Investor briefing

Rio Tinto Ltd (ASX:RIO)

Re: Resolution 24 on the Addendum to 2020 Notice of annual general meeting

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Resolution 24

Recognising the company's commitment to the Task Force on Climate-related Financial Disclosures and the aims of the Climate Action 100+, shareholders request that the company, in subsequent annual reporting, disclose short, medium and long-term targets for its scope 1, 2 and 3 greenhouse gas emissions and performance against those targets.

All targets should be independently verified as aligned with the climate goals of the Paris Agreement.

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Summary

The Task Force on Climate-related Financial Disclosures (TCFD) recommends:

> Organizations should describe their key climate-related targets such as those related to GHG emissions... in line with anticipated regulatory requirements or market constraints or other goals.

The Climate Action 100+ initiative aims to secure commitments from boards and senior management to:

> Take action to reduce greenhouse gas emissions across their value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2 degrees Celsius above pre-industrial levels.

Rio Tinto's current approach to climate change fails to meet these integral expectations, as:

- Rio Tinto's targets to reduce scope 1 and 2 greenhouse gas emissions fall well short of regulatory requirements anticipated under the Paris Agreement.
- Rio Tinto has no targets to manage its scope 3 emissions, which make up approximately 94% of the emissions across its value chain and represent by far the company's greatest exposure to transitional climate change risk.

These failures leave Rio Tinto lagging its peers, with rival miners BHP, Vale and Glencore all having committed to set targets to reduce scope 3 emissions.

Scope 1 and 2 targets

Rio Tinto knows its targets to reduce absolute scope 1 and 2 emissions by just 15% from 2018 to 2030 are not Paris-aligned. The Board's recommendation against this resolution, as set out in the Addendum to 2020 Notice of annual general meeting, notably lacks any claim that these targets are consistent with the Paris climate goals. Such a claim would be indefensible.

According to the Intergovernmental Panel on Climate Change, in order to meet the Paris Agreement's goal of limiting global warming to 1.5°C, "Global net human-caused emissions of carbon dioxide (CO_2) would need to fall by about 45 percent from 2010 levels by 2030, reaching 'net zero' around 2050."

The Science-based Targets initiative's Absolute Contraction Approach suggests Rio Tinto's absolute emissions would have to fall by 50% by 2030 to be in line with a 1.5°C pathway, or 30% to be in line with 'well-below 2°C' of warming. The SBTi-approved scenarios that are 1.5°C-aligned and do not rely heavily on negative emissions would require overall emissions reductions in the region of 55-60% by 2030.

Rio Tinto says it has "benchmarked" its targets against available tools, including the SBTi (see page 5 of the Addendum). Clearly these tools reveal the targets are not Paris-aligned, forcing Rio Tinto to claim the tools have "shortcomings." Yet Rio Tinto has failed to take the opportunity to work with the likes of SBTi to develop a methodology to determine Paris-aligned targets that are specifically applicable to its business, suggesting the company has no interest in overcoming the shortcomings it sees with current tools.

Section 3. Absolute Contraction Approach

Well below 2 degree scenario (WB2C)

Review all target modelling data

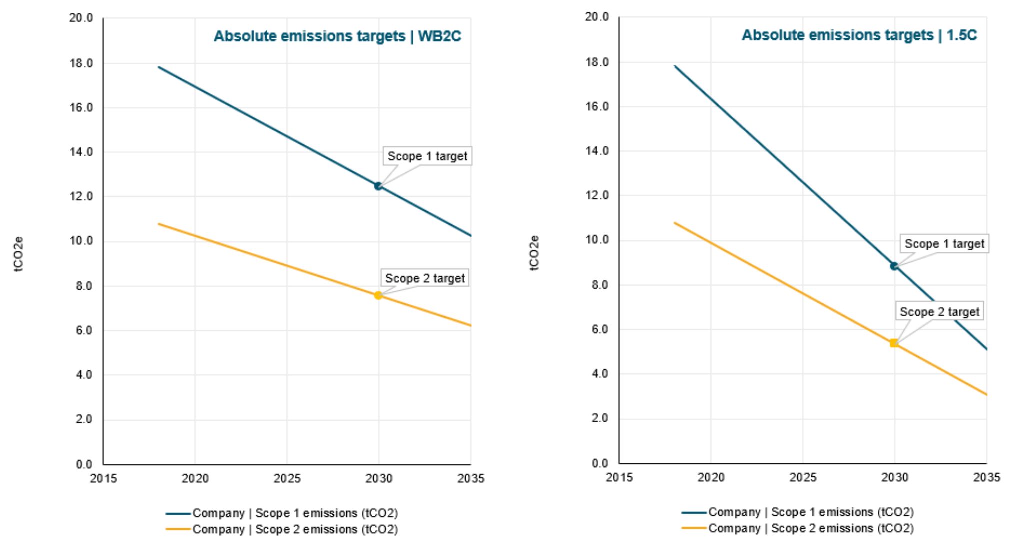
	Base year (2018)	Target year (2030)	% Reduction
Scope 1 emissions (tCO2e)	18	12	30.0%
Scope 2 emissions (tCO2e)	11	8	30.0%
Scope 1+2 emissions (tCO2e)	29	20	30.0%

1.5 degree scenario (1.5C)

Review all target modelling data

	Base year (2018)	Target year (2030)	% Reduction
Scope 1 emissions (tCO2e)	18	9	50.4%
Scope 2 emissions (tCO2e)	11	5	50.4%
Scope 1+2 emissions (tCO2e)	29	14	50.4%

Source: SBTi Tool, emissions data taken from Rio Tinto: Our approach to climate change 2018



Source: SBTi Tool, emissions data taken from Rio Tinto: Our approach to climate change 2018

Rio Tinto's 15% absolute scope 1 and 2 emissions reduction target clearly falls well short of anything that could be considered consistent with the Paris Agreement's goals of: "Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels."

The TCFD recommends "Organizations should describe their key climate-related targets such as those related to GHG emissions... in line with anticipated regulatory requirements or market constraints or other goals."

With scope 1 and 2 targets that are out of line with the regulatory requirements and market constraints required to meet the Paris climate goals, Rio Tinto's climate risk disclosures fail to meet this integral TCFD recommendation. That is unless Rio Tinto anticipates regulatory and/or market shifts will fail to align with the Paris Agreement, in which case the company would need to articulate this position to the market and retract its publicly stated support for the Paris Agreement.

Rio Tinto's failure to align its scope 1 and 2 emission reduction targets with Paris also leaves the company short of the Climate Action 100+ investor initiative's demand that companies: "Take action to reduce greenhouse gas emissions across their value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2 degrees Celsius above pre-industrial levels."

In order for Rio Tinto's commitments with respect to scope 1 and 2 greenhouse gas emissions to meet the expectations set by the TCFD and Climate Action 100+, the company must bring its medium-term (2030) target into line with the Paris climate goals. It must also disclose short- and long-term targets clearly demonstrate a Paris-aligned transition to complete decarbonisation.

Scope 3 targets

Rio Tinto's scope 3 emissions make up approximately 94% of the company's carbon footprint. This represents by far the company's greatest exposure to transitional climate change risk.

> Transition Risks
>
> "*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."* TCFD

The vast majority of Rio Tinto's scope 3 emissions are generated by its iron ore customers in the steelmaking process. In 2019, Rio Tinto's iron ore business accounted for $16.1 billion of our company's total Underlying EBITDA of $21.2 billion (76%). According to IPCC analysis, holding warming to 1.5°C will require emissions from industry, including steelmaking, to fall by around 40% from 2010 levels by 2030 and more than 80% by 2050.

Meeting the Paris climate goals will require the steel industry to either decarbonise or decline. Rio Tinto recognises the risk this poses to its business. However, contrary to the TCFD recommendations, the company has not disclosed any metrics or targets to manage this risk. In fact, Rio Tinto has outright refused to set such targets, suggesting the company is not interested in mitigating what represents the most significant exposure to transitional climate risk on its books.

Throughout Market Forces' extensive engagement with Rio Tinto over the last two years, we have been open to any alternative metrics and targets that would demonstrate Rio Tinto is managing its greatest transitional risk exposure. If the company were to articulate how this risk will be managed in line with the Paris climate goals, the request for scope 3 emission targets would be dropped. The company has offered no such alternative. When it comes to Rio Tinto's greatest climate risk exposure, the company continues to fail to meet the TCFD's key recommendation that companies disclose the targets used to manage such risks (see TCFD page 14).

The Board's recommendations against this resolution claims the company cannot accurately measure its scope 3 emissions, nor influence the emissions of its broader value chain. Yet the same document trumpets Rio Tinto's work with partners, including its largest iron ore customer, to produce better emissions data and explore methods to reduce emissions across the company's value chain. For Rio Tinto to claim it is impossible to mitigate Scope 3 emissions, then move to promote its efforts to do exactly that it is wildly incongruous.

To be clear, scope 3 emissions calculation methods, including the Corporate Value Chain (Scope 3) Accounting and Reporting Standard developed by Greenhouse Gas Protocol, already exist and are widely used. Rio Tinto already discloses best estimates of its scope 3 emissions.

Rio Tinto's claims of impossibility are further eroded by the scope 3 emissions commitments being made by rival diversified miners with major iron ore operations BHP and Vale. Rio Tinto says it cannot set targets for its scope 3 emissions as it doesn't produce carbon. However, coal, oil and gas products only account for just 43% of BHP's scope 3 emissions. For BHP to reduce scope 3 emissions in line with Paris, it will need to act on its other product value chains, including iron ore, which the company has vowed to do. Similarly, Vale's commitment to set scope 3 emission reduction targets will necessarily require action on emissions from its iron ore value chain, which makes up 74% of its revenue while coal contributes just 3%.

In order to meet the standards set by its rivals, comply with the requirements of the TCFD, and meet the Climate Action 100+'s demand for action to reduce emissions *across its value chain* in line with Paris, Rio Tinto must commit to setting scope 3 emission reduction targets, as requested by this resolution.

The key question for investors to consider is: **how comfortable are we in the knowledge that a company we hold has an unmitigated transitional risk exposure affecting 76% of its EBITDA, which it refuses to set targets to mitigate, despite its competitors committing to do so, and despite possessing the financial and technical capacity to work with clients to improve efficiency and reduce emissions?**

Engagement to date

Market Forces has engaged extensively with Rio Tinto over the last two years, and appreciates the constructive and frank conversations that have taken place. There is much common ground in each party's understanding of the transition required to meet the Paris climate goals.

Throughout our discussions with the company we have been left in no doubt as to Rio Tinto's technical and financial capacity to reduce emissions in its own operations and downstream through the value chain.

However, we remain disappointed that Rio Tinto's approach to target setting to date reflects only the inherent efficiency and emission reduction gains that stem from business as usual, rather than starting from a point of the emissions reduction required in order to be in line with the goals of the Paris Agreement. This knowingly and unnecessarily exposes the company to unmitigated transitional climate risk.

It is also disappointing to see the company mischaracterise resolutions such as these as anything other than a request to ensure climate risks to the company are mitigated and managed, in order to protect the value inherent to the company.

Advisory resolutions in Australia

The unique shareholder proposal mechanism in Australia requires a special resolution to be lodged in order for an advisory resolution to be included on the Notice of Meeting.

Regardless of the special resolution’s outcome, votes lodged on both resolutions prior to the AGM will be recorded and disclosed by the company.

In this case, Resolution 24 is an advisory resolution, which is open to be voted on as long as Resolution 23 remains open. Resolution 24 does not bind the company to any action, but provides an important opportunity for shareholders to express their opinion on the company’s approach and commitments to managing climate-related risks and reducing greenhouse gas emissions.

It is clear that Rio Tinto’s current plans fall short of investor expectations articulated by the TCFD and Climate Action 100+. Market Forces therefore urges shareholders to take the opportunity presented by Resolution 24 to demonstrate support for Rio Tinto improving its emission reduction targets to align with the Paris climate goals and address the climate risk posed by its broader value chain.

Market Forces urges investors to vote in favour of this resolution.

Appendix 1 - TCFD expectations

The G20 Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) published its final recommendations in 2017, designed to allow investors to "appropriately assess and price climate-related risk and opportunities." Regulators and investors now expect companies to fully comply with the TCFD recommendations.

The Australian Government welcomed the TCFD recommendations, encouraging "all stakeholders to carefully consider the recommendations of the Taskforce." ASIC foreshadowed regulatory action after its September 2018 report found many companies were breaking the law by failing to adequately consider and disclose climate risk.

The TCFD is supported by over 1000 organisations, representing a market capitalisation of over $12 trillion. All respondents to Morrow Sodali's 2019 Institutional Investor Survey believe companies with material exposures to climate-related risks should adopt the TCFD recommendations. The Australian Council of Superannuation Investors (ACSI) expects TCFD adoption to ensure companies can "successfully identify and manage the climate risks and opportunities [they] face."

Rio Tinto signed up as a supporter of the TCFD in 2017, but is yet to fully comply with the recommendations.

A core TCFD recommendation (see page 14) is that companies:

> Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Elaborating on this recommendation, the TCFD states (page 23):

> Organizations should describe their key climate-related targets such as those related to GHG emissions... in line with anticipated regulatory requirements or market constraints or other goals.

Appendix 2 - Climate Action 100+ expectations

The Climate Action 100+ investor initiative launched in 2017. Through coordinated investor engagement, it seeks to ensure the world's largest corporate greenhouse gas emitters take strong action on climate change.

More than 450 investors with over $40 trillion in combined assets under management have joined the initiative, and signed the Climate Action 100+ Sign on Statement, which is available in full at: https://climateaction100.wordpress.com/investors/.

Most pertinently, the Climate Action 100+ "aims to secure commitments from the boards and senior management to… Take action to reduce greenhouse gas emissions across their value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2 degrees Celsius above pre-industrial levels" and "Provide enhanced corporate disclosure in line with the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)."

Rio Tinto is on the list of Climate Action 100+ target companies.