Climate change voting – Our approach

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TACKLING THE CRITICAL INVESTMENT RISK CLIMATE CHANGE POSES TO PORTFOLIOS

The rise in global temperatures is a significant and ongoing challenge to our world.

While climate change will clearly impact how we live, it also poses an important financial risk that investors cannot afford to ignore.

As investors for our client accounts, we believe we have an important part to play in identifying and investing in companies that will benefit from the opportunities that arise from this rapid shift to a low carbon world and identifying the risks of investing in companies that are not prepared to make this transition.

Within our consideration of environmental, social and governance (ESG) criteria that are material and relevant to a company's performance, we have identified climate risk as one of the five areas of focus that can impact a company's ability to operate, today, tomorrow and in the longer term. In our research across asset classes, J.P. Morgan Asset Management considers the full range of relevant risks and opportunities to achieve strong, long-term outcomes for our clients.

We promote robust understanding of sustainability through our engagement with the companies in which we invest and interactions with the wider stakeholder base, which includes regulators and clients. We may also collaborate with other investors where we believe our combined engagement can achieve more effective progress towards managing climate risk. We leverage our shareholder rights pro-actively, through direct engagement with companies, and express our views on climate change risk through our voting activity.

VOTING ON CLIMATE CHANGE PROPOSALS

In the past five years, climate change has become an increasingly important and publicly visible topic in proxy voting, attracting great interest from a wide range of stakeholders. The focus has largely fallen on shareholder proposals to companies in carbon-intensive industries, such as hydrocarbon, electric utilities and mining, but it is now spreading to downstream industries including transportation, manufacturing, real estate and finance.

Climate change-related shareholder resolutions broadly fall into four categories:

- Strategy and governance
- Climate risk disclosure
- Lobbying
- Emissions targets and metrics – These have included establishing Paris-aligned targets for direct greenhouse gas emissions arising from operations and use of electricity (Scopes 1 and 2) and increasingly from the use of products/services (Scope 3).

We expect there to be renewed efforts in 2021, resulting in a notable number of these resolutions, alongside management proposed resolutions on what is being dubbed "say-on-climate".

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OUR CLIMATE VOTING FRAMEWORK

In 2020, we voted in favour of approximately 40% of climate-related shareholder resolutions. We believe it is important for us, as a large, global investor, to be clear on our position and our decision-making behind these votes.

1. **Materiality:** Our starting consideration is whether the resolution is focused on an issue that is material to the best economic interest of our clients. In many cases, successfully managing climate change is important for the future success of the company and resolutions around it merit our in-depth attention. But in some cases, the resolution proposes an action to the board that is, at best, incidental to the future success of the company and its stakeholders and may instead distract management from focusing on more imminent and material topics.
2. **Prescription:** Second, we analyse carefully whether the resolution is overly prescriptive. We consider if it is worded to give the company both the ability and capacity to select the strategy and implementation method it considers will most effectively achieve the resolution's intended outcome.
3. **Active insight:** Finally, we consider the extent to which the current business and financial situation at the company makes the resolution valuable to support. We often have regular, ongoing dialogue with the board, senior management and operational specialists of investee companies and may have a stronger understanding and insight than the proponent of the resolution into what is being done to manage an issue. We recognise that in many markets, holding just a small number of shares is needed to propose a resolution. In several cases, in recent years, we have been sufficiently satisfied with the seriousness and urgency with which a company has been tackling an issue and decided that the implementation of a resolution would not necessarily be useful.

To mitigate the financial impacts of climate change, along with other potential issues, companies need to develop a deep understanding of the related risks and opportunities that are material to their operations. They must also take responsibility and implement changes to address them.

We generally support resolutions on:

- Strategy and governance – Companies having senior-level oversight of climate risks and opportunities; or establishing a stated position on climate change; or being transparent on relevant capital allocation and corporate expenditures; or a business strategy in line with a low carbon economy.
- Climate risk disclosure – Companies regularly reporting on climate risks, such as following recommendations from the Task Force for Climate-Related Financial Disclosures.
- Lobbying – We expect companies to lobby in a manner that is consistent with their publicly stated position, given the potential reputational risk.

OTHER CONSIDERATIONS

Voting on climate resolutions illustrates the scale and complexity of the climate transition challenge itself. While some aspects are straightforward, others are a careful balance of thinking through various scenarios that may play out in the coming years and impact investors in a range of ways. These include changing local and national government policies and measures, technological advances, industry competitive dynamics and the cost of capital.

We also note that shareholder resolutions are not the only voting opportunity to express our views on the board's approach to climate risk. We will consider voting against director elections, executive compensation or other management resolutions, such as discharge of the board, where we are not satisfied with the steps taken by the company on climate change risk, the quality of the engagement discussion or its progress.

We recognise that some sectors have characteristics that do not suit broad brush, top-down action, which means we do not have a likely single voting outcome for certain climate resolutions. These include companies being pressed to implement an unrealistic business strategy on an unreasonable timeline or disclosing information using a methodology that does not consider company-specific positions, resulting in potentially misleading data. Equally, this may be relevant to resolutions on Scope 3 greenhouse gas emissions in sectors where the shape and magnitude of end-product demand remains highly uncertain.

MAKING PROGRESS IN THE ENERGY SECTOR THROUGH ENGAGEMENT AND DIALOGUE

The climate transition is challenging and will impact an already complex energy industry. Companies vary widely in their assets, greenhouse gas footprint and competitive position.

It is important to note that we do not expect every renewable or new technology energy company to be winners over existing suppliers, yet incumbents that do not recognise and adapt to the transition could destroy significant value.

Our engagement with such companies is therefore focused on their strategy to mitigate climate risk and the incorporation of these risks into their capital allocation process. We ask companies with whom we engage to clearly define the metrics used to assess climate risk, explain their choice and set targets to which management can be held accountable.

Yet, while we applaud companies for setting ambitious long-term net-zero targets, this intentionality alone is not enough. We seek more disclosure on the scope of greenhouse gas emissions included in such targets and any reliance on offsets, and ask companies to set intermediate-term targets to which management should report periodically. We ask companies to enhance their disclosures when they invest in new energy ventures so investors can make an informed view of their returns and competitiveness.

The challenge investors face is significant and further compounded by the lack of standardised disclosures to compare greenhouse gas emission-related risks across companies as they make capital allocation decisions. In many cases, a single metric may prove to be inadequate to measure climate risks. Moreover, a company's assessment of metrics, such as stranded assets, is fraught with significant uncertainty and assumptions about its own portfolio relative to peers.

However, in some industries, such as upstream oil and gas, standardised measures of reserves and value already exist. These measures can be modified to assess reserves and value under prescribed carbon prices applied across the portfolio. We encourage issuers, investors and regulators to further explore this approach.

CONCLUSION

The Paris Agreement aims to hold the increase in global average temperature to well below 2 degrees Celsius above pre-industrial levels, and ideally to 1.5 degrees Celsius. This would require the world to achieve net-zero emissions by 2050.

As shareholders, we support many climate-related shareholder resolutions that we believe will be valuable in the long term, but that is not the only way we apply effective stewardship. J.P. Morgan Asset Management investment stewardship specialists, investment analysts and portfolio managers actively engage with companies we invest in to understand their approach to managing the risks of climate change and greenhouse gas emissions. By mitigating climate change risks, we believe companies will be better able to achieve sustainable growth and create long-term value for investors and other stakeholders.

NEXT STEPS

For more information, contact your J.P. Morgan Asset Management representative.

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