Net zero investment progress report 2022

OCTOBER 2023

Welcome to LCP's net zero progress report

Foreword

Climate change represents a material systemic risk for our clients, and we want to help them understand both the risks and opportunities that it will bring. To mitigate the worst outcomes, we know that real world emission reductions are required, not just portfolio decarbonisation. So, whilst we encourage clients to set net zero targets / ambitions and engage with their investment managers, we also actively advocate for investing in climate solutions, so that we can make net zero a reality.

We are proud to be part of NZICI and pleased to report progress in this, our first full NZICI report. However, we know more needs to be done. Working alongside LCP Delta, we are in a unique position to become a leading energy transition consulting practice globally. We have the expertise and influence to make a difference and we will continue to work with policymakers, regulators, investment managers and our clients to align with net zero.

The challenge is significant, and time is against us, but we are committed to making a real difference.

Zuhair Mohammed
Head of Investment

October 2023

This is LCP's first full year report as a signatory to the Net Zero Investment Consultants Initiative ("NZICI"). In January 2023 we provided an interim report for the year ending 30 September 2022 which can found here. In this report, we have set out the progress we made during 2022 towards each of the nine commitments that we have signed up to as part of this initiative. In particular, this publicly available report reflects our adherence to commitment 9, relating to accountability.

> *We are pleased to be able to report progress on integrating net zero into our investment services; however, we acknowledge that more needs to be done to reduce real world emissions and better align our clients' portfolios with the transition to a net zero economy.*

Introduction

About LCP

LCP's mission is to fuse human expertise with powerful analytics to shape a more positive future. We help our clients make good decisions based on insightful analysis, industry expertise, and game-changing technology. We are independent, and we focus our efforts on making sure that every client gets the right advice for their own unique circumstances. Working across a wide range of sectors, including pensions and benefits, investments, insurance, energy, health, sports, and data analytics, we help our clients navigate complexity in order to take the action that matters.

Of our work, around 25% relates to investment services where we are responsible for advising on hundreds of billions of clients' assets across hundreds of mandates. We provide advice to a wide range of institutional investor clients, ranging in size from under £10m to tens of billions of pounds. We do not manage assets ourselves – investment decisions typically rest with the trustees or investment board after considering our advice.

We employ over 1,000 people in offices throughout the UK and Ireland. Our turnover was c.£190m for the year to 31 March 2023 and this has grown at a rate of about 10% per annum for the last five years. We are structured as a Limited Liability Partnership, which plays an important part in our culture and the experience of our clients since the leaders of our business are also our lead advisers. We have the freedom to focus the attention of our business on what our clients need and value.

In April 2022 we acquired Delta-EE and combined it with LCP's existing energy practice, rebranding it LCP Delta. These combined skills and expertise have created a unique offering within the energy sector, including advice on policy setting, utilities, operators, traders, investors and manufacturers. With LCP's wider experience in providing institutional investors with financial advice and modelling, the combined teams are able to advise institutional investors on the new landscape and how to invest responsibly.

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. Climate change has the potential to permanently destroy value for investors; it poses major threats (as well as opportunities) to the environment, society, economy and to the financial system as a whole. 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. We encourage our clients to align their investment strategy with net zero emissions by 2050 – this is incorporated into our overall responsible investment philosophy, which we formally launched in March 2023. Through our advice we seek to improve both our clients' financial outcomes and real-world outcomes.

About NZICI

The Net Zero Investment Consultants Initiative (NZICI) is a global group of investment consulting firms committed to supporting the goal of global net zero greenhouse gas emissions by 2050 or sooner, in line with the ambition to limit the global average temperature increase to 1.5°C above pre-industrial levels. Signatories recognise significant financial risks associated with climate change and the transition to a net zero and resilient economy.

These include, but are not limited to, the risk of stranded assets and loss of earnings for organizations with operations not aligned with this transition, as well as increased weather events, such as flooding, droughts and the consequences of sea level rise. Signatories have committed to support their clients on this journey. The initiative is managed globally by the Principles for Responsible Investment (PRI) and has been endorsed by the Race to Zero Campaign.

Executive summary

We are taking action to help our clients understand the importance of net zero and set targets and ambitions. This report highlights the progress we made over the year to 31 December 2022 in integrating net zero considerations across LCP's investment advisory services.

- We have been advising clients on climate risk management for several years including providing training on climate change. Over the first half of 2022 we provided training on net zero investing to our investment department and encouraged client teams to put net zero (including training for clients) on agendas over the second half of 2022.
- We improved the reporting on climate risks available to clients by producing summary pages of key climate metrics for investment portfolios to be included in standard performance reports. We continued to provide additional climate dashboards with more detailed metrics (based on data from a reputable third-party data provider) and climate scenario modelling (based on modelling from one of the world's leading climate modelling organisations).
- We enhanced our manager research and ratings process to consider climate risks and net zero more explicitly, both in traditional funds and in climate solutions focussed alternatives. Of particular note is our requirement for our "buy" rated managers to be Net Zero Asset Managers ("NZAM") initiative signatories.
- Following the release of the Department for Work and Pensions ("DWP")'s stewardship guidance we also encouraged all our clients to set stewardship priorities, highlighting the reasons why Trustees may wish to include climate risk as a key focus for engaging with managers.

Much of our advice on net zero integration over 2022 was focussed on our largest clients to help them set their own net zero targets, given the impact that such large asset owners can have. We also worked to incorporate net zero considerations in our investment services for the rest of our client base. We note that smaller clients are more resource constrained from a time, expertise and cost perspective and therefore in 2023 we started refreshing and simplifying our existing materials into a streamlined climate service to increase uptake.

Our original intention was for many clients to give explicit consideration to net zero investing in the second half of 2022. However, the September 2022 mini budget and the gilts crisis that followed resulted in the postponement of most net zero discussions in meeting agendas until 2023. As a result, a lot of the intended net zero work for our broader client base was not covered within the reporting period, and so is not within the scope of this report.

We are pleased to be able to report progress on integrating net zero into our investment services; however we acknowledge that more needs to be done to reduce real world emissions and better align our clients' portfolios with the transition to a net zero economy. Whilst we have endeavoured to integrate net zero considerations in our standard processes and template materials, we note that this in itself does not guarantee their use and so we are now looking into reviewing and improving usage, including through our streamlined climate service. In addition, and in line with our refreshed RI philosophy which focusses us on making real world changes, we continue to encourage all our clients to set a net zero ambition (a simplified form of a net zero commitment that we think is suitable for all clients). We also aim to do more in future with the broader industry, regulators and policy makers to reduce the barriers to clients adopting and achieving their net zero targets and ambitions.

Commitments 1-3

Commitment 1

We will integrate advice on net zero alignment into all our investment consulting services as soon as practically possible and within two years of making this commitment.

Commitment 2

We will work with our institutional asset owner clients to identify the investment risks from climate change, highlight the importance of net zero alignment and, where applicable, support our clients in developing policies that align their portfolios to a net zero pathway.

Commitment 3

We will support efforts to decarbonise the global economy by helping our clients prioritise real economy emissions reductions, reflecting the target of 50% emissions reduction by 2030 or sooner using existing decarbonisation methodologies.

Our Executive Committee (ExCo) is ultimately responsible for our ESG (environmental, social and governance) strategy including our NZICI commitments, ensuring we have senior leader responsibility for the oversight and implementation of net zero alignment of our investment consulting services. Our core Responsible investment ("RI") team, which is headed by Claire Jones, has responsibility for delivering LCP's overall ESG strategy which is reviewed periodically. For the year commencing 1 April 2022, the overarching ESG strategy included four strands explicitly related to climate change, each of which had an individual partner assigned as the owner responsible for delivering the objectives:

1. Support £1bn+ pension schemes in Taskforce for Climate-related Financial Disclosures ("TCFD") governance and reporting
2. Incorporate climate change into Defined Benefit ("DB") journey planning narratives
3. Integrate net zero alignment into our investment services
4. Build our expertise in sustainable investment opportunities and impact investing.

More information on our ESG governance structure can be found in our latest Stewardship Code report under Principle 2.

The TCFD requirements currently apply to all UK occupational pension schemes with relevant assets of >£1bn. It requires trustees to put in place a system for identifying, assessing and managing climate-related risks and opportunities, carry out climate scenario analysis, calculate climate metrics, set targets and produce an annual TCFD report. A significant proportion of our investment clients are subject to these rules and therefore all those clients did a lot of work on climate risk management over the year. The work on integrating net zero into our services therefore considered mainly how the remaining clients not subject to such extensive formal requirements could consider climate change.

Commitments 1-3 *Continued*

LCP assigned a small team to take responsibility for developing our net zero advice and integrating net zero into our standard materials and processes. The team analysed LCP's advice process in each investment service line and identified key assets and tools (such as modellers, checklists and office standards) into which net zero considerations were to be incorporated. The team then worked with other internal teams – for example LCP's investment strategy, stewardship and manager research teams – to implement changes where gaps were identified.

To further integrate net zero into our own values and culture, we ensure all investment staff and partners receive regular training on climate-related risks and opportunities and net zero alignment. During 2022, as part of the mandatory training for our investment department, we held six separate sessions covering 13 responsible investment topics, to understand the implications that the net zero transition will have across different asset classes, as well as specific sessions on net zero stewardship. This included training on how to help clients set climate risk and net zero alignment as a stewardship priority. The topics included:

- Introducing climate metrics and including climate risk in performance monitoring reports
- Selecting metrics and setting targets for TCFD purposes
- Assessing climate investment opportunities in illiquid credit
- Including climate change in strategic investment advice

Whilst the focus was on giving client teams the tools they need to integrate net zero into their investment advice, we are conscious that more work is required to ensure that the tools are being used as intended. The following sections set out what progress we have made in each area of our investment consulting services:

1. Client training and understanding

We encourage initial training for new trustees (or equivalent) and ongoing training for existing trustees to incorporate net zero, by including climate change broadly and net zero considerations specifically in our standard trustee training materials. These materials are developed and maintained centrally and made available for colleagues to use with their clients (suitably tailored). The RI team is available to support client teams with bespoke training sessions where required.

During the year, we developed a new set of standard training slides for our clients on net zero in order for them to understand the importance of aligning their portfolios with a net zero economy with a focus on real world emission reductions. This training covers background on what net zero is and why it matters, as well as actionable steps they can take to align their investments with net zero. We launched the slides internally in May 2022 at a mandatory department training session, where we provided training on the content of the slides and guidance on how to use them with clients.

The RI team also produced a number of publications and thought leadership papers over the year including:

- General information / educational documents eg RI training on the outcome of our deep dive into ESG scores.
- Topical articles on RI matters eg several blogs for our website over the year, two articles for each of our quarterly "Macro, markets and much more" document, five articles in our two six-monthly "Vista" publication as well as four podcasts on the topic in our increasingly popular "Investment Uncut" podcast series, which had a total of c.1,700 listens. These included climate change-related topics, such as net zero alignment in bonds and climate solutions.
- Wider communications including our insight hubs which curate news and content from our experts; articles published in periodicals such as our Vista magazines; blogs; podcasts; and events such as webinars and conferences.

Commitments 1-3 *Continued*

2. Investment policies and beliefs

Most of our clients set out their investment policies and beliefs in a formal Statement of Investment Principles ("SIP"). Our template materials for preparing SIPs have included climate change for several years.

We expect all our investment consultants to consider net zero and actively encourage them to discuss setting a net zero ambition with clients depending on their specific circumstances.

Over the year, we helped a number of our clients update their investment beliefs and policies to incorporate net zero considerations. We achieved this through running workshops and meetings with new and existing clients to:

- explore and build their understanding of climate change and net zero through training and discussion; and
- help develop their own investment policies and beliefs around net zero.

The outcomes of these sessions are reflected in customised wording in the clients' investment policy documents, including any net zero ambitions and targets agreed.

In early 2023, we updated our template SIP materials to include specific references to the importance of aligning with a net zero economy and setting a net zero ambition. The importance of net zero alignment is also incorporated into the materials we use to help our clients set and formalise their investment beliefs.

CASE STUDY: Agreeing a net zero commitment and action plan

We provide sustainability advice to a £10bn DB pension scheme, including supporting them on climate change risk management and reporting using the TCFD framework.

In early 2022, the Chair of Trustees and the Chair of the Scheme's Sustainability Committee decided that the Trustee should consider making a commitment to achieving net zero emissions by 2050 or sooner across the Scheme's assets. We provided training on net zero at the next Sustainability Committee meeting which included the financial case for net zero, example net zero commitments and the practical implications for managing the Scheme's assets. Following discussion by the Committee, a recommendation was made to the Trustee Board to make a net zero commitment and this was agreed at the Board's June meeting.

We are now supporting the Sustainability Committee in overseeing the implementation of that commitment. At the September 2022 Committee meeting, we presented a draft action plan for the next twelve months, based on the Net Zero Investment Framework ("NZIF") published by the Paris Aligned Investment Initiative. It included agreeing a set of interim targets, stewardship strategy and climate transition plan. The Committee agreed to focus initially on three priority mandates, namely those (other than LDI) which form part of the Scheme's planned long-term asset allocation. We are now working with the Scheme's in-house team and the three priority managers on implementing the Trustee's net zero commitment and establishing a clear framework to help the Trustee monitor their progress.

Commitments 1-3 *Continued*

3. Investment strategy

We help our clients incorporate climate change and net zero considerations into their strategic planning and asset allocation decisions. In 2022, we achieved this through the following actions:

- We provided internal training and updated the standard process that our consultants are expected to follow when advising clients on investment strategy to require them to think about climate change and net zero. This includes commenting in their advice on the potential impact of climate risk on investment markets and considering the asset class-specific net zero considerations of the strategies they propose.
- Our central assumptions underlying our investment modelling allow for the possible impacts of climate change on future economic growth. Whilst there are many possible pathways that climate change might follow, we aim to allow for a reduction in growth expectations that is greater than the cost of an orderly transition to an economy consistent with the Paris Agreement (under the United Nations Framework Convention on Climate Change), but less severe than no transition at all.
- We carried out climate scenario analysis for dozens of clients, either as part of their TCFD requirements or separately to help them better understand the climate risks of different strategic asset allocations and journey plans. We use scenarios to analyse climate-related risk over the short, medium and long-term based on modelling from a leading provider. Whilst we recognise and highlight the limitations of such modelling, the narrative reporting around these scenarios has helped provide context and a basis for clients to actively consider incorporating net zero into their investment strategy.
- For DB pension scheme clients, an important part of setting the funding and investment strategy is considering how physical climate risks, and the climate risks and opportunities from transitioning to a net zero economy, might impact their sponsoring employer. This can affect their choice of target end state (such as securing benefits with an insurer or continuing the scheme with low reliance on the sponsor) and appetite for investment risk. Where our clients assessed that their sponsor is exposed to significant climate risk, we supported them with strategic advice, which for example may have included advice to seek to shorten funding plans and request higher contributions in the near term.

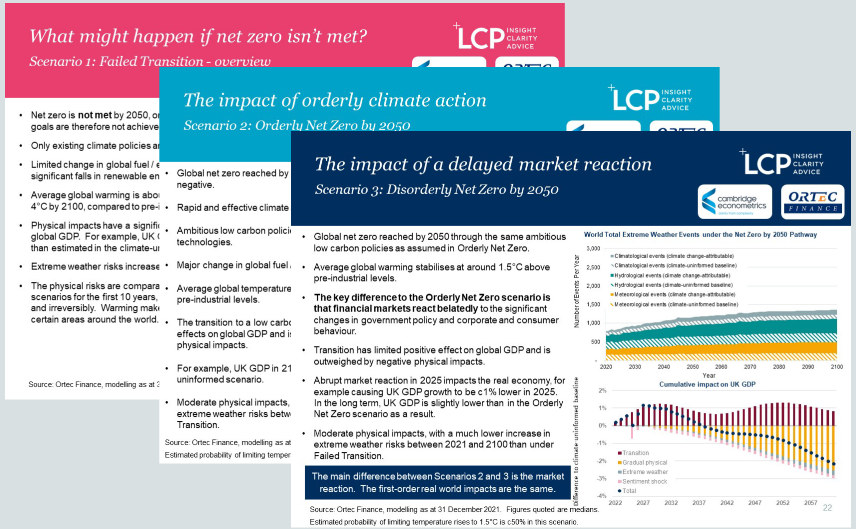
Commitments 1-3 *Continued*

Climate scenario analysis

We have a partnership with a leading provider, that enables us to provide a set of climate change scenarios to help clients better understand their climate-related risks and in turn, the mitigating actions they could be taking.

The service is being used increasingly by our large DB and Defined Contribution ("DC") clients to support them in meeting their TCFD regulatory requirements. It's also being accessed by smaller clients wishing to understand the systemic risk that climate change poses to their pension arrangements.

The scenarios are fully integrated into our in-house modelling tools, LCP Visualise Pro (for DB clients) and LCP Horizon Pro (for DC clients), with options that illustrate year-on-year impacts and help clients understand how climate risks may evolve over time. Client advice sessions are normally delivered by one of our expert presenters who have undertaken detailed training on the scenario modelling and receive periodic refresher training.



We updated these scenarios twice during 2022 to reflect our latest thinking and that of our provider partners as well as to reflect recent developments in climate data and policy. In the first round of updates (with an effective date of 31 December 2021), two of the scenarios were recalibrated to reach net zero carbon dioxide emissions by 2050, reflecting client interest in this particular target, whereas the previous scenarios had been designed to limit temperature rises to "well below 2°C".

We've seen the benefits of using this service in a broad range of trustee decision-making, including changes to DB journey planning and investment strategy.

Commitments 1-3 *Continued*

4. Mandate design / Implementation of strategy

There is generally more scope to consider net zero in the decisions around choice of mandate, for example seeking low carbon funds and / or funds with explicit net zero targets, than when setting the high-level asset allocation. The reporting section on commitment 4 provides more details on this.

We have focussed on helping our clients to assess their asset managers on net zero alignment and working with asset managers to design products that provide better alignment with net zero. To support clients with implementing net zero aligned strategies, we expanded the coverage of funds that we research that are aligning with net zero and / or investing in climate solutions. Consequently, we have a range of “buy rated” funds across the main asset classes (including equities, corporate bonds, multi-asset credit and infrastructure) that are targeting net zero by 2050 or earlier.

For many DB pension scheme clients, the starting point for integrating net zero has been their corporate bond mandates – see case study on the next page. Typically, these clients have high allocations to gilts and low allocations to growth assets such as equities, so corporate bonds is the asset class where net zero integration is easiest. It is also likely to be the most important one from a climate risk perspective, as (along with gilts) it is the key component of many clients’ medium / long term asset allocation.

For DC pension scheme clients, the focus on incorporating net zero into investment strategy decisions has been via the design of the default strategy. Many of them use low carbon passive equity funds as one of the main building blocks in the growth phase of that strategy, such as the LCP-initiated fund range outlined below.

We have worked with asset managers to develop new funds that are expected to achieve our clients’ financial objectives, but which are also are aligned with net zero pathways. For example, following a review of passive ESG equity funds in 2019, we ran a competitive tender process to select a manager to work with us to design an innovative low carbon equity fund range which better met our client needs than the funds available at that time. The fund range was launched in April 2021, with dozens of LCP clients investing over subsequent months. It continued to receive inflows over 2022 taking total investment in the fund range to £7.6bn as at 31 December 2022. Of this, the majority is non-LCP advised assets, showing that the design met the needs of other investors too.

Commitments 1-3 Continued

CASE STUDY: Designing net zero corporate bond solutions

Much attention had been focused on climate risk within clients' listed equity portfolios and significantly less on that within fixed income mandates, including corporate bonds. However, many of our clients, particularly DB pension schemes, have a much higher allocation to corporate bonds than listed equities.

As a result, in 2022, we decided to encourage our clients to prioritise climate risk management and net zero alignment when investing in corporate bond funds, reflecting the alignment between the holding period and sustainability issues.

We've since worked with a wide range of clients on over £10bn of buy and maintain credit mandates to incorporate sustainability guidelines, ranging from basic emissions-focused guidelines to more forward-looking net zero alignment and "do no significant harm" sustainability screens or Sustainable Development Goals tilts. We have also provided input to several managers on the development of new pooled buy and maintain funds, with the focus on integrating net zero into these funds.

We saw the opportunity to leverage the insights and influence gained from working on these mandates and portfolios. Accordingly, we decided to draft our own climate transition guidelines in line with the Paris Aligned Investment Initiative's NZIF which we have used as a starting point for discussions with fund managers on other credit strategies.

5. Manager / provider selection

Over the year, we have worked with our clients to help them select asset managers and DC providers that offer better alignment with net zero.

In September 2021, we announced that we would not 'buy rate' any manager unless they are a signatory to the Net Zero Asset Managers ("NZAM") initiative effective from 1 April 2022. Net zero considerations therefore influence the manager recommendations we make to clients. Further details on this can be found under commitment 4 of this report.

When a client team selects a shortlist of managers to put forward for a selection exercise, they are expected to comment on the responsible investment credentials of that manager, and the fund under consideration. A checklist reminds them to tailor this to reflect what the client's SIP says about responsible investment – which would include any net zero ambition or target set by the client.

During the year, the RI team produced a guide to incorporating climate change in manager selection exercises, which is linked from the checklist mentioned above. The guidance suggests three levels of climate information that client teams could provide in selection reports, depending on how important climate change is to their client.

We conduct periodic research to assess the RI practices of bulk annuity providers[1], including their climate and net zero practices, and encourage DB clients with a buy-in, or who are approaching buy-out, to use it for monitoring existing providers and for new provider selections. We highlight to trustees the need for them to consider tail risk exposure from climate change when selecting a provider and the influence they have in promoting improvements in providers' RI practices. We published a summary of the findings of our 2021 research in relation to climate risk and will shortly release information about our 2023 research.

[1] Insurers offering annuity contracts which cover the pension benefits of many DB pension scheme members. The contract may be held by the pension scheme trustees, with responsibility for future benefit payments remaining with the scheme (a "buy-in"), or responsibility for future benefit payments may pass to the insurer (a "buy-out") enabling the scheme to be wound up.

Commitments 1-3 *Continued*

6. Manager monitoring

We provide our clients with access to tools to monitor their funds' current alignment and potential future paths towards net zero, their exposure to climate-related risks and opportunities, and the net zero commitments of their asset managers. Relevant examples of these include:

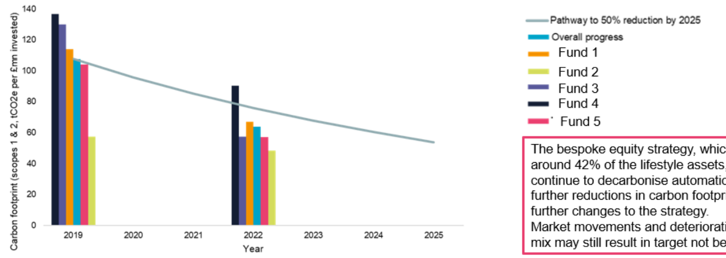
- We have developed a tool called LCP ACT (Analysis of Climate Threats) to help clients triage where the key climate risks and opportunities within their portfolio lie, at an asset class level, and what steps they can take to address it. This helps clients convert broad training on climate change into clear actions on initial steps to take.
- We have standardised performance monitoring templates which summarise the underlying emission intensities of our clients' portfolios, whether their managers are NZAM signatories and whether the funds they invest in have net zero targets. We use these monitoring reports to suggest to our clients where they should be taking action, such as engaging with managers or considering an alternative fund, based on the most material levels of climate risk in their portfolio.
- For clients wanting to explore more detailed climate metrics, for example to support TCFD disclosures, we can prepare climate dashboards for listed equity and corporate bond funds, using data sourced from a reputable third-party data provider. For other asset classes, we request information from investment managers, typically focusing on total greenhouse gas emissions, carbon footprint, the quality of emissions data and the proportion of the portfolio with science-based emissions reduction targets.
- We can provide assessments of the climate change approach taken for the clients' funds, drawing upon our manager research programme and RI survey of managers, with varying levels of detail depending on the client's needs (as described above for manager selection exercises). More information about our RI survey is given on page 16.
- For clients with other monitoring needs, such as those with net zero commitments wishing to track progress against interim targets, we work with them to develop bespoke monitoring reports (see case study below).

CASE STUDY: Ongoing monitoring of emissions against targets

Here is an example of a monitoring template we created for one of our clients, to help them monitor their progress against their net zero target.

XYZ is on track versus a -50% by 2025 target

LCP powering possibility



The bespoke equity strategy, which is currently around 42% of the lifestyle assets, will also continue to decarbonise automatically, driving further reductions in carbon footprint without further changes to the strategy.
Market movements and deterioration in the energy mix may still result in target not being realised.

		2019		2022			
	% total assets at 31/12/22	Carbon footprint (Scopes 1 & 2, tCO2e per £1m)	Coverage	Carbon footprint (Scopes 1 & 2, tCO2e per £1m)	Coverage	Change in carbon footprint %	Contribution to total change
Overall in-scope assets	**97%**	**107.5**	**79%**	**76.0**	**80%**	**-39%**	**-39%**
Fund 1	43%	113.9	84%	67.1	84%	-41%	-18%
Fund 2	28%	104.1	92%	57.1	92%	-45%	-13%
Fund 3	15%	136.7	65%	90.4	68%	-34%	-5%
Fund 4	7%	57.5	87%	48.4	88%	-16%	-1%
Fund 5	4%	129.9	33%	57.5	38%	-56%	-2%

Commitments 1-3 *Continued*

7. Risk management

Climate change is integrated into broader risk management services we provide to investment clients, and we have a range of suggested items on climate change and net zero alignment which can be added to clients' risk registers. We have a detailed resource document that all client teams can access to help them identify and assess climate-related risks and opportunities which can be used in conjunction with any risk management exercises. We encourage climate risk management to be incorporated into broader risk management, rather than being seen as a standalone item.

The identification, assessment and management of climate risks is central to our TCFD advice. Once the risks have been identified they are typically documented in a risk register along with an assessment of impact and likelihood of the risks.

8. Stewardship

Following the release of stewardship guidance by the DWP in the second half of 2022, we helped our pension trustee clients select their stewardship priorities, generally by using a shortlist of six topics that we identified from a client poll conducted at the start of 2022. Most of our clients selected between one and three priorities and almost all included climate change. We worked with our clients to communicate these priorities to their managers and set expectations for the managers, which typically included endorsing LCP's expectations of managers on net zero.

Most of our clients do not have their own voting policy and instead rely on their managers' voting policies. Similarly, very few of our clients undertake their own engagement with investee entities and instead expect managers to do this on their behalf. In response to DWP's guidance, we are helping our clients to strengthen their oversight of their managers' voting and engagement practices. Our recommended approach includes regular review of case studies which relate to their stewardship priorities, along with a process for raising any concerns identified and then engaging with managers to seek improvements in their practices where appropriate. The priorities will also be used to help select the trustees' most significant votes for inclusion in their Implementation Statements[2]. In addition, we encourage our clients to discuss their priorities both with their existing managers and as part of any new manager appointments.

Formal net zero targets

We believe in the importance of reducing overall real economy emissions, rather than just moving around between different owners the investment in companies producing these emissions. Climate science indicates that global emissions need to be reduced by around 50% relative to 2019 levels by 2030, to be on track to limit temperature rises in accordance with the Paris Agreement.

Pension trustee clients within scope of the TCFD requirements must set targets for at least one of their chosen climate metrics. Our usual recommendation to these clients is to target higher levels of the portfolio with science-based targets to reduce emissions. This is due to our preference to focus on alignment of assets and reducing real world emissions rather than decarbonising portfolios on paper only.

We advised some of our largest clients on making formal net zero commitments over 2021/2022. A number of them have formally joined collaborations such as the Paris Aligned Asset Owners, a group of large asset owners committed to transitioning their investments to net zero greenhouse gas emissions by 2050 or sooner, drawing on the initiative's NZIF to deliver this commitment. Other clients are also using the NZIF and other resources from the Paris Aligned Investment Initiative to guide their actions in relation to their net zero

2 For an explanation of Implementation Statements, see Investment guidance News Alert August 2019 (lcp.uk.com).

Commitments 1-3 Continued

commitments. We are helping clients set, monitor and work towards a suite of interim targets, typically including increasing their portfolio alignment with net zero pathways and reducing emissions consistent with a 50% reduction by 2030. This work has mainly taken place since the end of 2022, so we will report in more detail next year.

Our Responsible Investment Philosophy, published in March 2023, focusses on real world change, and addresses the fact that the transition to a net zero economy is crucial to protect our clients' investments and promote the integrity of markets.

However, we recognise that having a formal public commitment is not appropriate for many smaller schemes, particularly where they are mainly invested in pooled funds. For these smaller schemes we are now encouraging them to set a net zero ambition to demonstrate to members and fund managers that managing climate risk is a key priority. Instead of a formal target, this is a publicly stated ambition (typically in their SIP) to align their assets with net zero global greenhouse gas emissions by 2050 through selecting managers, and investing in funds, with credible net zero targets. We will provide an update on this in our next report.

CASE STUDY: Helping a DC client set a net zero target and transition plan for a default strategy

Over 2022, we worked with a large DC pension arrangement to incorporate a target to meet net zero by 2050 into its investments. This had three elements: a review of the 15 funds used within the arrangement's default investment strategy; input to the design of a bespoke passive equity strategy; and a framework for monitoring.

We reviewed each of the 15 funds which compose the client's default investment strategy, engaging each of the four underlying managers to understand their progress in committing to NZAM at the organisation level, and in setting a net zero target for each fund. As a result of investment changes which we had advised on the previous year being implemented within the strategy, every manager had committed to NZAM, and the majority of the assets was invested in funds with an explicit target for reducing emissions.

A key component of the investment strategy, and core to the client's net zero target, is a bespoke passive equity strategy, which we worked with a large passive manager and the client to design and implement. This fund is designed such that it has a minimum carbon footprint 30% less than its parent index from day one and reduces its carbon footprint every year by 7% versus a 2019 baseline. It also was uniquely designed to incorporate tilts which increase investments in companies which undertake activities such as improving health outcomes, which members view favourably, and away from companies which are associated with activities which members view negatively, such as producing large amounts of pollution.

Finally, we have designed a framework to help our client understand a) the funds which make the largest contribution to its overall carbon footprint, and b) the stewardship activity being undertaken by the manager of each of its funds in respect of climate. This helps to focus activity on the most important exposures – those which are largest or least managed – and to engage with managers to ensure that they are improved.

Commitments 1-3 *Continued*

KPIs

We have compiled information on the NZICI KPIs to the best of our ability and the figures are set out below. However, we note that many clients are still considering how best to incorporate net zero considerations based on their own beliefs and circumstances. In addition, there are significant challenges for some clients, for example having limited governance budgets and short investment horizons. There are also a number of difficulties in the data collection, which are likely to result in under-reporting our activity in this area. For example:

- Where client teams have not been able to provide data, we have assumed that clients had not met any of the KPIs by the end of 2022.
- We have only included data for clients where we provide regular ongoing advice and are in a position to advise on transitioning assets to a net zero economy. In other instances, we may be asked to provide advice on a single project and therefore not be able to offer such advice.
- Some of our clients have multiple advisers, so there may be instances where we have not provided the advice underlying some of their KPI statistics, eg where they have obtained emissions data elsewhere.
- Assets under management (AUM) figures are approximate and not stated as at a single date.

By 31 December 2022:

- 62 clients (representing c. £98bn of AUM) had received meaningful education on net zero. We note that a significantly higher proportion of clients have previously had meaningful education on climate change; however, we did not record that information centrally.
- 46 clients (representing c. £100bn of AUM) had access to baseline carbon emissions data on their portfolio, where available.
- 22 clients (representing c. £72bn on AUM) had decided to incorporate a net zero ambition for 2050 or sooner into their policies.
- 8 clients (representing c. £36bn of AUM) had set a formal net zero target along with interim targets and the intention to be Paris-aligned.
- 10 clients (representing c. £25bn of AUM) had set a formal goal to increase exposure to climate solutions.

Commitment 4

We will assess and monitor asset managers on the integration of climate risks and opportunities in their investment decisions and stewardship and reflect this evaluation in our client recommendations:

For several years, our investment research views and ratings for all investment products have included an assessment of managers' practices in relation to responsible investment, including climate change. These views are an integral part of our manager selection and monitoring advice.

During 2022, we updated our assessment approach with the aim of making it more consistent, comprehensive and robust. The new approach was launched in late 2022 and is being implemented through research meetings over the course of 2023. Researchers now follow a detailed framework which leads to a rating for each of ESG integration, voting and engagement, climate risk management, and net zero practices, along with an overall score. We are monitoring the implementation of the new framework and will modify it as appropriate to reflect our colleagues' experiences as well as evolving views of best practice.

We also assess asset managers' firmwide climate approaches through our regular responsible investment survey. A significant proportion of our 2022 survey, published in January 2022, related to climate change risk management and net zero.

Some of our findings from this survey were:

- 36% of managers had already published a TCFD report at the time of writing.
- 70% of managers were using climate scenario analysis to some extent in their decision making.
- 42% of managers were working towards net zero for all assets under management, although their plans to achieve this were at a fairly early stage.
- 66% of managers noted they engaged frequently on climate change matters.
- 90% of managers stated that they engage with policymakers and regulators on industry wide topics.

More details on our findings can be found here. The results of the survey were often shared with clients as part of a wider annual RI review of their managers which highlighted red flags and other issues for clients to engage on with their managers to address concerns.

An investment manager must be a signatory of the Net Zero Asset Manager initiative for its funds to be eligible to receive a "buy rating" from us. We communicated our expectations to managers six months ahead of this requirement being introduced on 1 April 2022 and encouraged more managers to join, addressing some of the common concerns they raised. Where clients' funds were downgraded due to their manager not being an NZAM signatory, we encouraged them to engage with their manager in the first instance and consider changing their manager if they were not satisfied with the response received. You can read more in this blog.

Commitment 4
Continued

We published a set of [net zero expectations for investment managers] in September 2021, setting out our thinking on best practice in this area. As well as encouraging managers to become members of NZAM, this also encourages managers to provide climate-related reporting to our clients, improve data availability and quality, seek real world reductions in emissions, and use voting and engagement effectively to encourage investee entities to reach net zero emissions by 2050. Consistent with this, our revised manager research grading framework helps us monitor how well managers are meeting these expectations.

As noted in the stewardship section above, we help our clients monitor and engage with their managers to improve their voting and engagement, and most of our clients have selected climate change as a priority topic for this stewardship activity. In addition, pension trustee clients within scope of the TCFD requirements are expected to take action to address the data gaps underlying the climate-related metrics in their reporting, which often will involve engaging with managers to improve data availability and quality.


OUR VIEWPOINT

Net zero: Our new minimum expectation for managers

30 March 2022

Laasya Shekaran, Consultant

From 1 April 2022, LCP will require any asset manager we research to have signed up to the Net Zero Asset Manager Initiative (NZAMI) in order for the products or pooled funds they manage to get a "buy" rating from us.

Commitment 5

With respect to any full discretionary services, we will align with the Net Zero Asset Manager Initiative as soon as practically possible and within two years of making this commitment.

We do not provide discretionary services, so this commitment is not applicable to us.

Commitment 6

With respect to our own business operations, we will set emissions reduction targets across all our operational emissions in line with 1.5 degree C scenarios

We closely monitor our emissions and produce streamlined energy and carbon reporting each year. While the firm has seen significant growth since our base year of 2018, our location-based[3] scope 1 & 2 emissions have grown at a much slower rate, resulting in a 26% decrease to our per person energy intensity ratio.

We continue to take steps to reduce our location-based emissions, including installing solar panels in our Winchester office, and we have chosen to obtain our electricity from renewable sources backed by Renewable Energy Guarantees of Origin. We offset the remaining (i.e. market-based[4]) scope 1 & 2 emissions in line with our 2021 commitment to becoming operationally carbon neutral along our journey to net zero.

We are currently agreeing a fuller climate plan targeting reductions across all scopes aligned with a 1.5-degree trajectory. This includes engaging closely with our suppliers to reduce our scope 3 emissions as well as continuing to focus on reducing business travel, commuting, and operational emissions.

KPI: Level of emissions across operations

Over the year to 31 March, the LLP's location-based energy usage and carbon emissions were as follows:

	2022-2023		2021- 2022		2017-2018	
	MWh	tCO_2e	MWh	tCO_2e	MWh	tCO_2e
Gas	63.1	11.5	39.4	7.2	36.8	6.8
Total Scope 1	63.1	11.5	39.4	7.2	36.8	6.8
Electricity	635.2	122.8	490.7	104.2	621.1	218.4
Total Scope 2	635.2	122.8	490.7	104.2	621.1	218.4
Business travel in employee-owned cars	50.9	11.9	24.1	5.6	59.2	14.1
Other scope 3 items	Not quantified					
Total Scope 3	50.9	11.9	24.1	5.6	59.2	14.1
Total	749.2	146.2	554.2	117.0	717.1	239.3
Intensity Ratio – Per Person	0.805	0.157	0.674	0.142	1.093	0.365

The figures above are in line with the 2019 UK Government environmental reporting guidance, Greenhouse Gas Protocol Corporate Accounting and Reporting Standard, Energy Saving Opportunity Scheme (ESOS) and have been converted into carbon emissions using the UK Government Conversion Factors.

We have provided this data over the year to 31 March 2023, rather than 31 December 2022, given that this is the reporting period for which the data has been collected.

3 Location-based methodology calculates emissions from energy use based on the average output of the relevant power grid (in the UK, the National Grid, for example).
4 Market-based methodology calculates emissions based on the energy supply choices a company makes – ; i.e. it takes into account the purchase of renewable energy tariffs.

Commitment 7

Within the wider financial community, where suitable net zero methodologies do not exist, we will work collaboratively for the benefit of our clients to address these challenges, seeking harmonised methodologies

We note that we are at an early stage of our net zero journey with clients and therefore we expect challenges to emerge as we progress along our journey, such as a lack of suitable methodologies in some areas. We believe such issues are best addressed through collaboration and so we expect to collaborate more with various groups including the Investment Consultants Sustainability Working Group ("ICSWG") and IIGCC on net zero in the future. We already collaborate on various responsible investment topics (see page 49 from our stewardship report), some of which are relevant for climate and net zero, and examples are outlined below.

During 2022, we were part of a number of industry groups as well as NZICI, including the Investment Consultants Sustainability Working Group ("ICSWG"), the Institutional Investors Group on Climate Change ("IIGCC") and the Institute and Faculty of Actuaries ("IFoA") Sustainability Board. Our contributions included:

- Within NZICI, we helped to establish the initiative's terms of membership, governance and reporting requirements. We also contributed to the NZICI response to a consultation issued by the Glasgow Financial Alliance on Net Zero ("GFANZ") on portfolio alignment metrics, as described below under Commitment 8, and an earlier consultation on a precursor "concept note".
- Within the IFoA's Sustainability Board, we fed into the IFoA's Beginner's Guide to Net Zero Investing which was published in December 2022.
- Within the ICSWG, we assisted with enhancements to, and further promoted, the engagement reporting guide ("ERG"). The ERG is designed to ease the reporting burden for managers and to provide asset owners with clear and consistent information on the engagement undertaken by their managers.

We regularly attend IIGCC webinars and access information on the IIGCC website to understand developments in net zero investing and in methodologies for asset classes without established frameworks, which informs our advice to clients. It is an important way in which we keep abreast of this rapidly changing area. We have not yet formally participated in IIGCC collaborative activities and initiatives, and note that these generally seem aimed at asset owners rather than consultants, but hope to do so in future.

Commitment 8

Within the wider financial community, we will engage independently or as a group with regulators and policymakers to facilitate the transition to net zero carbon emissions, addressing any barriers to our clients adopting and achieving their net zero targets.

We engage regularly with policymakers and regulators, both individually and via the collaborative initiatives that we are part of. We have regular conversations with people from the DWP and The Pensions Regulator (“TPR”) around a range of topics, including climate change and net zero alignment. For example, since 2022 we have had regular discussions with TPR where we’ve shared our experiences from advising clients on TCFD governance and reporting.

We regularly take part in consultations relating to ESG, climate change and net zero. During 2022, this included responding to:

- DWP’s consultation on introducing the requirement for pension schemes undertaking TCFD reporting to collect and report data for a portfolio alignment metric;
- the GFANZ consultation on “Measuring Portfolio Alignment: Enhancement, Convergence and Adoption” which builds on previous industry work to develop portfolio alignment metrics; and
- the Network for Greening the Financial System (“NGFS”) consultation to inform the ongoing updates and improvements to its climate scenarios, to express our view that more realistic models of the impact of climate change on both the economy and the financial system were needed.

Commitment 9

To ensure accountability we will report progress by our firm against the commitments made here at least annually in the public domain.

This report has been prepared to meet this commitment.

Contact us

If you would like more information please contact your usual LCP adviser or one of our specialists below.

Claire Jones
Partner, Head of Responsible Investment
+44 (0)1962 873373
claire.jones@lcp.uk.com

Ken Willis
Partner
+44 (0)20 7432 6701
ken.willis@lcp.uk.com

James Moore
Partner
+44 (0)20 7432 0604
james.moore@lcp.uk.com

Ian Gamon
Partner
+44 (0)1962 872718
ian.gamon@lcp.uk.com

Laasya Shekaran
Consultant
+44 (0)1962 672950
laasya.shekaran@lcp.uk.com

At LCP, our experts help to power possibility by navigating you through complexity to make decisions that matter to your business and to our wider society. We are powered by our desire to solve important problems to shape a more positive future. We have market leading capabilities across pensions and financial services, insurance, energy, health and analytics.

Lane Clark & Peacock LLP
London, UK
Tel: +44 (0)20 7439 2266
enquiries@lcp.uk.com

Lane Clark & Peacock LLP
Winchester, UK
Tel: +44 (0)1962 870060
enquiries@lcp.uk.com

Lane Clark & Peacock Ireland Limited
Dublin, Ireland