

Running out of time

As world leaders descend on Glasgow for COP26, Bruce Duguid, head of stewardship at EOS, explains what's at stake, what we want to see from policymakers, and how we will engage for net zero.

The UN's postponed climate talks – COP26 – will finally go ahead in Scotland at the start of November, following the starkest warning yet from the Intergovernmental Panel on Climate Change (IPCC). This particular COP is considered pivotal as it marks the first formal five-year review of emissions reduction commitments since the Paris Agreement was signed in 2015 – albeit one year late, due to the pandemic. Currently these commitments, called Nationally Determined Contributions or NDCs, fall far short of where we need to be, and we are running out of time in which to address this.

The IPCC's latest report on climate, published on 9 August 2021¹, called for drastic action. It warned that this is the last decade in which we have a chance of achieving the original Paris Agreement goal of limiting global temperature rises to 1.5°C. With wildfires raging across southern Europe and the US this summer, and devastating floods in northern Europe and China, the evidence was undeniable.

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What we want to see

Countries must commit to more ambitious NDCs to reduce emissions in line with 1.5°C. To limit global heating to this level, we need to cut global emissions by 40-60% from today's baseline by 2030. Published NDCs indicate that global emissions would barely fall by 2030 compared with today's levels. The NDCs also need to cater for both the short-to-medium term up to 2030 and the period beyond, and need to be underpinned by a detailed roadmap. This should include specific policies – such as carbon pricing – impacting consumer and company behaviours, and the promotion and implementation of green solutions by sector.

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\$100bn

Developed nations should also not only meet but go beyond the pledge of \$100bn per annum dedicated to bringing people out of energy poverty and helping developing nations with the climate transition. We also believe it is crucial that Article 6 of the Paris Agreement is watertight, to support the Paris Agreement rather than damaging its credibility. This is the Article allowing those nations that underachieve against their NDC targets to use over-achievement by other nations to meet the goals, via international carbon markets.

¹ <https://www.ipcc.ch/report/ar6/wg1/>

Over the last two years, we have advocated for a number of changes to public policy and market best practice, including asking governments to commit to more ambitious climate targets. We also asked the International Energy Agency to produce a 1.5°C scenario, which was published in May 2021, and have advocated for mandatory TCFD disclosures for companies, through engagement with the US Securities and Exchange Commission, the European Union and the UK government.

To complement our advocacy for more ambitious and rapid public policy commitments, Federated Hermes is hosting a two-day conference, 'Further, Faster', in Glasgow from 4-5 November 2021. This event will identify actionable objectives to tackle the linked emergencies of climate change, the degradation of nature, and intolerable social injustice. EOS is leading discussions on climate change action; the protection of nature, including biodiversity and our expectations of COP 15; and a case study on the fast fashion industry, illustrating how unsustainable environmental and social issues need to be tackled together.

Our stewardship ambition for net zero

Since the Paris Agreement was finalised, we have engaged with companies around the globe, urging them to put in place strategies that are consistent with the Paris goals, alongside goals and targets aligned with a 1.5°C pathway.

In July this year, the international business of Federated Hermes committed to being a net-zero investor under the Net Zero Asset Managers Initiative and many other EOS clients are similarly committed, some as members of the Net-Zero Asset Owners Alliance. Many signatories are using the Net-Zero Investment Framework (NZIF) to support development of their strategy, which makes clear that stewardship has to be the primary means through which to achieve change in the real economy, with selective divestment seen as a last resort option. With investors representing almost \$50tn of assets now committed to net zero, there is considerable pressure on companies to change their strategies to align with 1.5°C.



Next year we will target vital sectors such as food and agriculture.

In 2020 we saw a tripling in the number of companies with a net-zero commitment. However, data from the Climate Action 100+ benchmark shows that while 52% of 159 of the world's biggest emitting companies have a net-zero goal, only 20% have short and medium-term targets covering a majority of their emissions, and only 7% have targets that are actually aligned to 1.5°C. Given this worrying outlook and the limited time left for companies to take the necessary actions, EOS plans to intensify its engagement on climate change.

We aim to take companies up a ladder of ambition, starting with an initial commitment to net-zero emissions by 2050 or sooner. This should be followed by putting in place short, medium and

long-term targets aligned with 1.5°C, underpinned by a comprehensive strategy, with capital expenditure aligned to the Paris goals and good disclosures of progress, in line with the TCFD recommendations. The final step is for companies to become 'Aligned' by demonstrating good progress against these targets. Ultimately this should lead to a portfolio of net-zero companies, ideally by 2030 or sooner.

There are other important elements for engagement that will support these core objectives. These include demonstrable board oversight of climate change, with executive remuneration aligned to delivering net-zero goals, no political lobbying contrary to the Paris Agreement goals, and ensuring a Just Transition for employees and other stakeholders.

Escalating engagement

We believe that escalation of engagement will be increasingly important to ensure that companies make the necessary changes at the pace required. Collaborating with other investors is also critical to driving change. EOS is a significant supporter of the collaborative initiative Climate Action 100+ (CA100+), leading or co-leading engagement at over 25 companies across all regions.

We have been at the forefront in using escalated engagement techniques, including:

- Helping to lead the drafting of, and co-filing, the first and only CA100+ resolution in Europe at BP's annual shareholder meeting in 2019, which resulted in a significant shift in strategy towards becoming a net-zero company.
- Co-filing a resolution at Berkshire Hathaway in 2021 demanding improved climate reporting, which gained support from a near-60% majority of the independent vote.
- Recommending a vote against the election of the responsible director for climate change at over 100 laggard companies in this year's voting season; this included not supporting four 'Say on Climate' votes at major companies due to material misalignment with the Paris goals.
- Making statements at nine annual shareholder meetings in 2021 and asking live questions at six; this included moving a collective statement at Total's meeting in our role as CA100+ co-lead and leading a delegation of eight institutional investors at LyondellBasell's meeting in our role as CA100+ lead. This involved the use of a legal mechanism under Dutch law to require a discussion on climate change at the chemicals company's shareholder meeting.

New areas of focus for next year

In previous years engagement has mainly focused on the biggest emitting sectors such as oil and gas, utilities and steel. Next year we will widen this to include vital sectors such as food and agriculture, the apparel industry and its supply chain, and banks, which need to align their lending portfolios to 1.5°C, in step with investors.

As we await the outcome of COP26, the investor community is increasingly demonstrating that it is the most progressive force for rapid action on climate change. Stewardship sits at the heart of driving this change, including advocating for supportive policy action, and we look forward to playing our role on behalf of clients to meet the Paris goals.

Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes. Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new strategies from the entire group.

Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

Why EOS?

EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

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