CDP
DRIVING SUSTAINABLE ECONOMIES

Leadership now: UK companies and the global environmental challenge

CDP 2014 UK Corporate Environmental Report

Contents

CEO foreword

One irrefutable fact is filtering through to companies and investors: the bottom line is at risk from environmental crisis.

The global economy has bounced back from crisis and a cautious optimism is beginning to pervade the markets. As we embrace recovery we must remember that greenhouse gas emissions continue to rise and we face steep financial risk if we do not mitigate them.

The unprecedented environmental challenges that we confront today—reducing greenhouse gas emissions, safeguarding water resources and preventing the destruction of forests—are also economic problems. One irrefutable fact is filtering through to companies and investors: the bottom line is at risk from environmental crisis.

The impact of climate events on economies around the world has increasingly been splashed across headlines in the last year, with the worst winter in 30 years suffered by the USA costing billions of dollars. Australia has experienced its hottest two years on record and the UK has had its wettest winter for hundreds of years costing the insurance industry over a billion pounds. Over three quarters of companies reporting to CDP this year have disclosed a physical risk from climate change. Investing in climate change–related resilience planning has become crucial for all corporations.

Investor engagement on these issues is increasing. In the US a record number of shareholder resolutions in the 2014 proxy season led 20 international corporations to commit to reduce greenhouse gas emissions or sustainably source palm oil.

As mainstream investors begin to recognize the real value at risk, we are seeing more action from some of the 767 investors who request disclosure through CDP's climate change programme. The Norwegian pension fund, Norges Bank, with assets worth over US$800 billion, expects companies to show strategies for climate change risk mitigation and water management, and have divested from both timber and palm oil companies that did not meet their standards.

There is growing momentum on the policy front with President Obama's announcement of new federal rules to limit greenhouse gases in the US. In the EU, some 6,000 companies will be required to disclose on specific environmental, social and governance criteria as part of their mainstream reporting to investors. In China over 20,000 companies will be required to report their greenhouse gas emissions to the government.

There is a palpable sea change in approach by companies driven by a growing recognition that there is a cost associated with the carbon they emit. Measurement, transparency and accountability drives positive change in the world of business and investment. Our experience working with over 4,500 companies shows the multitude of benefits for companies that report their environmental impacts, unveiling risks and previously unseen opportunities.

We are standing at a juncture in history. With the prospect of a global climate deal coming from the United Nations process, governments, cities, the private sector and civil society have a great opportunity to take bold actions and build momentum in the run up to the Paris 2015 meeting. The decisions we make today can lead us to a profitable and secure future. A future that we can all be proud of.

Paul Simpson
Chief Executive Officer, CDP

Investor foreword

There is wind in the sails of the stranded assets argument.

The anti-climax that was the Conference of the Parties in Copenhagen in 2009 marked the beginning of a period when the energy and will for action on climate change was debilitated by understandable short-term worries over the global recession. Now that the recession appears to be receding, we are getting back a sense of opportunity, and a will – judging by President Obama's rear-guard action on regulating emissions in the US and China's planned action on pollution and energy security – to have another go.

There is wind in the sails of the stranded assets argument, with even well-known City columnists for the Financial Times and The Telegraph lending support. As Martin Wolf put it, the risk to investors "cannot be zero." Some hope a catalyst will be the Conference of the Parties in Paris in 2015 (COP21), billed as the successor to Copenhagen – only hopefully better organised and with meaningful, binding targets.

Free market thinking argues that the tortured negotiations are a sideshow, but *nil desperandum*: technology disruption may achieve what global regulation never could. Some sell-side commentators are beginning to say the unsayable: that the dominance and longevity of the oil economy are not assured. They say the penetration of low-cost solar, likely improvements in battery storage and electric vehicles are threatening to undermine the economic case for dragging expensive and often risky marginal barrels of oil and gas from the earth. Coal is taking a bruising at least in part thanks to regulation and the US shale gas revolution, which is of course not without its own issues.

And there is greater recognition of the energy-water-resources nexus. More desalination requires more energy and emissions. Increasing yields in some crops through irrigation or expansion of agricultural areas may not be an option because of supply shortages, the impact of deforestation, conflicts and so on. This interconnectedness is recognised in the format of the CDP UK corporate environmental report 2014, which for the first time includes company responses on water and forests, respectively. I'm pleased that 71% of the FTSE 350 has responded to CDP's climate change information request and that more companies are looking at water and products associated with deforestation in their supply chain. Even so, the standard of reporting and of planning is highly variable, even amid sectors most commonly associated with these risks.

At Royal London Asset Management, we are also trying to come to terms with what these issues mean for our investments. Some of the long-dated debt we own is financing climate-sensitive assets out to the 2060s, for example. CDP has done the world a service by providing pressure and some consistency in how companies and cities report their risks, opportunities and actions on climate, water and forests. Still, I have the sense that markets still don't know what to do with this information, if they even know it's there. We can but hope that, as momentum returns to the debate, a strong price for carbon emerges and action on water and forests accelerates, these reports provide a rich seam of insight for those seeking to identify the companies that will still be around in the 2050s having adapted to a defining phenomenon of our time.

Robert Talbut
Chief Investment Officer
Royal London Asset Management

Executive summary

The planet faces ever-growing pressure from the demands of a rapidly increasing human population and its myriad, often unpredictable impacts on every aspect of the natural environment. In 1800, less than 2% of the world's population lived in cities; today, more than half do[i]. Annual global carbon dioxide emissions for 2014 are expected to rise to 40 billion tonnes – 65% above 1990 levels[1]. Further, as populations in some parts of the world find themselves with more disposable income, diets are becoming increasingly meat-based and the demand for rare and finite resources is becoming more intense, further accelerating deforestation and land use change.

The effects of these changes are already being felt: the planet's average temperature has increased by 0.85°C since 1880 and is increasing faster than ever before[ii]; the global water cycle has been affected[iii]; crop yields have altered[iv]; and tree mortality has escalated[v]. The Intergovernmental Panel on Climate Change's (IPCC) Fifth Assessment Report (AR5) concludes that these impacts are a result of the unprecedented increase in atmospheric greenhouse gases (GHG) from specifically human activities[vi]. Climate change and its far-reaching impacts will cause a loss of global consumption of up to 4% by 2030[vii].

Impacts such as these will affect human well-being and sustainable economic growth; indeed, inadequate responses to the effects of climate change are already eroding the potential for truly sustainable development[viii].

The world must take action and the next year holds great potential for real reform. The world's leaders met in New York in September 2014 for the UN Climate Summit, hoping to lay the groundwork for meaningful legal action at COP21 in Paris in the winter of 2015. The private sector has a crucial role to play: companies provide up to three quarters of annual mitigation financing[ix]. Further, they have huge scope to control emissions and accelerate action in reducing them, as well as enhancing water stewardship and managing land use responsibly and sustainably.

To help drive consensus and action toward an agreement at COP21, CDP has launched CDP Road to Paris 2015, which invites businesses to commit to a set of practical initiatives. The initiatives range from putting a price on carbon emissions, to developing a strategy to procure electricity from renewable sources, to setting GHG emissions reduction targets that align with climate science.

This year, for the first time, the CDP UK corporate environmental report[2] explores data disclosed through all three of CDP's programmes (climate change, water and forests) and reveals what UK companies are doing to target global environmental challenges. In 2014, CDP issued its climate change information request to the FTSE 350 companies[3] on behalf of 767 investors representing US$92 trillion in assets, asking them to disclose what climate change means for their business. 71% (248) of companies in the FTSE 350 sample responded to this request[4].

Leading companies are now also benefiting from measuring, managing and reporting water use management and the deforestation linked to corporate supply chains. 2014 was the inaugural year for CDP's Water FTSE 100 sample; the water information request was sent to 61 companies from the FTSE 100[5]. The water data analysis is based on the responses of 32 Water FTSE 100 companies and three other UK-based companies[6, 7]. The forests data analysis is based on the responses of 27 UK-based companies[8] requested to take part.

This report explores some of the key areas in which companies are addressing environmental issues, including those outlined in the AR5; primarily, are they managing natural resource and climate change issues appropriately; are they setting ambitious enough targets; and what are the top environmental risks and opportunities companies are identifying? It also illustrates what the climate performance leaders[9] are doing differently to the rest. UK companies are uniquely positioned because of the scope of mandatory GHG reporting[10] in this country and legally-binding carbon budgets; the Timber Procurement Policy[11] to ensure the legality and sustainability of sourcing, as well as the Government's commitment to sustainable palm oil use by 2015[12]; and the proposed water abstraction reforms[13]. With this framework in place, what are UK companies doing to manage and minimise their environmental impact?

The findings show that the UK companies are taking the lead in some aspects of their forest-risk commodity target setting but there's disparity in the timelines companies disclose for different commodities' targets. Meanwhile, the majority of UK respondents' targets are focussed on water efficiency measures in direct operations UK climate leader companies are showing much more commitment to reducing their GHG emissions.

Companies are identifying reputational factors as a serious risk associated with procurement or production of forest-risk commodities, although within climate change, the leaders have a much more even spread of risk type. Similarly, companies report a range of direct water risks, including increased water scarcity and flooding. Encouragingly, all companies that identify risks in their supply chain through the water programme also require their suppliers to report on their water use and management. This is positive because ensuring resilience to water challenges in the supply chain depends on collaboration and communication.

There are encouraging indications within the opportunities companies are identifying in relation to their forest-risk commodities, whilst many more companies report water opportunities than risks. Interestingly, the majority of the most common climate opportunities companies report are also the top risks.

> Leaders are more likely to meet their GHG targets, and are more likely to set absolute targets.

> Sustainable palm oil is widely seen as a business opportunity, and other commodities could follow this trend.

> The majority of companies are still focussed predominately on efficiency measures, but need to focus on local watershed risk management.

Roman numerals refer to document references. Please see p.32 for more details

1 http://www.globalcarbonproject.org/carbonbudget/14/files/UK_UEA_GCPBudget2014.pdf
2 In previous years, this report has been the CDP UK FTSE 350 Climate Change report
3 The FTSE 350 index used by CDP is based on the market price of 350 companies listed on the London Stock Exchange, including companies on the FTSE 100 index and FTSE 250 index as of 1 January 2014
4 This report is based on the analysis of the 230 responses received by 1 July 2014
5 CDP's water information request is targeted at a subset of the biggest companies by market capitalisation that have the greatest potential to be impacted by, or to impact upon, water resources. To see a full list of the companies in the Water FTSE 100 sample, please visit: https://www.cdp.net/en-US/Programmes/Documents/2014-water-companies.pdf
6 Responses submitted to the Forests and Water progams by 1 August 2014 were included in analysis. Several companies submitted after this date.
7 The three UK-based companies that chose to take part in CDP's water programme this year, without being requested to do so by our signatory investors, are: Croda International, DS Smith and Morgan Advanced Materials.
8 One company, Greencore Group plc, is headquartered in Ireland but it also takes part in CDP's climate change program as part of the FTSE 350 sample so its forests data is included in this report's analysis as well
9 Companies that achieve an "A" performance band
10 A result of the Climate Change Act 2008 and which took effect from 1 October 2013, requiring all UK quoted companies to report on their greenhouse gas emissions as part of their annual Directors' Report. For more information: https://www.gov.uk/government/publications/environmental-reporting-guidelines-including-mandatory-greenhouse-gas-emissions-reporting-guidance
11 For more information, please see: https://www.gov.uk/timber-procurement-policy-tpp-prove-legality-and-sustainablity
12 For more information, please see: http://sd.defra.gov.uk/2012/11/uk-commitments-to-source-sustainable-palm-oil/
13 For more information, please see: https://www.gov.uk/government/policies/reforming-the-water-industry-to-increase-competition-and-protect-the-environment/supporting-pages/protecting-our-water-sources-the-future-of-abstraction-reform

2014 climate change leadership criteria

Each year, company climate change responses are analysed and scored against two parallel scoring schemes: performance and disclosure.

The performance score assesses the level of action, as reported by the company, on climate change mitigation, adaptation and transparency. Its intent is to highlight positive climate action as demonstrated by a company's CDP climate change response. A high performance score signals that a company is measuring, verifying and managing its carbon footprint, for example by setting and meeting carbon reduction targets and implementing programs to reduce emissions in both its direct operations and supply chain.

The disclosure score assesses the completeness and quality of a company's response. Its purpose is to provide a summary of the extent to which companies have answered CDP's questions in a structured format. A high disclosure score signals that a company provided comprehensive information about the measurement and management of its carbon footprint, its climate change strategy and risk management processes and outcomes.

The highest scoring companies for performance and/or disclosure enter the Climate Performance Leadership Index (CPLI) and/or the Climate Disclosure Leadership Index (CDLI). Public scores are available on the CDP website and in CDP reports, through Bloomberg terminals, Google Finance and Deutsche Boerse's website.

This year, for the first time, CDP has published a report that looks at all climate leader companies around the world –"The A List: The CDP Climate Performance Leadership Index 2014". To find out more, please visit www.cdp.net /reports

What are the CPLI and CDLI criteria?

To enter the CPLI (Performance Band A), a company must:

- Make its response public and submit via CDP's Online Response System
- Attain a performance score greater than 85
- Score maximum performance points on question 12.1a (absolute emissions performance) for GHG reductions due to emission reduction actions over the past year (4% or above in 2014)
- Disclose gross global Scope 1 and Scope 2 figures
- Score maximum performance points for verification of Scope 1 and Scope 2 emissions
- Furthermore, CDP reserves the right to exclude any company from the CPLI if there is anything in its response or other publicly available information that calls into question its suitability for inclusion.

Note: Companies that achieve a performance score high enough to warrant inclusion in the CPLI, but do not meet all of the other CPLI requirements are classed as Performance Band A– but are not included in the CPLI.

To enter the CDLI, a company must:

- Make its response public and submit via CDP's Online Response System
- Achieve a score within the top 10% of the total regional sample population*

* Note: while it is usually 10%, in some regions the CDLI cut-off may be based on another criteria, please see local reports for confirmation. The minimum disclosure score needed to achieve a place on the FTSE 350 CDLI in 2014 is 95.

How are the CPLI and CDLI used by investors?

Good performance and disclosure scores are used by investors as a proxy of good climate change management or climate change performance of companies.

Investors identify and then engage with companies to encourage them to improve their score. The 'Aiming for A' initiative which was initiated by CCLA Investment Management is driven by a coalition of UK asset owners and mutual fund managers. They are asking major UK-listed utilities and extractives companies to aim for inclusion in the CPLI. This may involve filing supportive shareholder resolutions for Annual General Meetings occurring after September 2014.

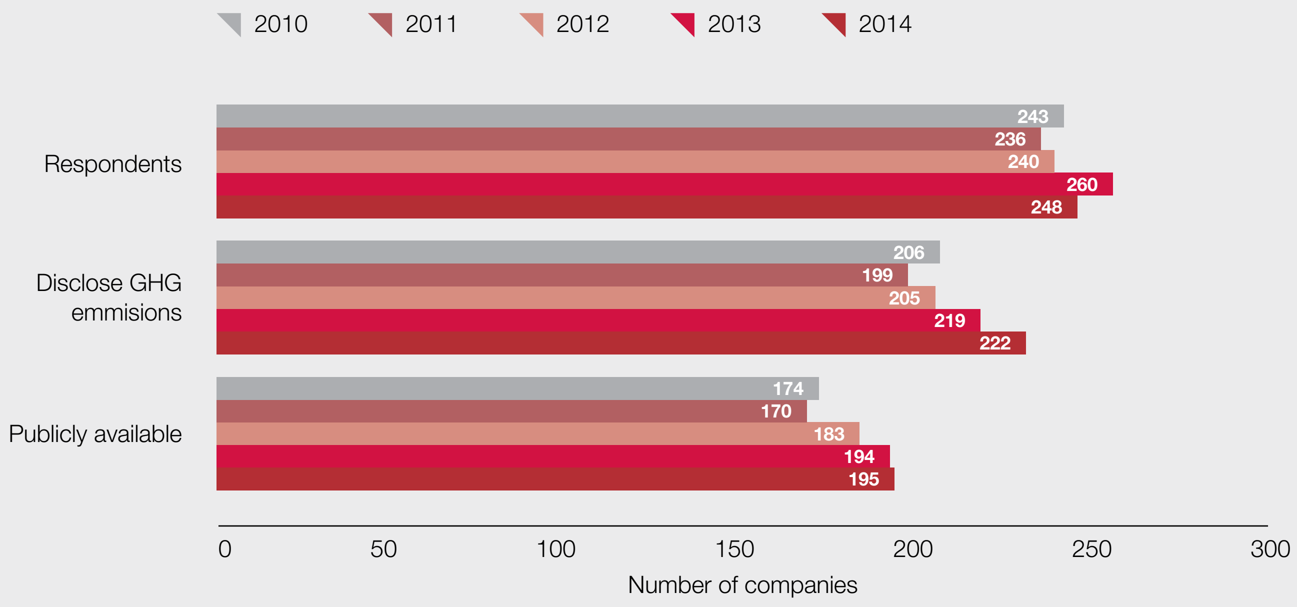
Investors are also using CDP scores for creation of financial products. For example, Nedbank in South Africa developed the Nedbank Green Index. Disclosure scores are used for selecting stocks and performance scores for assigning weight.

For further information on the CDLI and the CPLI and how scores are determined, please visit www.cdp.net/guidance.

Table 1: Top companies by disclosure and performance

Company Name	Sector	Disclosure Score	Performance Score
Centrica	Utilities	100	A
Diageo	Consumer Staples	100	A
Carillion	Industrials	99	A
Standard Chartered	Financials	99	A
Unilever	Consumer Staples	99	A
Johnson Matthey	Materials	98	A
BT Group	Telecommunication Services	97	A
Henderson Group	Financials	97	A
HSBC Holdings	Financials	97	A
Coca-Cola HBC AG	Consumer Staples	96	A
Reed Elsevier Group	Consumer Discretionary	96	A

Figure 1: Year on year climate change disclosure levels for FTSE 350 companies



2014 FTSE 350 Climate Performance Leadership Index (CPLI)

CDP CLIMATE PERFORMANCE LEADER 2014

Sector	Company	Disclosure score	Performance band	Consecutive years in the FTSE 350 CPLI
Consumer Discretionary	Reed Elsevier Group	96	A	2
Consumer Staples	Diageo Plc	100	A	3
	Unilever plc	99	A	3
	Coca-Cola HBC AG	96	A	1
	J Sainsbury Plc	94	A	1
	Morrison Supermarkets	92	A	1
	Associated British Foods	89	A	1
	SABMiller	85	A	1
Financials	Standard Chartered	99	A	1
	Henderson Group	97	A	1
	HSBC Holdings plc	97	A	2
	Aviva	94	A	1
Health Care	AstraZeneca	93	A	1
Industrials	Carillion	99	A	2
	Balfour Beatty	94	A	1
	Cobham	92	A	1
Materials	Johnson Matthey	98	A	1
Telecommunication Services	BT Group	97	A	2
Utilities	Centrica	100	A	1
	SSE	94	A	1

2014 FTSE 350 Climate Disclosure Leadership Index (CDLI)

CDP CLIMATE DISCLOSURE LEADER 2014

Sector	Company	Disclosure score	Performance band	Consecutive years in the FTSE 350 CDLI
Consumer Discretionary	TUI Travel	100	A-	7
	WPP Group	98	B	2
	Next	96	B	1
	Reed Elsevier Group	96	A	7
	British Sky Broadcasting	95	A-	5
	Kingfisher	95	A-	1
Consumer Staples	Diageo Plc	100	A	4
	Reckitt Benckiser	100	A-	6
	Unilever plc	99	A	1
	Coca-Cola HBC AG	96	A	1
Financials	British Land Company	99	A-	4
	Standard Chartered	99	A	3
	Lloyds Banking Group	98	B	7
	Old Mutual plc	98	B	6
	Royal Bank of Scotland Group	98	B	7
	Henderson Group	97	A	1
	HSBC Holdings plc	97	A	7
	Prudential PLC	97	B	1
	Land Securities	96	A-	3
	London Stock Exchange	96	B	1
	Standard Life	95	B	2
	Quintain Estates*	95	C	1
Health Care	GlaxoSmithKline	96	B	7
	Smith & Nephew	95	B	3
Industrials	Carillion	99	A	2
	Morgan Advanced Materials	97	B	3
	Morgan Sindall Group*	97	B	3
	Serco Group	97	B	5
	International Consolidated Airlines Group, S.A.	95	B	2
Materials	Johnson Matthey	98	A	1
	Marshalls*	98	B	1
	Lonmin	96	B	2
	Mondi PLC	96	B	1
	Anglo American	95	B	5
Telecommunication Services	BT Group	97	A	5
Utilities	Centrica	100	A	7
	United Utilities	99	A-	1
	National Grid	97	B	2

* These FTSE SmallCap companies aren't in the FTSE 350 but achieved the required score to be recognised on the CDLI

Key themes and highlights of 2014 responses

Targets

Climate change: Leaders are more likely to meet their GHG targets, and more likely to set absolute targets

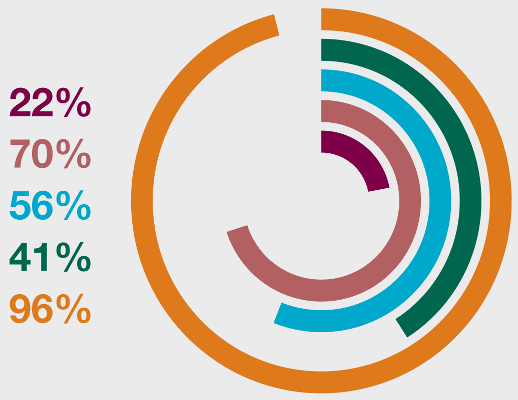
Figure 2: Climate change targets

More than double the number of leader companies are setting absolute targets; further, nearly two thirds (64%) of their absolute targets are on track, as opposed to just over half of the pack's (55%). Both these factors demonstrate "A" companies' real commitment to reducing their emissions.

* "Pack" companies are all those respondents that didn't achieve a performance band "A"

Forests: A third of responses across the commodities demonstrate no quantified target for certification

Figure 3: Percentage of companies reporting on each commodity

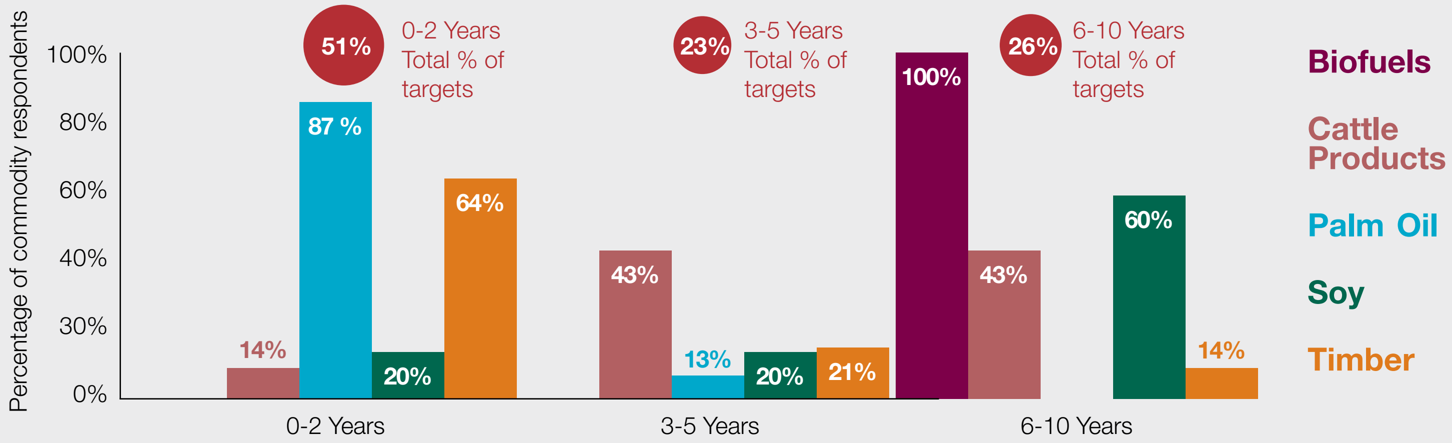


An unusually high percentage of companies report on cattle products (surprisingly, higher than palm oil), indicating that UK companies may be taking a lead on a commodity for which work on deforestation is still at an early stage.

Figure 4: Percentage of commodity responses stating a quantified target for third party certification

It is very concerning that a third of responses across the commodities demonstrate no quantified target for certification, given the urgency of the challenges in the AR5.

Figure 5: Timeline of targets for third party certification



* excludes commodities with no target or targets that are 100% achieved

It is interesting to compare the reported short term targets for soy and palm oil (see Figure 5). The responses demonstrate considerable ambition in the short term for reaching 100% third-party certified palm oil. Soy has received less attention from non-governmental organisations (NGOs) than palm oil over the last few years, perhaps accounting for the lower ambition being reported. With the soy moratorium in Brazil destined to finish at the end of 2014, this will be an interesting commodity to watch over the coming year.

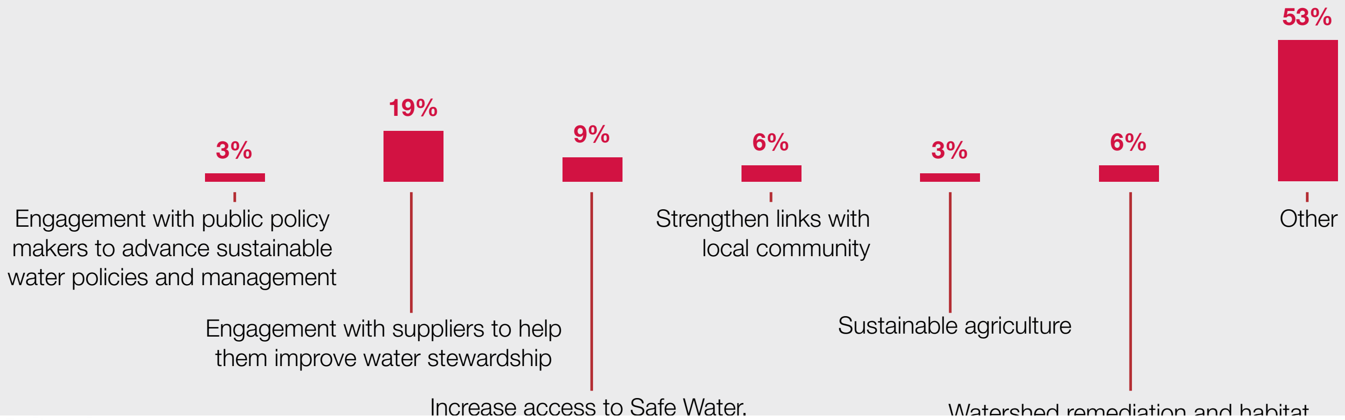
Water: The majority of companies are still focussed predominantly on efficiency measures, but need to focus on local watershed risk management

Figure 6: Frequency and timeline of water targets

Target	Near-term targets (0-5 years, as % of all reported targets)	Long-term targets (>5 years, as % of all reported targets)
Absolute reduction of water withdrawals	7%	5%
Reduction in consumptive volumes	7%	2%
Reduction of water intensity	9%	27%
Water pollution prevention	5%	7%
Other*	11%	20%

e.g. product development, WASH

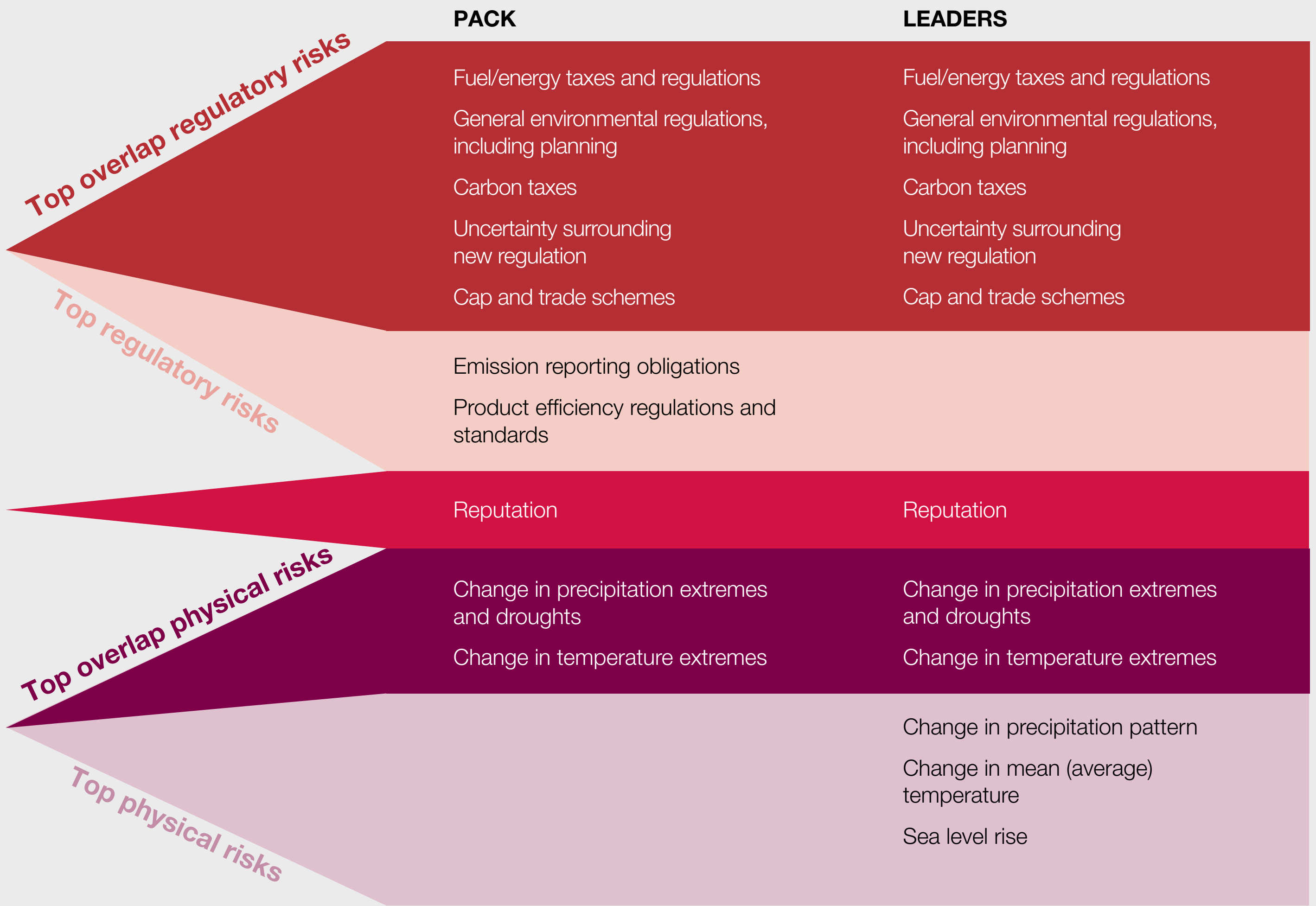
Figure 7: Frequency of water goals



Risks

Climate change: Leaders are likely to have absorbed climate reporting into their business-as-usual and are targeting physical challenges

Figure 8: Top climate change risks*



* All risks data includes Regulatory, Physical and Other: Reputational risks

Remarkably, there is little disparity between the top risks the leaders and pack identify apart from the most common risk for leaders ("Change in precipitation pattern") (see figure 8). Further, one of the pack's top long-term risks ("Emission reporting obligations") is only a near-term risk for the leaders (see Figure 9). Together, this indicates the leaders are more aware and better prepared for any additional reporting legislation that may be put into place and therefore don't see reporting obligations as a long-term risk but are more aware of physical challenges that may arise. Indeed, the leaders have a much more even and consistent spread of the types of risks they report (see Figure 10), demonstrating the thoroughness and scope of their risk assessments.