Written evidence submitted by Legal & General Group Plc

Dear Environmental Audit Committee

Inquiry: The financial sector and the UK's net zero transition – Call for Evidence

Introduction & Summary

1. We welcome the opportunity to input to this Inquiry by your Committee. As you may know, the Legal & General Group was established in 1836 and is one of the UK's leading financial services groups and a major global investor. We are the UK's largest life insurer and a major investor in "UK PLC", having invested c£30 billion in direct investments such as homes, urban regeneration, clean energy and small business finance, supporting both the economic recovery and the Government's levelling-up agenda. Our direct investments include, for example, Podpoint (Electric Vehicle charging), Onto (Electric Vehicle leasing), Oxford PV (photovoltaic solar), and Kensa (ground source heat).

2. Our investment management business, Legal & General Investment Management (LGIM), is one of the largest institutional investors globally with assets under management of £1.4 trillion (as at 31 December 2021), managing assets for a wide range of global clients including pension schemes, sovereign wealth funds, fund distributors and retail investors.

3. I am Chief Executive of LGIM, as well as being (i) co-Chair of the Government's COP26 Business Leaders Group; (ii) a Principal of the Glasgow Financial Alliance for Net-Zero (GFANZ); and (iii) a member of the UK Transition Plan Taskforce (TPT). In addition, we are a founder member of the Net-Zero Asset Manager Initiative and a member of the Net-Zero Asset Owner Alliance as well as being engaged in the Sustainable Markets Initiative (SMI), the Women in Finance Climate Action Group (WiFCAG) and One Planet Sovereign Wealth Framework. Whilst not exhaustive, this gives a sense of our commitment to meaningful activity to address climate change. It was a great honour to take part in COP26 in Glasgow; it was a powerful showcase for the UK's commitment to climate change. The importance of the Glasgow Climate Pact cannot be underestimated. GFANZ played a key role in the summit as did Alok Sharma and Mark Carney. We continue to work alongside our partners as preparation for COP27 progresses.

4. We see sustainability as a core business principle - not an 'optional extra' or a 'nice to do'. We invest billions of pounds of capital into projects that aim to improve society, including low-carbon technology, infrastructure, affordable homes and support for small businesses. We believe that the management of climate risk and the maximising of climate-related investment opportunities are not activities that take place in isolation; they are integral to the way we do business. Addressing climate change is one of our six strategic growth drivers and to remain within the Paris targets "green finance" needs to be thought of as mainstream finance, and vice versa.

5. It is because of this that we are responding to this call for evidence. Our response is set out in the following sections:
   i. Our approach and "journey" to delivering ambitious climate targets;
   ii. Explaining our investment management approach to net zero which provides information about how we can, as a sector and business, actively support the decarbonisation of the economy – a key element of your inquiry;
   iii. The effect on the pace and scale of disinvestment plans of disruption to supply chains and energy markets, arising from the 2022 Russian invasion of Ukraine, and what is being done to mitigate any such effects;
   iv. Pathways to reducing investment in fossil fuel extraction, and
   v. Likely pathways to the responsible retirement of fossil fuel assets: we have provided a few additional points not already included in other parts of our response.

6. A successful transition to a decarbonised economy, consistent with less than 1.5 degrees warming, will require a substantial change in capital allocation. Several trillion dollars a year of incremental capital will need to be invested into low carbon energy, energy infrastructure and energy efficiency. For this capital allocation to occur, a financial services industry that is aligned with net zero outcomes will be crucial. Equally, this requires global policy action at international governmental level, particularly on an effective regulatory structure to price carbon and other greenhouse gases.

7. We are extremely aware of the current cost of living squeeze impacting millions of households in the UK. We believe that to address this, and ensure a just transition and higher productivity, the UK needs to continue to address climate change – they are mutually supporting issues. Clean, affordable and stable energy supplies would be a key component in addressing the current spiralling inflationary pressures. Equally, an economy that addresses climate change will reduce both future household cost pressures as well as provide jobs and economic productive growth. Delivering our climate change ambitions is equivalent to a new industrial revolution in terms of living standards, cost of living and prosperity.

a) Our approach and "journey" to delivering ambitious climate targets

8. We are addressing climate change through our investment, influence and operations. For example:
   i. We are making good progress towards halving our own balance sheet's portfolio carbon intensity by 2030 and we are targeting net zero by 2050;
   ii. In partnership with our clients, in October 2021, our investment business set an interim target of 70% of eligible assets[1] to be managed in line with the attainment of net zero emissions by 2030;
   iii. These interim targets are part of our journey to 100% net zero assets by 2050, and we have highlighted additional measures we are taking alongside the actions that our investment business has been taking;
   iv. Since 2016 we have operated our Climate Impact Pledge (CIP) which has used 'engagement with consequences' to call out 'leaders and laggards'. This is part of our wider approach of engagement being more effective than automatic divestment.
   v. Our climate-related goals have been strengthened and we are committed to decarbonising the assets on our balance sheet and our operations to align with the Paris Agreement, which we interpret as limiting global warming to 1.5°C. We are in the process of setting and externally validating science-based targets (SBTs) and will disclose our targets in early 2023.

b) Explaining our investment management approach to net zero

9. Investment management plays a pivotal part in ensuring that climate change is effectively addressed and below we set out our activities in more detail.

10. **Scope 1, 2 & 3 Emissions:** our investment business has been rolling out the use of carbon emissions data to inform the climate risks and opportunities within portfolios. We integrate carbon and other GHG emissions data from 3rd party aggregators on corporate and sovereign emissions. Where providers are not able to obtain an actual / reported disclosure, we use estimated data from the data provider. At present, for sovereign emissions, we integrate producer basis emissions and for corporates we integrate scope 1 and 2 data where relevant.

11. We do not yet believe the quality of data generally available allows us to integrate scope 3 emissions across all corporates. By conducting our own research we calculate an estimated

[1] For this first interim target, LGIM has excluded government securities and derivative assets due to the lack of clear industry methodologies to account for these asset classes. As a result, the 70% target that LGIM has set to be managed in line with net zero covers eligible asset classes only. We will be reviewing our target every two years, taking into account developments across our client base and the markets in which we operate.

figure that attempts to capture the emissions that we believe are relevant for selected energy and financial companies.

12. Portfolio managers and analysts can view the carbon intensity of their portfolio using a variety of tools.

13. **Prioritise the achievement of real economy emissions reductions within the sectors and companies in which we invest:** our approach to climate related expectations of investee companies is set out across several of our responsible investment policies, which are listed below:

    i. *Corporate Governance & Responsible Investment policies (CG&RI):* sets out our expectations for companies across broad environmental, social and governance matters;

    ii. *Coal & Oil Sands Policy*: exclusion of investing in those companies that have a material proportion of their revenue from the mining and extraction of coal mining or coal based energy production and oil sands, as well as engagement to ensure no new thermal coal generation is developed and no further oil sands are exploited;

    iii. *Climate Change Policy*: details our approach to accelerating the net zero transition;

    iv. *Biodiversity Policy*: outlines our investment business' approach to biodiversity and nature loss, and the interlinkages with climate, and

    v. *Sustainability Policy*: a framework as to how i) our investment business integrates sustainability risks and opportunities into the investment decision-making process and ii) how it considers principal adverse impacts of investment decisions on sustainability factors.

14. Our specific climate change expectations of reporting companies are clearly defined within these policies. Additionally, through our Climate Impact Pledge, we assess the largest companies across 15 climate critical sectors on their approach to climate change, resulting in a publicly available data-driven assessment on our website, centred around the five pillars of the Task Force on Climate-Related Financial Disclosure (TCFD). The methodology for our assessment is publicly available, helping companies to self-serve and with the aim of driving standards across the market.

15. This year, we have also been transparent in laying out our specific criteria for supporting management-proposed climate transition plans in so called 'Say on Climate' votes. We want to encourage ambitious and credible plans to be put forward and we will strongly discourage companies from putting poorly drafted plans to a vote.

16. **Use of offsets:** meeting the Paris targets will ultimately require the removal of carbon from the atmosphere ('negative emissions'), whether through nature-based solutions or carbon capture. Negative emissions form a critical element of our modelling, and in nearly all of the modelling we have seen for a scenario where the world achieves a 1.5°C outcome, there will be some emissions which will not be viable to abate. Offsetting schemes and over-reliance on negative emissions can be a distraction from the key priority - to reduce absolute emissions as quickly as possible.

17. In the short to medium term, we prefer to focus our efforts on credible reductions to our carbon footprint and encouraging investee companies to do the same.

18. However, we recognise that negative emissions have a critical role to play in the long term. New solutions are starting to be developed, and much more investment and research will be required, to scale both technological and nature-based solutions to meet future net zero demands. In the longer term we will monitor the emerging investment opportunities in negative emissions.

19. **Create investment products aligned with net zero emissions by 2050 and facilitate increased investment in climate solutions:** drawing on industry best practise, we have

created a net zero portfolio framework of the key requirements for a fund or investment portfolio to be considered net zero aligned.

20. Our methodology incorporates recommendations from the Paris Aligned Investment Initiative's Net Zero Investment Framework as well as the UN Net Zero Asset Owner Alliance and the Science-Based Targets Initiative's guidance for financial institutions. Our investment business' approach shares much of the underlying frameworks, including net zero targets, decarbonisation pathways, targeted sector-based exclusions and engagement.

21. We are working with clients to design bespoke net zero index strategies that incorporate the requirements above and can also be constructed to meet additional requirements such as the EU Technical Expert Group definitions of Paris Aligned or Climate Transition benchmarks.

22. Across all investment styles, net zero considerations can be incorporated alongside other responsible investing methodologies - that also incorporate climate considerations - such as our ESG score, UN SDG alignment methodology and Climate Impact Pledge exclusions. This enables delivery of client outcomes that consider their climate goals as well as broader responsible investing requirements. These strategies can be delivered across our investment business in various pooled fund structures or on a segregated basis to individual clients in order to achieve bespoke outcomes.

23. Our investment business uses a number of responsible investment methodologies that bring climate risks and opportunities into the investment process. These methodologies are implemented in several ways that can be broadly grouped into (i) stewardship and engagement; (ii) exclusions; (iii) ESG score weightings; (iv) active portfolios only selecting best in class; (v) portfolios designed to climate themes and (vi) transitioning real estate portfolios to achieve net zero aligned targets and developing greater climate resilience.

24. **Provide asset owner clients with information and analytics on net zero investing and climate risk and opportunity:** we believe that recognising the potential risks and opportunities from climate change, and providing solutions for a net zero transition, is firmly part of our fiduciary duty of managing assets in the best interest of our clients. We regularly engage and communicate with clients on the topic through a variety of channels. Below are some examples of how we do this:

    i. **Annual Sustainability Summit:** our annual sustainability summit is a client conference which highlights our purpose, capabilities, and leadership as a responsible investor. A core focus of the summit has been the importance of tackling the climate emergency, the related investment implications and the actions that our investment business is taking. Key senior LGIM executives have led many of these sessions along with external experts.

    ii. **Reporting and publications:** we produce several publications that address climate change and how it impacts the way we manage our clients' assets as well as thought pieces, some of which are described here:
        i. The Climate Impact Pledge (CIP) report summarises the targeted climate engagement campaign we began in 2016 and outlines the results of our annual assessment;
        ii. The Active Ownership (AO) report outlines our actions and outcomes over the course of the year across a broad range of ESG issues including climate change;

iii. The Quarterly ESG Impact report complements our annual AO report and provides a more detailed overview of our key activity over the period alongside detailed voting and engagement statistics, and
iv. 'Dotting your i's and crossing your TCFDs' is a five step checklist for pension schemes' climate reporting which aims to help clients act today to prepare for TCFD disclosure requirements.

iii. **LGIM Destination@Risk**: we have developed proprietary modelling capabilities to assess climate risks and opportunities. The LGIM Destination@Risk tool creates bespoke energy transition scenarios based on over one hundred unique public and proprietary data sources and over two million variables and assumptions including detailed energy technology costs. This allows us to evaluate climate risks (both transition and physical) across multiple scenarios based on forward-looking valuations of individual companies across the capital structure.

iv. **Portfolio level reporting:** to assist clients in assessing their investment exposure to climate risks and opportunities we report portfolio level ESG information on a quarterly basis.

v. **Direct client engagement:** we prioritise regular direct engagement with clients to ensure the full detail of our climate related activity and its implications are well understood, scrutinised and challenged. For example, we actively engage with clients on our Climate Impact Pledge strategy and progress, and encourage them to adopt its exclusion list in their investment strategies.

25. **A stewardship and engagement strategy towards net zero by 2050, or sooner:** through our approach to investment stewardship, as already set out, we seek to improve companies' standards by engaging with them and using our voice and influence. Engagement and voting are two key levers available to us to support our commitment to align assets with a net zero by 2050 trajectory. By setting clear expectations in our Climate Impact Pledge, and through regular review, we are able to monitor the effectiveness of our engagement through improvements and actions taken by companies. We want to encourage ambitious and credible transition plans to be put forward and we feel it is important to be transparent about how our voting policy will be applied.

26. Collaborative engagement is undertaken by regularly working with peers, industry groups, NGOs, academia and civil society. Through these collaborations we can amplify our voice and have a greater impact with our climate change initiatives. Examples include:

i. Our involvement with the Climate Action 100+, a global investor engagement initiative with 671 investor signatories representing $65 trillion in assets that aims to speak as a united voice to companies on climate expectations and transitioning to net zero, and

ii. In April 2021, we announced our partnership with the Environmental Defense Fund (EDF), an NGO that uses its in-depth research to drive progress on tackling climate change. Through this collaboration, we have accelerated direct engagements with the largest methane emitters, encouraging them to participate in the Oil and Gas Methane Partnership. We have held discussions with policymakers, including the submission of a public comment to the Environmental Protection Agency (EPA) on pending methane regulation.

27. **Broader engagement:** we engage with actors key to the investment system including credit rating agencies, trade bodies, auditors, stock exchanges, proxy advisers, investment consultants, and data and service providers to ensure that products and services available to investors are consistent with the aim of achieving global net zero emissions by 2050 or sooner.

c) The effect on the pace and scale of disinvestment plans of disruption to supply chains and energy markets arising from the 2022 Russian invasion of Ukraine, and what is being done to mitigate any such effects.

28. The war in Ukraine has exposed the vulnerability of our societies to the dependence on fossil fuels. Meanwhile, on climate, the science is clear: we need rapid reductions in greenhouse gas emissions and, if we act now, we have solutions across sectors to at least halve emissions by 2030.

29. In our view, the war in Ukraine could mark a turning point in the priority that UK & European policy makers place on energy security. We have long believed a significant acceleration of investment into low carbon energy is the most effective resolution to long term energy prices, and this guides our views on the most effective policy set and investor response.

30. The early response indicates that policymakers recognise that the steps to achieving climate objectives also support energy security. We believe the current conflict will focus policymakers' minds on creating the conditions for private capital to play the part that many want in supporting the energy transition.

31. Such investment would also work hand-in-hand in helping to address the cost-of-living crisis faced by many households in the UK by ensuring we have access to more affordable and stable energy supplies, as well as promote job creation – thereby supporting a just transition.

d) Pathways to reducing investment in fossil fuel extraction

32. As an investment manager we do not directly finance fossil fuel projects. However, we do invest in companies that may do this. We prioritise company engagement over exclusion – if we simply divest somebody else would own the asset – it does not deal with the issue, it passes it to somebody else who may not necessarily be as active in seeking to address climate concerns. If through our encouragement and influence, we can facilitate currently high emissions companies to decarbonise their business model, this makes a greater contribution to the overall economy decarbonising than simply investing in already low emissions companies. However, where engagement is considered to provide limited scope for change; where activities present investment risk and or where they are in breach of International Conventions and Treaties, we may apply company-wide exclusion policies.

33. As part of our minimum standards, we apply a coal policy (see paragraph 13 above) across all of our active strategies and certain index funds where we control the index. Where we do not control the index, we will continue to engage with index providers in order to raise market standards. L&G, with its own balance sheet, is pushing ahead by going above and beyond the minimum standards that we set.

34. For funds we have committed to manage in line with net zero, we will exclude, in addition to the above, companies making new investments in thermal coal and oil sands. Across all of our funds, we will use active and escalating engagement with the aim of ensuring no new thermal coal generation is developed and no further oil sand resources are exploited. Across all of our funds, we will use active and escalating engagement with the aim of ensuring that phase-out of existing unabated capacity and activity is undertaken in line with net zero pathways. This will take into consideration the need for a just transition in countries or regions where there is significant economic dependence on thermal coal power or mining.

e) Likely pathways to the responsible retirement of fossil fuel assets

35. In addition to the points already made, to deliver diversified investment portfolios and to reach the end goal of a net zero economy, decarbonising the real economy is essential. This means achieving emission reductions across the sectors and companies in which we invest. It is why the net zero challenge is broader than the exclusion of high-emitting sectors. All companies generate some emissions – either directly through their operations or indirectly through their value chain. Some high-emitting companies will have an important role in developing and investing in the solutions required by the broader economy in their transition plans, such as renewable energy, infrastructure or carbon capture. While selective exclusions have a role to play, unilaterally divesting holdings is, therefore, not guaranteed to lead to the decarbonisation of the real economy and indeed could impede necessary investment in climate solutions.

36. As already mentioned, we have developed the LGIM Destination@Risk proprietary climate model to link a company or government's emissions and decarbonisation targets to an implied temperature increase. This enables us to examine company, sector and portfolio-level implications as well as assess alignment with net zero outcomes. LGIM Destination@Risk is now helping to inform our long-term investment decisions and develop dynamic pathways for the energy system.

Conclusion

I hope that this response provides you with useful evidence for your Inquiry. If we can be of any further assistance, please do not hesitate to contact me. It is only through positive and constructive collaboration between parliament, government, business, civil society and academia that we can work together on these issues in a way that supports addressing climate change alongside ensuring a just transition.

Yours faithfully,

Michelle Scrimgeour
Chief Executive – Legal & General Investment Management

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