For professional clients only, not suitable for retail investors.

Climate risk policy

27th November 2020

ROYAL LONDON
ASSET MANAGEMENT

Contents

RLAM's view

At RLAM, we recognise the science of climate change and believe it can have an impact on the financial outcomes for our clients if not managed appropriately.

The impacts of climate change create both risks and opportunities for the companies and issuers we invest in. We believe that the best way to address climate risks is through engagement, advocacy and prudent investment risk management rather than by adopting strict company or sector exclusions. However, we recognise our clients may have their own exclusion requirements and we have a history of working with clients to design products that meet their needs and the needs of their end beneficiaries.

We will consider material climate risks and opportunities when making investment decisions on behalf of our clients, and evaluate and monitor our investments against the goals of the Paris Agreement. We support a resilient and just transition to a low carbon economy, while we minimise any associated negative impacts on nature and society. We aim to achieve this within the context of our fiduciary duty to our clients and end beneficiaries, who have entrusted us with their savings and investments.

Background

The acceleration of human activity on the planet since the industrial revolution has made economic growth and reduced poverty attainable, and is driving improvements in the quality of life for millions of people.

Fossil fuel energy, industrial activity and modern agricultural practices which have mostly driven this economic prosperity are accelerating degradation of the natural world. Human activity is altering the planet's biophysical cycles and crossing ecological boundaries under which livelihoods and biodiverse ecosystems have coexisted[1]. This threatens to impact society by eroding the services nature provides to support our economic activity. Unsustainable development also puts the profitability of some of our investments at risk.

The accumulation of greenhouse gases (including carbon dioxide) contributes to climate change and will have a significant impact on people and the planet. Permanent changes to biophysical cycles as a result of climate change will trigger further need for adaptation by society and nature. The scientific community, embodied by the Intergovernmental Panel on Climate Change (IPCC), has demonstrated the link between economic activity and climate impacts since 1990, and has ratified this with increased certainty in its reports. The IPCC's 2018 Special Report shows that emissions have driven global warming to about 1°C already. Rapid global scale decarbonisation to meet Net Zero emissions by 2050 is required for the world to maintain global warming to below 1.5°C, the very ambitious threshold that is considered safe[2].

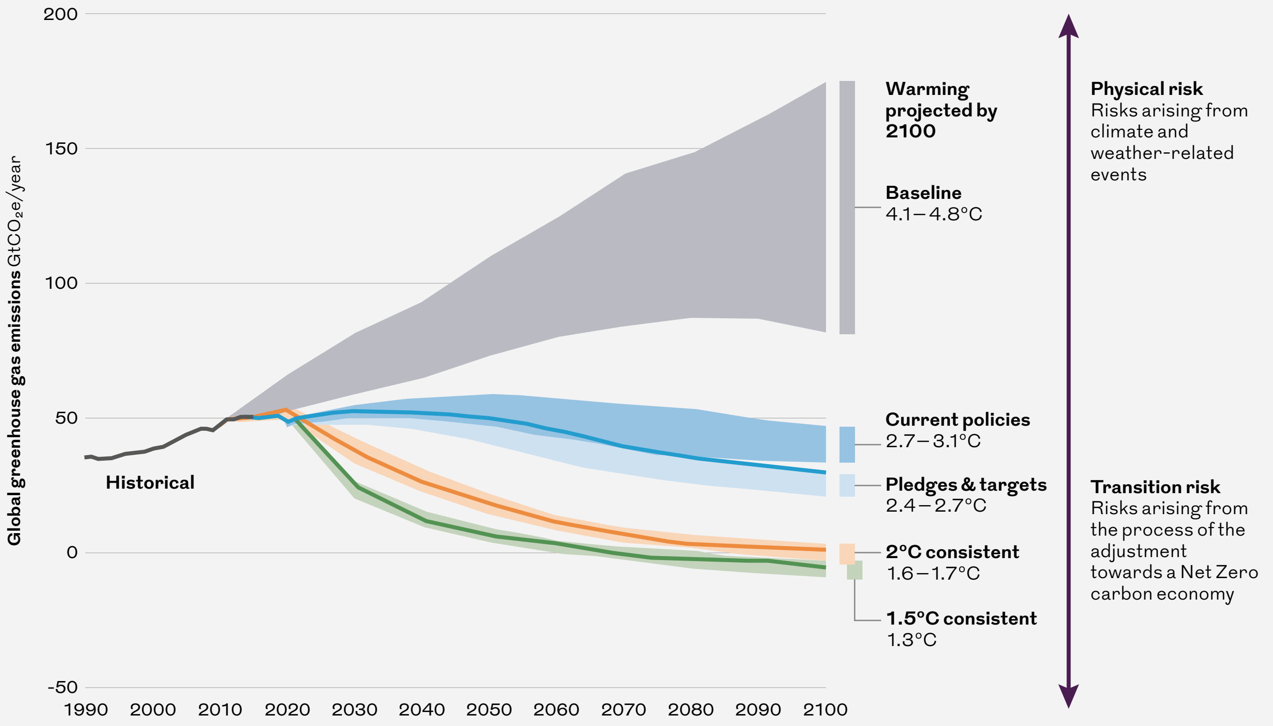
Beyond an ecological risk, climate change has become a systemic economic risk as stated by the Bank of England, the Financial Stability's Board Taskforce for Climate-related Financial Disclosure (TCFD), the International Monetary Fund (IMF) and several other intergovernmental bodies. Financial institutions are exposed to two types of climate risk: the **physical risk** of increased climate impacts and the **transition risk** from the decarbonisation of our economies.

Understanding the collective responsibility we have to maintain global temperature rise, governments committed in the 2015 Paris Agreement to drive emissions to Net Zero in time to maintain temperatures 'well below 2 degrees'[3]. But despite this clear collective vision, economies are still not aligned to achieving the Paris goals.

Figure 1: Definition of climate-related risks: physical and transition risk[4]

Possible carbon emissions pathways and their implications to global mean temperature

Source: Climate Action Tracker. Data as of 23 September 2020.



The role of asset managers

As a responsible asset manager, we have an opportunity to positively influence the world in which we, our clients and investee companies operate in. In the first instance, we have a fiduciary duty to ensure that our clients are aware of the material risk that climate change poses, how this may impact their investments, and the actions we take to integrate climate change risk into investment decisions.

Additionally, as both bondholders and shareholders, we have an opportunity to engage directly with our investee companies and encourage them to take strong stances on climate change strategy, performance and disclosure. This enables us to influence companies and the markets where they operate in a positive way and help support the transition to a low carbon economy.

This policy explains our approach to monitoring, assessing and addressing risks and opportunities from climate change, and the commitments we are making to support an orderly transition to a low-carbon future.

Managing climate risk

As an asset manager, RLAM faces three principal risks from climate change: investment risk, strategic risk, and operational risk.

Investment risk

Climate change might affect investment returns on assets we manage for our clients. In our approach we integrate material ESG analysis, including climate change, into our investment process to support and enhance risk-adjusted returns. Investment risk from climate change is defined by RLAM as the "risk that climate change may impact the investment outcomes for our clients". This could be the result of greater volatility in markets, impacts to company financial results, or impacts due to physical disruption to the operations of companies and issuers we invest in.

We seek to address and mitigate climate investment risks in three ways:

1. We ensure climate risk is integrated into our risk framework and we have appropriate governance to ensure it is monitored and assessed with a view to protecting client assets and ensuring we can continue to operate our business;
2. We integrate material environmental, social and governance (ESG) issues, including climate risk, into our investment decision-making; and
3. We are active stewards of our clients' capital and use proxy voting and engagement as tools to highlight potential climate risks and influence company and regulator behaviour in order to reduce any investment risks, or improve outcomes or opportunities.

Strategic risk

Being a transverse risk [5], climate risk can manifest itself in a variety of ways and have diverse implications for the long-term strategic success of our business. It is therefore recognised and addressed as part of our business strategy. RLAM defines strategic climate risk as "the risk associated with failing to respond sufficiently to shifting sentiment towards climate change, and which may result in brand, proposition or market share being negatively impacted."

Recent changes observed in consumers preferences and awareness of the impacts of climate change require us to adapt our products and investment capabilities to incorporate climate risks and opportunities. We have responded to this risk by increasing the number of experts in our Responsible Investment team who can advise on climate risk. This expertise includes the latest information on climate science, risk analysis tools and reporting frameworks including the TCFD and the EU Taxonomy, as inputs in the investment decision-making process. We have also purchased additional climate data, and are building tools and systems to help us interrogate data to build new products and capabilities.

Furthermore, RLAM and other UK asset managers face an uncertain future regulatory environment regarding climate change. The UK regulators have emphasised the importance of integrating climate risk within the financial industry standards, and have committed to prioritising environmental issues after the UK leaves the EU. New regulatory standards are also coming into force in the EU and we are monitoring the potential impact of this on both our strategy and operations.

Operational risk

Operational risk resulting from climate change is defined by RLAM as "the risk that climate change may impact our operations and our ability to manage assets or continue to serve our clients." RLAM's material exposures to climate change risks will be included in our Internal Capital Adequacy Process[6].

Operational risk resulting from climate risk is managed in partnership with our parent, Royal London Group, through shared services, infrastructure and the buildings we operate from. As a mutual, Royal London Group takes a long-term view when looking at what's best for clients, members and society as a whole. Jointly with the Group, we aim to operate our business in a responsible manner, seek efficiencies to reduce our environmental and climate impacts, and strive for continual improvement. The Group approach to climate change operational risk is set out in the Royal London Group Climate Framework. We have put in place an environmental improvement plan for our business which seeks to reduce energy usage and carbon emissions in our main offices, achieve BREEAM 'very good' or above for any new buildings we operate from, set targets for reducing waste and diverting waste from landfill.

You can read more about our approach to operational climate risks in the Royal London Group Climate Change Commitments Policy Paper.

Governance of climate risk

Board oversight

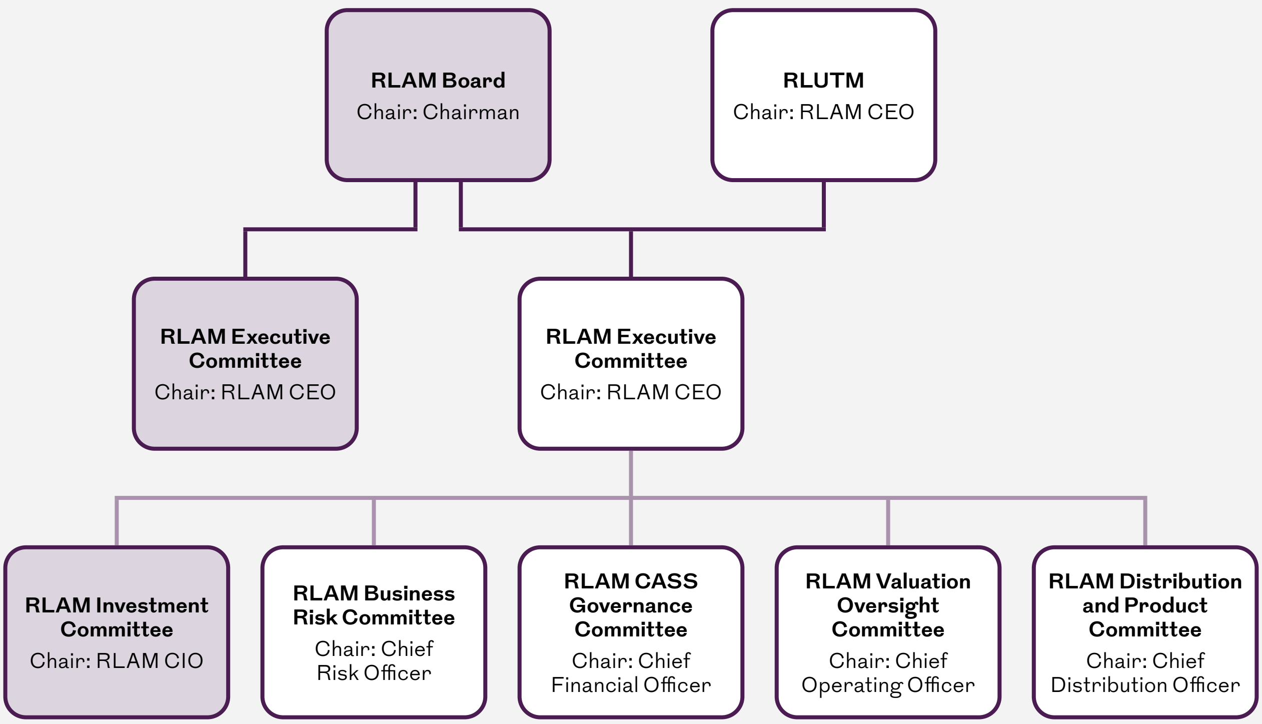
The Board has ultimate responsibility for setting RLAM's risk appetite and reviewing our strategic risks. Our Chief Investment Officer (CIO) is a regulated Senior Management Function (SMF) and is the Executive team member that is accountable for setting the investment strategy, and overseeing our Responsible Investment function, climate change policy, and approach to climate investment risk. The CIO, with support from the investment teams, updates the Board and monitors climate change risk in line with RLAM's risk tolerance threshold. The CIO is also responsible for ensuring climate change risk management is embedded across RLAM's investment strategies. The CIO is a member of RLAM's Executive Committee and chairs the Investment Committee.

An overview of roles and responsibilities and our governance structure surrounding climate risk is detailed below.

Role	Responsibility
Head of Asset Class and all investment managers	Responsible for ensuring material climate risks are considered within investment decisions and contributing to engagement and proxy voting decisions.
Head of Responsible Investment (RI) and the RI team	Provides subject matter expertise, support, information, data and analytics to the investment teams and oversees day to day implementation of engagement and proxy voting activities across all asset classes.
Chief Investment Officer (CIO)	Senior Management Function (SMF) with Executive Committee responsibility for RI and climate change.
Investment Committee	Chaired by the CIO. Responsible for monitoring, oversight and advice to the CIO on investment matters as they relate to RI and climate change.
RLAM Board Risk Committee	Board-level committee responsible for monitoring climate risk on a regular basis, in line with the RLAM risk appetite.
RLAM Board	Overall responsibility for agreeing RLAM's approach to climate risk.

Figure 2: RLAM governance structure

Source: RLAM as at November 2020.



Our climate change commitments

RLAM is committed to being a responsible and good steward of our client's capital. Unmitigated climate risks present a systemic threat to financial stability over the coming years. We must respond promptly to understand and manage this risk, and to capitalise on any potential investment opportunities presented by the climate transition.

We will fulfil our fiduciary duty as stewards of our clients' capital and encourage climate-aware economic development by carrying out the following:

We will review the progress of our implementation and commitments on an annual basis as part of our commitment to issue a TCFD report. We will consider the outcome of the formal review of the Paris Agreement scheduled for 2023, and then every five years thereafter.

Area	RLAM actions
Risk management	**1** We will integrate backward- and forward-looking climate factors in the stress-testing of our investments where we are confident we have good quality and reliable data. **2** We will interrogate and seek to improve the quality of climate data, acknowledging that this is a nascent area and that data and knowledge is continually improving.
Climate risk integration	**3** We will empower our investment teams to integrate material climate risks, for risk management and investment advantage, into investment analysis and decision-making in alignment with the goals of the Paris Agreement, using the recommendations of the TCFD and climate transition pathway tools. **4** We will consider climate risk in any new fund design proposals and enhance our capabilities to deliver climate-aware and carbon transition funds that align with the goals of the Paris Agreement.
Stewardship	**5** We will use our voting rights and engage with companies to support policies and practices that encourage proactive management of climate risks and corporate TCFD reporting.
Advocacy	**6** We will advocate for policies and regulation that support long-term value creation that avoids or pre-empts unnecessary climate impact.
Communication	**7** We will encourage an open dialogue with our clients about climate change risks and opportunities and disclose information and data in line with the TCFD exists.

Definitions

TCFD

The Financial Stability Board Task Force on Climate-related Financial Disclosures was set up to develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers and other stakeholders.

CFRF

The Climate Financial Risk Forum (CFRF) is an industry forum jointly convened by the Bank of England Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) in early 2019. The forum's aim is to build capacity and share best practice across industry and among financial regulators, to advance the sector's responses to the financial risks from climate change.

Climate transition risk (source: TCFD)

Transitioning to a lower-carbon economy may entail extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change. Depending on the nature, speed, and focus of these changes, transition risks may pose varying levels of financial and reputational risk to organizations.

Climate physical risk (source: TCFD)

Physical risks resulting from climate change can be event driven (acute) or longer-term shifts (chronic) in climate patterns. Physical risks may have financial implications for organisations, such as direct damage to assets and indirect impacts from supply chain disruption. Organisations' financial performance may also be affected by changes in water availability, sourcing, and quality; food security; and extreme temperature changes affecting organisations' premises, operations, supply chain, transport needs, and employee safety.

Climate Stress-testing (source: CFRF)

A stress test is a projection of the financial condition of a firm or economy under a specific set of severely adverse conditions. This may be the result of several risk factors over multiple periods of time. Stress testing is a risk management tool used to increase a firm's awareness of its business model vulnerabilities to climate risks. Firms might consider sources of transition and physical risks that will be particularly difficult for them to withstand.

Paris agreement[7] (TCFD)

The United Nations Framework Convention on Climate Change's Paris Agreement was signed in December 2015. Nearly 200 governments agreed to strengthen the global response to the threat of climate change by "holding the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C".

Net Zero (adapted from the Paris Agreement article 4)

To achieve the long-term temperature goal set out in the Paris agreement, a global peaking of greenhouse gas emissions must occur followed by rapid reductions thereafter. This is to achieve a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gases (net zero emissions).

IPCC

The Intergovernmental Panel on Climate Change (IPCC) is the United Nations body for assessing the science related to climate change. The IPCC was created to provide policymakers with regular scientific assessments on climate change, its implications and potential future risks, as well as to put forward adaptation and mitigation options.

Notes

1. https://www.nature.com/articles/461472a
2. https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_LR.pdf
3. https://unfccc.int/process-and-meetings/the-paris-agreement/what-is-the-paris-agreement
4. https://climateactiontracker.org/global/temperatures/
5. Global Association of Risk Professionals (GARP): https://www.garp.org/newmedia/gri/climate-risk-management-guide/Challenges_052919_PDF.pdf
6. The ICAAP is an ongoing assessment of the risks to which an investment firm is or might be exposed and levels of capital considered adequate to cover these risks; it is a regulatory requirement that such assessment be performed at least annually.
7. https://unfccc.int/sites/default/files/english_paris_agreement.pdf

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