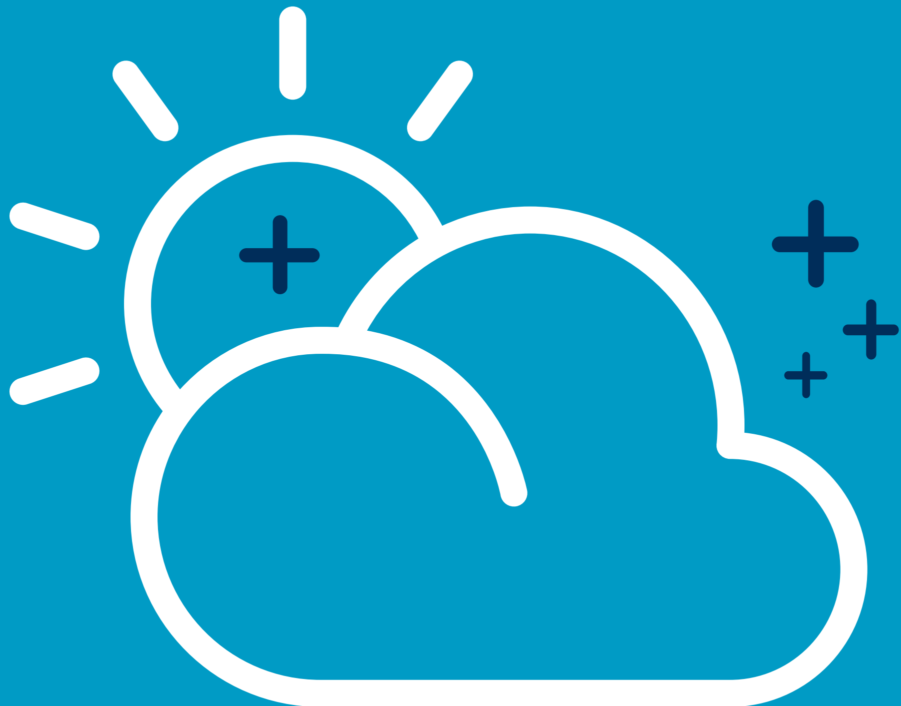
Our climate competency as investment consultants

September 2021



Climate change is now widely recognised as a material financial risk to investors. It is therefore important that asset owners and their advisers have the necessary skills and resources to address climate-related risks and opportunities for their investments. Indeed, this forms part of the statutory climate guidance for large UK pension schemes introduced through the Pension Schemes Act 2021. In this document, we focus on LCP's climate competency as investment consultants, whilst acknowledging that climate change is important for all parts of our business.

Summary of our climate credentials

At LCP, we have been building our expertise in climate change for over a decade and it is now an integral part of our investment consultancy services. We emphasise to our clients that climate change poses major threats (as well as opportunities) to the environmental, social, economic and financial systems on which they depend to achieve their investment objectives – not to mention broader societal aims. We therefore fully support action to mitigate climate change by transitioning to a low carbon economy, meeting net zero emission targets and adapting to the physical effects of climate change.

Climate competency theme	How LCP provides solutions and supports our clients under these themes
Firmwide climate expertise and commitment	• Approximately 50 people across the firm are involved in the development and maintenance of our responsible investment (RI) or climate-related services, including three full-time RI specialists, three other climate metrics specialists and nine trained climate scenario presenters. • We are working with some of the largest UK pension schemes on developing and implementing their approach to climate-related risks and opportunities, following the TCFD (Taskforce on Climate-related Financial Disclosures) recommendations. We are supporting several schemes in setting net zero emission targets and starting the journey to achieving them. • We have committed to become operationally Net Zero from 2021 and are signatories of the Net Zero Investment Consultants Initiative which commits us to nine actions, including integrating advice on net zero alignment into all our investment consulting services as soon as practically possible.
Individual consultant climate expertise	• We have a team of approximately 180 investment professionals, most of whom have practical experience of advising on climate change. Notably, based on our advice, approximately 25 clients have switched a total of more than £1bn of equity holdings to track low carbon indices and approximately 50 clients are considering switching a further £2.5bn. In 2020, we researched how 17 investment managers could incorporate climate-related criteria into buy and maintain credit mandates, and are now working to implement such criteria into client mandates totalling around £8bn. • We have approximately 40 investment clients subject to the new climate regulations for large UK pension schemes, which means that many of our around 180 investment professionals are starting to work with at least one client in this area. • Expertise is maintained and strengthened through compulsory monthly technical training for the investment department. This included ten presentations on RI topics in the year to 31 March 2021, with climate change being the sole focus of three of those. We also held several online "bitesize" sessions on climate change topics during the year, open to anyone in the firm to attend, each lasting around 30 minutes.

Tools and software	• We have a climate dashboard which helps clients to monitor a range of climate-related metrics for their public equity and debt holdings, using data from MSCI. We are working on incorporating climate-related metrics in performance monitoring reports as standard, across all of our clients. • We can provide climate scenario analysis, using modelling we developed in partnership with Ortec Finance, to illustrate the potential impacts of three climate-related scenarios on pension scheme assets and liabilities, year-by-year for 40 years. Our covenant specialists can supplement this with qualitative consideration of the impacts on the sponsor to provide trustees with an integrated assessment of climate risk to their funding and investment strategy. • We will soon be launching a triage tool to help trustees identify priority actions for managing their scheme's climate-related risk at portfolio level and to provide pathways for how the portfolio's alignment with climate targets may evolve over time.	
Thought leadership and policy advocacy	• Climate change features prominently in our client briefings, blogs, publications and events. For example, our Climate Centre for Pension Trustees hosts a wealth of easy-to-access information and links to our latest climate thinking. The full version, which is available to clients, also includes guidance and resources on ten specific areas of climate action. • We are active participants in various industry groups. Our specialists have made substantive contributions to climate-related projects with the Investment Consultants Sustainability Working Group (ICSWG), the Pensions Climate Risk Industry Group (PCRIG) and the Institute and Faculty of Actuaries (IFoA). • We have good relationships with key regulators, including the Department of Work and Pensions (DWP) and the Pensions Regulator. We respond to relevant consultations, such as those relating to the new TCFD requirements for pension schemes, and engage with them on climate-related policies.	
Assessment of investment managers and engagement with them	• We have a range of "buy rated" funds across the main asset classes providing solutions to climate-related risks and opportunities. Our investment research views and ratings incorporate climate change for all asset classes, so this automatically forms part of our manager selection and monitoring advice. • From 1 April 2022, an investment manager must be a signatory of the Net Zero Asset Manager Initiative for their funds to be eligible to receive a "buy rating" from us. • We have published a set of net zero expectations for investment managers, setting out our current thinking on best practice in this area, and have extended our research questions to help us monitor how well managers are meeting these expectations.	

Next steps

The assessment and risk management of climate change for investors is rapidly evolving. With that ongoing evolution, there is more we would like to do to enhance our climate-related services. We are committed to doing so and are investing considerable resources in that evolution. We value our clients' feedback, so welcome your views on how we are doing, what else you would like to see us do and what you would like to see us doing differently.

To help you meet fiduciary and regulatory expectations, we suggest that you:

1. Consider adding climate change to the objectives you set for us
2. Ensure all your advisers are climate competent
3. Provide feedback to your usual LCP consultant on our approach to climate-related investment advice

The appendix provides more detailed information on our climate credentials.

Appendix: Our climate credentials, mapped to the ICSWG Climate Competency Framework

In January 2021, the Investment Consultants Sustainability Working Group (ICSWG) – a collaboration between 17 investment consultancy firms – published a "Climate Competency Framework". This sets out five themes against which trustees should expect their Investment Consultants to demonstrate their climate competency. The indicators are described as deliberately stretching and the guide acknowledges that some of them will be aspirational. In this appendix, we set out our approach for each of the ICSWG's competency indicators.

Theme 1 – Firmwide climate expertise and commitment

ICSWG's positive indicators	LCP's approach
Clear governance structure and responsibilities stated to ensure appropriate oversight of climate-related factors into client services	Our Responsible Investment (RI) Panel provides strategic oversight of the integration of climate-related factors into investment client services and manager research. It consists of seven senior individuals and is chaired by Clay Lambiotte, our Head of Investment and member of the firm's Executive Committee (ExCo). This ensures a direct reporting line to ExCo which has ultimate responsibility in this area.
Assigned senior leader (partners / board member) responsibility for the oversight of climate-related issues	Clay Lambiotte, our Head of Investment, is the assigned senior leader.
Firm-wide strategic response to manage climate-related risks and opportunities and steward an orderly transition which is publicly available (for example, in line with the recommendations of the Taskforce on Climate-related Financial Disclosures)	We included information about our response to climate-related risks and opportunities in our public 2020 Stewardship Report. We will continue to report publicly on our climate response at least annually, including our progress against the commitments we have made under the Net Zero Investment Consultants Initiative.
Specialists with depth of climate expertise	Our Core RI Team consists of 10 individuals, including three who work full-time on RI. Approximately 40 other people across the firm are involved in the development and maintenance of our ESG or climate-related services, including climate metrics and climate scenario specialists. Our RI experts have built up climate expertise through a range of formal and informal learning, as well as on-the-job experience. They support the rest of the investment department on climate-related matters.
UN PRI signatory	LCP has been a service provider signatory of the PRI since 2014.
Signatory to the UK Stewardship Code 2020 (from mid-2021)	LCP is a service provider signatory of the 2020 Code.

Theme 1 – Firmwide climate expertise and commitment	
Conflicts policy which addresses potential conflicts related to advice on climate as a result of differences between the investment consultant's commercial interests and the trustees' climate objectives, or business relationships between the investment consultants and the asset managers or trustees	Our conflicts policy is available in our 2020 Stewardship Report (p24-25).
ICSWG's best practice indicators	**LCP's approach**
Performance assessment of the investment consulting firm's consultants and senior leaders is aligned with helping clients achieve their climate-related objectives	Some of our consultants have explicit RI and/or climate-related objectives. Our 12-month RI plan, which has a strong climate change focus, has 17 workstreams, each led by a senior professional who is held accountable through regular progress reports to the RI Panel. More broadly, our consultants' performance assessment takes into account the quality of service to and feedback from their clients, which incentivises consultants to help their clients achieve their objectives including their climate-related objectives.
Signatory of (or affiliated to) other climate related initiatives	LCP is an associate member of the Institutional Investors Group on Climate Change (IIGCC) and an influencer member of Pensions for Purpose.
Produce climate risk management thought pieces	Our recent thought leadership publications include: Climate change: A primer for investors; Climate centre for pension trustees; Climate change for charities: The investment risks and opportunities; Climate change for sovereign investors and central banks: The investment risks and opportunities; Aligning the stars: Asset owners and energy investment toward Net Zero; and The tip of the iceberg: How UK institutional investors are responding to climate risks. Climate change is often a focus of our investment blogs and articles in our biannual Vista magazine.
Inclusion of climate-related issues in regular client communications	Our quarterly "Macro, markets and much more" analysis for clients always includes articles on ESG (environmental, social and governance) topics, with usually at least one on a climate-related issue. Our weekly Pensions Bulletin – which summarises and comments on policy, regulatory and other industry news – often includes climate-focused stories.
Demonstrate an awareness of climate justice, including a just transition	The just transition was the lead ESG article in the Q2 2021 edition of our "Macro, markets and much more" update for clients. It was also one of the topics covered in our recent blog "The silent S in ESG".

Theme 2 – Individual consultant climate expertise

ICSWG's positive indicators	LCP's approach
All investment consultant colleagues receive regular and appropriate climate-specific training by both internal and external experts	Climate change topics are often covered in our compulsory monthly technical training for the investment department. During the year to 31 March 2021, there were ten RI topics lasting approximately 3.5 hours in total, with climate change being the sole focus of three of those. Since April 2020, we also have held online "bitesize" sessions lasting around 30 minutes which anyone from across the firm can join. In the year to 31 March 2021, four of these were exclusively on climate change topics. There have been other internal climate change training sessions for specific groups such as investment partners and investment researchers. Training sessions are recorded for those unable to attend live, including subsequent new joiners. In addition, investment consultants are encouraged to attend external training such as webinars to gain outside perspectives and deepen their knowledge.
Seek to understand client needs and views on climate change, and where relevant educate clients on climate-related risks to their investments	Our consultants primarily seek to understand their client needs and views through client-specific interactions such as meetings and conference calls. We are considering ways in which we can gather views and feedback on climate-related needs in a more systematic manner. We encourage clients to include RI, including climate change, as a regular item in their annual business plans. As well as including climate-related topics in thought leadership materials and news bulletins, we provide tailored training sessions for clients on request. We have an extensive bank of precedent training materials on climate change to support this.
Able to identify and assess climate-related risks and opportunities	Our climate-related training aims to build consultants' knowledge of these topics, particularly recent sessions on metrics and scenario analysis. Our intranet includes a "climate hub" with a wide range of guidance and precedent advice documents which consultants are encouraged to access.
A working understanding of how to apply and disclose against the recommendations of the Taskforce on Climate-related Financial Disclosures	The TCFD requirements being introduced by the Pension Schemes Act 2021 are a key focus for client advice this year. We have approximately 40 investment clients subject to these requirements, which means that many of our consultants are starting to work with at least one client in this area.
ICSWG's best practice indicators – Demonstrable record of helping clients:	**LCP's approach**
...develop climate related beliefs and understanding of key issues	Many of our clients have received climate change training from their consultants and a significant minority have undertaken RI belief surveys with specific questions on climate change.

Theme 2 – Individual consultant climate expertise	
...shape voting policy to include explicit guidance on climate-related voting, including policies on shareholder proposals, and influencing asset managers to accept these	Most of our clients' equity investments are held in pooled funds where it is not possible to direct how votes are cast. Their voting policies therefore focus on oversight of the managers' voting practices. Through our engagement with investment managers and our published set of net zero expectations for investment managers, we are shaping guidance on climate-related voting and influencing asset managers in this area. Where requested, we will also help clients develop explicit guidance on climate-related voting to influence their managers.
...develop climate-related targets (such as Paris alignment, decarbonisation and other targets) in line with recommendations of the Taskforce on Climate-related Financial Disclosures	Some of our largest investment clients have recently set net zero targets and we supported them in that process. We expect to help many more of our clients develop climate-related targets over the next few years, including those required to do so under the Pension Schemes Act 2021.
...develop climate-related policy frameworks	Most of our clients have a general ESG policy, rather than one that specifically focuses on climate change. However, we are now working with some to develop climate-related policy frameworks and expect that number to increase.
...integrate climate-related considerations across all asset classes	Climate-related considerations form part of our manager research across all asset classes, as described below. We research specialist climate-focused strategies spanning equity, credit and real assets.
...shape their investment strategy, incorporating climate-related risks, pricing opportunities and climate-related impacts	Our standard asset-liability modelling assumptions reflect a climate adjustment to the equity risk premium, informed by our climate scenario analysis work. We use these assumptions when providing strategic asset allocation advice which shapes clients' high-level investment strategy. When helping them implement that strategy, climate-related considerations are incorporated – as a minimum – through our manager selection advice. Where appropriate, we advise on specific climate-focused fund options.
...with practical recommendations to reduce their climate-related risk exposure and/or develop strategies to steward an orderly transition to a net zero and resilient economy	On our advice, approximately 25 clients have switched a total of more than £1bn of equity holdings to track low carbon indices and approximately 50 clients are considering switching a further £2.5bn. In 2020, we researched how 17 investment managers could incorporate climate-related criteria into buy and maintain credit mandates, and are now working to implement such criteria into client mandates totalling around £8bn.
...with guidance on climate-related reporting	Although few of our clients have yet reported publicly on their climate-related activities, this will become an important part of our work with £1bn+ pension scheme clients over the next two years.
...fully integrate climate considerations into manager selection and monitoring	Our research views and ratings have incorporated ESG factors for all asset classes for several years, so this automatically forms part of our manager selection and monitoring advice. In 2020, we changed the structure of our research notes to have separate sections describing ESG integration, voting and engagement, and climate change, to ensure that all three aspects are covered.
...keep abreast of and meet regulatory expectations	We keep clients informed of regulatory expectations through communications such as our Pensions Bulletin and our Briefing Note on the new climate regime for pension schemes. Our starter advice documents are informed by regulatory expectations. These include a roadmap for helping £1bn+ pension scheme clients develop a plan to meet (and exceed where appropriate) the TCFD requirements.

Theme 3 – Tools and software

ICSWG's positive indicators	LCP's approach
Have a database of climate metrics for investments covering for example: • Carbon intensity • Carbon emissions • Alignment with goals of the 2015 Paris climate agreement and implied temperature rise • Climate Value at Risk • Exposure to 'green' revenues	LCP has an MSCI ESG licence which provides climate metrics for listed equities and corporate bonds, including carbon intensity, carbon emissions, carbon targets (including whether they are certified by the Science-Based Targets initiative (SBTi) as being aligned with the Paris Agreement goals) and green revenues. We do not currently subscribe to a service for implied temperature rise or Climate Value at Risk metrics as we do not feel such metrics are yet sufficiently robust for use with our clients. These metrics rely on many assumptions which are often opaque and lack consistency between providers. Also, unlike the other metrics listed, it is not practical to obtain them for unlisted assets not covered by our MSCI licence.
Help clients monitor climate-related metrics	We have an ESG dashboard which helps clients to monitor a range of ESG metrics, including three climate-related ones. We recently launched a complementary climate dashboard that provides a more in-depth analysis of climate-related metrics. We are working on incorporating some of these metrics in performance monitoring reports as standard, across all of our clients. We also prepare bespoke climate-related metrics reporting for some clients.
Use freely available tools such as PACTA or PRA stress test data to help clients assess climate risk	We are happy to use these tools in our advice on request. However, we generally prefer to use the climate scenario analysis service we have developed in partnership with Ortec Finance (see below) because it better suits most of our clients' needs. For example, it models climate-related impacts on assets and liabilities consistently and is integrated into our investment modelling tools, enabling real-time demonstration of the results in meetings.
Help clients set and monitor appropriate climate-related targets	We are developing a tool to help clients assess the Paris alignment of their portfolios and hence inform target setting. As our clients set climate-related targets, we will adapt our reporting of climate-related metrics to facilitate monitoring of these targets.
ICSWG's best practice indicators	**LCP's approach**
Capability to conduct scenario analysis for assets, liabilities and sponsor covenant to help clients understand how climate change might affect investment returns and value at risk over the short-medium and long-term	We have developed climate scenario analysis modelling in partnership with Ortec Finance which illustrates the potential impacts of three climate-related scenarios on pension scheme assets and liabilities, year-by-year for 40 years. Our covenant team can supplement this with qualitative consideration of the impacts on the sponsor to provide trustees with an integrated assessment of climate risk to their funding and investment strategy.

Theme 3 – Tools and software	
Consideration of an orderly transition, disorderly transition and failed transition scenario with their associated direct transition and physical risks as well as systemic risks that could arise	Our three standard scenarios are the Paris Orderly, Paris Disorderly and Failed Transition scenarios. These all incorporate physical risks and the first two incorporate transition risks as well. The modelling is top-down, translating economy-wide impacts into financial market impacts. It therefore reflects systemic risks, although – as with almost all modelling of this type – is not able to fully capture certain effects such as tipping points.
Where relevant, help clients consider real world impacts on climate change of their investment choices	Our MSCI ESG licence includes impact metrics, for example, alignment of company revenues with the UN's Sustainable Development Goals and green revenues. We can use these to support our advice to clients on the real-world impacts on climate change of their investment choices.

Theme 4 – Thought leadership and policy advocacy	
ICSWG's positive indicators	**LCP's approach**
Encourage better standards of corporate governance of climate-related risks, for example through positive contributions to public consultations on guidance and regulation of climate-related risks	In the last 18 months, we have responded to: the Pensions Climate Risk Industry Group (PCRIG) consultation on its draft TCFD guidance; the Department for Work and Pensions' (DWP) two consultations on the climate requirements being introduced through the Pension Schemes Act 2021; the Financial Conduct Authority's (FCA) consultation on TCFD disclosures by asset managers, life insurers and FCA-regulated pension providers; and the Pensions Regulator's consultation on its draft TCFD guidance.
Supportive of public policy initiatives on climate change	We have shown our support through our thought leadership materials (see comment above under Theme 1), press comments and consultation responses. We are also encouraging our clients to sign the 2021 Global Investor Statement to Governments on the Climate Crisis.
Collaboration as part of climate industry groups	We are active participants in the ICSWG, including in the development of this climate competency framework, and recently joined the Paris alignment implementation working group of the IIGCC. Our Head of RI made a substantive contribution to the PCRIG guidance. She also initiated and was heavily involved in an Institute and Faculty of Actuaries (IFoA) working party which published six papers on the implications of resource and environment issues for the work of pensions actuaries between 2017 and 2020.
ICSWG's best practice indicators	**LCP's approach**
Engage with regulators on latest climate-related policies	We have good relationships with key regulators, including the DWP and the Pensions Regulator, and our engagement with them includes climate-related policies.

Theme 4 – Thought leadership and policy advocacy	
Engage with the developers of climate reference scenarios	We have not engaged with the developers of climate reference scenarios, although we regularly exchange views on such scenarios with our partner Ortec Finance and they do engage with the scenario developers.
Contribute meaningfully to system decarbonisation and achieving the goals of 2015 Paris climate agreement	We aim for our climate-related work with clients to contribute meaningfully to these goals, thus helping to reduce the systemic impacts of climate change which could undermine both the personal and professional aims of our colleagues and clients. In our advice and our expectations of investment managers, we have increased our emphasis on the importance of achieving real-world emissions reductions rather than focusing on individual portfolio decarbonisation.
Active monitoring of related developments, for example, nature-related financial risks such as biodiversity loss.	Members of our RI team use a wide range of sources to track relevant developments across ESG topics, sharing insights with colleagues and clients as appropriate. For example, two of our last three "Macro, markets and much more" updates for clients included articles on nature-related financial risks.

Theme 5 – Assessment of investment managers and engagement with them	
ICSWG's positive indicators	**LCP's approach**
Engage with investment managers about their climate practices (eg integration into investment decisions, voting and engagement)	To complement our ongoing engagement with managers in this area, we undertook a series of eight dedicated meetings on net zero in the first half of 2021. This led to the development of a set of expectations for investment managers which sets out our current thinking on best practice and we have since shared this with the managers we research to encourage them to improve in this area.
Climate change is integrated into manager research and is a topic of discussion at research meetings	As noted above, climate change is a standard part of our research views. It is therefore discussed in research meetings in order to develop our views on managers' climate practices. It is a standard agenda item and our materials for researchers include suggested supplementary questions to ask managers.
Provide assessment of investment managers' firmwide approaches to climate change risk management, including through both asset allocation and stewardship	We assess managers' firmwide climate approaches through our biennial RI survey. Our 2020 survey included climate change risk management. We have extended our coverage of this topic for the 2022 survey (for which questionnaires were issued in July 2021).

Theme 5 – Assessment of investment managers and engagement with them	
ICSWG's best practice indicators	**LCP's approach**
Provide assessment of investment managers' fund-specific approaches to climate change risk management	Each research view includes commentary on the fund's approach to climate change, to support our overall RI rating for the fund. We are developing detailed asset-class specific guidance to help researchers assign these RI ratings, setting out what is expected for each grade in relation to ESG integration, voting and engagement, and climate change.
Disclose details of methodologies and framework for assessing investment managers' approaches to managing climate-related risks and opportunities	We have disclosed our broad approach in this document and are happy to answer clients' specific questions on request.
Investment managers' approaches to managing climate-related risks and opportunities feed into the consultant's ratings of investment managers	As described above, climate change is one of the three areas assessed as part of our RI rating of each fund. This assessment then feeds into our overall rating for the fund.
Prepared to exclude fund recommendations on sustainability criteria	We have announced that, from 1 April 2022, a manager must be a signatory of the Net Zero Asset Manager Initiative for their funds to be eligible to receive a "buy rating" from us. If a client has specific sustainability requirements, we are happy to apply sustainability criteria to our fund recommendations and this may result in funds being excluded from our advice.
Encourage improvement in investment managers' climate competencies including on stewardship, and set expectations on best practice	To support our engagement with managers on stewardship, in 2020 we published a set of voting and engagement expectations for each asset class along with firm-level stewardship expectations. As noted above, in 2021 we developed a set of 'best practice' expectations for managers on net zero and are encouraging all our clients' managers to take account of these in their investment process.
Encourage investment managers to become signatories to the UK Stewardship Code 2020	In June 2020, we wrote to the managers we research to encourage them to become signatories to the UK Stewardship Code 2020.

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