planning, TCFD reporting, supply chain management, management of physical risk exposures and whether the company has or is considering the adoption of science based targets (SBTs).

We seek to work with investee companies to encourage positive change. In particular, we believe investors have an important role to play in encouraging businesses in the energy sector, and other sectors, to embrace the low-carbon transition, meeting society's long-term energy and infrastructure needs in a sustainable and responsible manner. In line with our fiduciary duty concerning our clients' assets, if we believe that a company is insufficiently managing key, material climate risks and we see little change after ongoing engagement efforts, we will use the available levers to take appropriate action.

Voting

We plan to implement a more structured voting strategy to address climate change-related considerations. M&G's current voting policy reflects our recognition of the importance of climate risk management at company level. However, our views on this issue are currently implemented primarily via climate-focused shareholder resolutions that, for example, seek better company disclosure or more ambitious emission reduction targets.

To build on this existing approach, we are developing a voting policy that integrates an assessment of climate performance more structurally into our voting decisions for all companies. We will use our position as an investor to encourage greater climate-related disclosures, as well as the transition to a low carbon economy.

Collaboration

We work with other investors and stakeholders to push for improved disclosures and risk management and to encourage positive change. We collaborate with the Institutional Investors Group on Climate Change (IIGCC) and were a founding signatory of Climate Action 100+ (CA100+), a collaborative engagement initiative focusing on supporting low carbon transition of the highest GHG emitters globally.

At an industry level, investors (asset owners and managers) are working to define the determinants of a Paris-aligned asset portfolio and the measures that would need to be taken to demonstrate that alignment. We are part of the Paris Aligned Investor Initiative (PAII) which is designed around this intention, to help investors effectively implement their ambitions to reduce carbon emissions and increase investments in climate solutions in line with the Paris goals.

We will continue our participation in other industry-led collective engagement groups and climate change initiatives to help accelerate progress in investment approaches and wider policy direction. This includes our involvement in ClimateWise, the IIGCC and its Paris Aligned Investment Initiative, the Climate Bonds Initiative and the Better Buildings Partnership.

Ongoing development

While the approach described above covers the significant majority of our assets, we recognise that enhancements to this approach will be needed in those areas where the data is currently too limited to conduct the necessary analysis, or where the tools available to investors remain in a nascent stage of development. In particular, these challenges apply to the evaluation of physical climate risk in real assets and to the accurate assessment of climate risks in non-listed assets. These are challenges we are working to resolve; we will provide updates to our clients in line with our progress over time.