UK policy advocacy for climate change in LDI investment management

Our expectations of LDI investment managers

March 2024

At LCP, we believe some of the biggest risks we face today, including climate change, are systemic in nature. Investors should use their influence to undertake systemic stewardship to not only protect individual holdings within their investment portfolios but also help protect the economy and the stability of financial markets.

All participants in the investment chain have a role to play in addressing systemic risks via systemic stewardship, including asset owners, asset managers, advisers and insurers.

This note sets out our views on one specific area of systemic stewardship: best practices for UK policy advocacy on climate change by LDI managers. It updates our note of December 2023.

Scope of this paper

Systemic stewardship can consist of a range of different activities such as policy advocacy, engagement with industry bodies and collaborative activity. It can also relate to many different systemic risks. However, we have focussed specifically on LDI managers and UK policy advocacy in this note, given the important role that gilts play in our DB pension scheme clients' investment portfolios, and the potential influence that DB pension schemes have given the amount of lending they provide to the UK government. We have focussed specifically on climate change, given this is one of the greatest systemic and existential risks that our clients face.

LDI investment managers' climate-related systemic stewardship activities

We have set out below our views on best practice principles in relation to UK policy advocacy on climate change for LDI managers. We expect to evolve our thinking over time and make updates accordingly.

We recognise that asset managers' strategies, policies and frameworks in this area are likely to extend beyond UK climate policy. For example, they may encompass engagement with governments in other jurisdictions and the areas of government policy. In addition, some of the disclosures we have outlined below may be integrated into wider stewardship or sustainability reporting, rather than standalone documents. For the avoidance of doubt, such approaches are compatible with our best practice principles.

We also recognise that asset managers may undertake some climate engagement in collaboration with others, for example as members of industry groups. Such collaboration may help them meet our best practice principles, although we would expect to see evidence of substantive contributions to the collaborations.

- **Clear policy views:** Asset managers should state their views on climate policy clearly and publicly. These views should:
    - recognise that climate change is a systemic risk;
    - recognise the materiality of climate change to the managers' clients;
    - be aligned with the latest climate science (in particular, with the goal of restricting global average temperature rise to 1.5ºC above pre-industrial levels);
    - support the importance of a just and nature-positive transition;

- encourage governments to set clear, credible, consistent net zero plans, so investors can invest in the net zero transition with confidence;
- highlight where policy ambition and implementation falls short of what is needed to meet governments' climate commitments (for example under the UK Climate Change Act 2008 and the Paris Agreement); and
- recognise the need for investment in climate adaptation and resilience as well as the net zero transition.

- **Alignment of trade associations:** Asset managers should examine the climate policies of any trade associations or industry groups that they are part of, identify any inconsistencies with its own climate policy views, and use their influence to resolve these where possible. Where there is material misalignment which cannot be resolved, the asset manager should leave the association.
- **Strategy for climate policy engagement:** Asset managers should have a climate policy engagement strategy setting out their approach to undertaking climate policy engagement and any internal communication strategies. To help inform this strategy, managers should aim to identify where their key avenues of influence lie. The strategy document should specify the desired outcomes of engagement, as well any key principles and codes of conduct that underlie the framework. The engagement strategy should involve engaging on real economy climate policies, consistent with the manager's areas of expertise, as well as policies specifically related to financial services regulation on climate change. Asset managers should disclose a summary of their approach to climate policy engagement.
- **Governance framework:** Asset managers should have a governance framework in place to implement their climate policy engagement strategy. This governance framework should involve clear oversight mechanisms, with board or senior management level ownership of the process. This oversight should include ensuring that direct and indirect engagement activity is in line with the firm's stated climate policy views and commitments. This governance framework should be documented, and the document should be made publicly available.
- **Resourcing:** Asset managers should be adequately resourced to deliver their climate policy engagement strategy, in terms of number, expertise and seniority of people.
- **Methods of engagement:** Climate policy engagement strategies should cover various avenues such as: the production of thought pieces; sponsorship of research; public statements; participation in panel discussions; responses to consultations (which should be made publicly available); bilateral and roundtable conversations with policymakers and regulators; and collaborative activity with other investors, NGOs and/or academics.
- **Parties to engage with:** LDI managers should engage with an appropriate range of stakeholders such as government ministers, civil servants, select committees, the Debt Management Office, regulators and central banks.
- **Disclosure of activity**: In addition to publicly disclosing their climate policy views, approach and governance frameworks, asset managers should maintain an internal record of all their policy interactions and publicly disclose their main engagement activity and any outcomes as far as they are able to. (We note the confidential nature of some policy engagement activities and that it is unlikely to be possible to isolate the impact of the manager's engagement from other factors.) Any activity that cannot be publicly disclosed and so remains private should still be consistent with public messaging.

Claire Jones FIA
Head of Responsible Investment

+44 (0)1962 873373
Claire.Jones@lcp.uk.com

David Wrigley FIA
Investment Partner

+44 (0)1962 873358
David.Wrigley@lcp.uk.com

Julian Thakar FIA
Investment Consultant

+44 (0)20 7432 6717
Julian.Thakar@lcp.uk.com

Laasya Shekaran, CFA
Investment Consultant

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

Batool Zuberi
Investment Analyst

+44 (0)1962 672982
Batool.Zuberi@lcp.uk.com