Net zero investment report Progress during 2023

Reporting against our commitments made as a member of the Net Zero Investment Consultants Initiative (NZICI)

LCP powering possibility

SEPTEMBER 2024

Executive summary

We continue to be committed to helping clients take action to mitigate climate change and invest in solutions that can make net zero a reality.

Our investment advisory clients are predominantly asset owners, so our activity is heavily focussed on ensuring our clients have the tools and information to drive change through their investments.

Our Executive Committee is ultimately responsible for our ESG (environmental, social and governance) strategy, ensuring we have senior leader responsibility for the oversight and implementation of net zero alignment of our investment consulting services. Our central Responsible Investment (RI) team has responsibility for delivering LCP's overall ESG strategy which is reviewed periodically.

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

Zuhair Mohammed
Head of Investment

This is LCP's second formal progress report as a signatory to the Net Zero Investment Consultants Initiative (NZICI). In this report, we have set out the progress we made during 2023.

Whilst we have made good progress in helping our clients understand the risks and opportunities from climate change and the importance of moving towards net zero, there is still a lot of work to do to have a real impact on the world's progress towards net zero.

Climate change can only be mitigated through collective action and policy change. Therefore in 2023 we developed LCP's climate policy asks (which were launched in 2024), to enable clients to stand behind our requests of policy makers to drive change.

At LCP we fuse human expertise with powerful analytics to shape a more positive future.

Commitments 1 to 3

LCP Transform, regular training, central templates

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.**
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.**
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.**

We are fully committed to integrating net zero alignment throughout our investment advice to clients. Indeed, we expect all our investment consultants to consider net zero when giving advice and actively encourage them to discuss setting a net zero ambition with clients depending on their specific circumstances.

To demonstrate our approach, we have set out below some tools we are using. We also covered details of our approach in our 2022 LCP net zero report much of which remains relevant.

LCP Transform – helping our clients invest in the energy transition

In 2023, having integrated with LCP Delta, our energy consulting business, we began a holistic review of the opportunities for our clients to invest in the energy transition. Energy investments will play a key part in progressing towards net zero. Therefore, combining our expertise in energy and investment, we began developing a service to enable our clients to invest in the technology and infrastructure needed for the energy transition. This service continues to develop, with clients actively reviewing investable options in 2024.

Regular training of the investment team and the wider business

Over 2023, our investment team has been provided with a range of training sessions including:

- **Systemic risks** – a session with representatives from Aviva Investors on the systemic risks that the physical impacts of climate change present, and the action that is required across the financial system to mitigate it.
- **Communicating climate risk** – a session about using a simple slide to illustrate the possible significant physical impacts of climate change and how this might feed through the economy.
- **Systemic stewardship** – a discussion on what is it and how we can help our clients undertake it.

We also had sessions on the energy transition and how to invest in it, and our research into LDI managers and how they are approaching policy advocacy on climate change.

Central templates throughout the advice chain, including for:

Setting a net zero objective, target or ambition – an initial considerations paper for clients looking at setting a net zero target or ambition. This template has been used with clients for a couple of years and has supported those clients who want to set net zero ambitions or targets.

Advice papers on investment manager selection and assessments that highlight a range of investment options available to clients that want to invest in climate solutions or climate-focussed funds. They include each manager's approach to net zero and details of any net zero commitment.

Commitments 1 to 3 (continued)

Climate dashboard, stewardship priorities and engagement

LCP Monitor climate dashboard was released to the firm and is now being used in client advice

We released a climate dashboard within our performance monitoring tool, LCP Monitor, that helps our clients focus on those mandates which are most exposed to climate transition risk and where they can have the biggest impact with regards to climate change with their portfolio.

Based on our experience of using the tool with clients, we have adapted how we use it to ensure that they can quickly focus on the main components of their portfolio that have room for improvement in their carbon emissions or the alignment of the portfolio with net zero.

Case study

One of our large pension scheme clients had spent some time understanding and considering climate risk and the net zero transition but had not agreed any immediate actions to take.

We took our climate dashboard to a trustee meeting to generate further discussion and determine the actions they could prioritise and take.

LCP Climate Monitor enabled the trustees to get a tangible view of the current climate impact of their investment portfolio and where they could improve this. In particular, the trustees were able to focus on what commitments their investment managers have made on climate change, what emissions their portfolio currently finances, and the alignment of their investments towards a net zero position.

The trustees were then able to consider alternative investments that may be better aligned to a low carbon economy.

In turn this enabled the trustees to interrogate their current investment managers on their approach to climate change, highlighting specific concerns on their climate risk management, as well as consider alternative investments if their current managers are not performing as expected.

Stewardship priorities and engagement

The majority of our clients now include climate change as one of their stewardship priorities. Stewardship and engagement are critical areas for addressing climate change and form a key part of our stewardship and engagement advice. Details of our stewardship approach are set out in our stewardship reports.

Commitments 1 to 3 (continued)

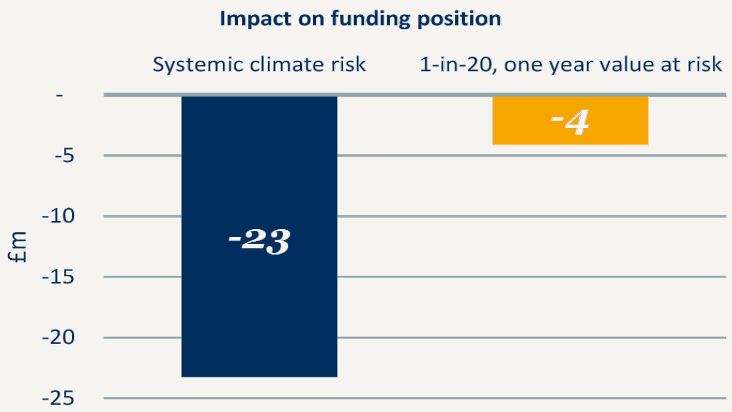
Systemic climate risk, RI assessment of bulk annuity insurers

LCP Visualise systemic climate risk module released and being used to drive discussions on systemic risks of climate change

We find that many clients have not had the chance to fully consider the system-wide impacts that climate change may have and how this may impact their assets and the benefits that they are due to pay with those assets. To help them understand it, we have added a systemic climate risk illustration to our asset liability modelling software that is available to our DB pension scheme clients online. This shows the possible impact on a pension scheme's funding level of a systemic climate risk shock.

As an example of the output, the chart below shows client advice where we highlighted the possible magnitude of systemic climate risk in the context of another form of investment risk that our client discusses regularly. Whilst we make it clear to clients that these two measures are not directly comparable, it does illustrate the importance of our clients understanding systemic climate risk and considering their actions to mitigate it.

Possible impact of systemic climate risk



This illustrative shock has helped our clients engage with the systemic nature of climate risks and how they can influence their investment managers and policy makers (eg through LCP's climate policy asks (see next page) to take action against these systemic risks.

Our asset liability modelling tool is used across our DB pension scheme client base. The addition of the systemic climate risk illustration is an example of how we are embedding climate change in our systems to encourage a culture of discussing it in our advice to clients.

RI assessment of bulk annuity insurers

In mid-2023 we conducted our third review of bulk annuity insurers' responsible investment practices, including their approach to climate change. This review serves a number of purposes:

1. Assessing each bulk annuity insurer's approach to sustainability against our view of best practice
2. Understanding the key gaps in sustainability practices within the bulk annuity sector
3. Engaging with insurers and others to encourage improvements in sustainability practices.

Our research helps our clients consider the net zero journey of insurers when they are going through a bulk annuity process, or when they have carried out a transaction. For those going through a transaction, it provides a way of differentiating the more progressive insurers, and for those who have already transacted, it gives them information they can use to encourage their chosen insurer to improve their practices.

Feedback from clients and each insurer's positioning in our survey is fed back to the insurers with clear indications of our views on how they can and should improve their practices.

Commitments 1 to 3 (continued)

LCP's climate policy asks, enhancements to our climate scenario advice

LCP's climate policy asks have been developed to help give weight in our discussions with policy makers

At LCP, we want to use our influence to drive forward the best possible climate outcomes for our clients and the pension scheme members we ultimately serve. But we also know that our voice is so much more powerful when we have the voices of others behind us, which is why we've invited our clients to support the following policy asks.

Our policy asks are:

1. Climate regulations for investors should aim for real-world impact, not just disclosure
2. It should be easier for DB and DC pension schemes to invest in climate solutions, including growth and/or illiquid assets
3. Climate action needs to match the scale of the risk, removing the current disconnect between the levels of policy ambition and implementation.
4. Governments should set clear, credible, consistent net zero plans, which are nature-friendly and socially just, so investors can invest in the net zero transition with confidence
5. Pension trustees' fiduciary duty should be reinterpreted to have a longer time horizon and include macro (impact) as well as micro (risk) considerations

Clients started signing up to these in 2024. You can find more information here.

Enhancements to our climate scenario advice to reflect the recent criticisms

During the year, there were a number of criticisms levelled at climate scenarios and the advice provided by consultants to pension schemes. In particular, reports from Carbon Tracker Initiative ("Loading the dice against pensions") and the IFoA report in partnership with the University of Exeter ("The emperor's new climate scenarios") led the way, with some detailed criticisms of the modelling and the conclusions being drawn by pension schemes.

Whilst our approach to climate scenario analysis has always been to focus on the narratives of the scenarios rather than specific numerical outputs, we recognise the issues raised by the criticisms and have acted to discuss the criticisms with our clients to help them reconsider their decisions and update them if appropriate.

In particular, we developed further advice materials for clients to remind them of the narratives of the scenarios they had seen previously, the limitations of the scenarios, and the limitations of the modelling that may be leading to underestimates of the physical impacts of climate change on the economy. These materials have been used with large pension clients who need to consider annually whether to commission updated climate scenario analysis for their Task Force on Climate-related Financial Disclosures (TCFD) reporting. We have also encouraged colleagues to take these slides to other clients for whom they have carried out climate scenario analysis. The messaging in our standard climate scenario material has also been updated to improve the communication of the limitations.

This has helped our clients focus on the key messages from the analysis and consider both the physical and transition risks from climate change in a more informed context.

Key Performance Indicators

The KPIs below are as at 31 December 2023 and are provided in line with the NZICI reporting requirements.

	Number of clients	% of AUM for LCP investment consulting clients
Number of clients, and their respective assets under management, who have received **meaningful education** on net zero alignment	179	90%
Number of clients, and their assets under management, who had access to **baseline carbon emissions data** on their portfolio	70	71%
Number of clients, and their respective assets under management, who had decided to incorporate a **net zero ambition** for 2050 or sooner into their policy	49	35%
Number of clients, and their respective assets under management, who had set a **net zero target** for 2050 or sooner along with interim target(s) and the **intention to be Paris-aligned** using appropriate methodology	15	31%
Number of clients, and their respective assets under management, who have agreed a formal goal to increase exposure to '**climate solutions'** however defined.	12	19%

The table above provides insight into the number of clients we have advised on net zero against the metrics defined by NZICI. The figures show a significant increase from the previous year as we rolled out access to net zero advice and opportunities across our client base. Asset under management (AUM) figures are approximate and not stated at a single date and data is taken from information available at 31 December 2023.

Data is available for over 250 clients with total assets under management in excess of £175bn.

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.

Net zero assessments of managers

We grade each investment product from 1 to 4 (where 4 is best) on responsible investment, based on ratings for four underlying pillars – ESG integration, voting & engagement, climate risk management and net zero alignment.

In order to assess each of the four pillars, our researchers assess whether the product meets a series of "good practice" indicators within that pillar. Examples for each pillar are:

- "Has the investment team demonstrated strong ESG expertise (eg confidence talking about a wide range of ESG-related topics relevant to their portfolio)?"
- "Have you seen evidence from the manager that it uses engagement (and voting where applicable) to encourage better ESG practices (ie not just greater disclosures)?"
- "Have you seen evidence that the manager considers physical climate factors as well as transition factors?"
- "Does this specific strategy have a formal net zero target?"

Following the completion of our research of a product, we typically provide feedback to the investment manager on areas in which it can improve, including on responsible investment and stewardship matters. We do this both to improve outcomes for our clients and to raise standards within the investment industry as a whole.

We also have a requirement that asset managers have signed up to the Net Zero Asset Managers (NZAM) initiative, in order for them to achieve a buy rating from us.

Use of our RI grades

The grades that investment products are assigned by our investment researchers in respect of responsible investment have two key uses in helping our clients achieve their climate goals.

The first is when appointing investment managers to manage a specific allocation. When client consultants conduct manager selection exercises, there is a requirement in our process that the shortlisted managers' approaches to ESG, voting & engagement and climate change and net zero are considered.

There is a requirement for consultants to comment in any briefing document for a selection exercise (or direct recommendation advice paper) on these specific considerations and, if advising a UK pension scheme, how this compares to the policies in the client's Statement of Investment Principles. If this information is not included, client consultants must evidence where these issues have been raised and discussed with the client on a prior occasion.

The second key use of the output is in ongoing manager monitoring. Our client consultants share our RI grades for individual products with clients who are invested in them. LCP Monitor, shows the RI grades for each product to clients as standard. Clients can have access to this tool either through regular meetings with their LCP advisors, or directly through their internet browser.

In addition, we have developed performance monitoring report templates that provide different means by which to display our RI grades and explain the context to clients.

Net zero expectations of investment managers

We wrote a letter to CEOs in December 2023 setting out our updated net zero expectations for investment managers. 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.

Commitments 5 and 6

Commitment 5 is not applicable to our business.

With respect to our fully 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

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 are proud that we have been operationally carbon neutral (through offsets) since 2021-22 (for scope 1 and 2 emissions).

We measure and disclose our CO_2 reduction both with and without the renewable tariffs, as we know that views of the impact of these tariffs can differ. However, we believe that irrespective of how CO_2 is accounted for, using renewable tariffs helps to drive and stimulate investment in the renewable energy sector.

Our scope 1 and 2 CO_2 emissions, including the impact of renewable tariffs, have reduced by 94% since 2019/20, and by 44% if we exclude the impact of the renewable tariffs. This demonstrates we have made significant strides in reducing our emissions, no matter how you account for electricity. We have also reduced our carbon intensity ratio per person by 59% since 2018/19, and by 4% in the last year alone without the benefit of renewable tariffs.

Like many professional services firms, around 90% of our emissions are part of what is known as our scope 3 footprint, which includes purchased goods and services (around 67% of emissions), commuting (around 25% of emissions), and business travel (around 3% of emissions).

While we continue to seek and implement practical ways of reducing our carbon footprint, much of our data is currently calculated using estimates and standard formulas. We know that by better understanding our carbon footprint we will be able to better target reduction initiatives and see the impact of any changes we make. That's why we are, in 2024, investing in a carbon management platform and data quality improvements at the same time as we continue to build our carbon reduction plans. This will enable to us to review our emissions commitments and make better decisions about the real-world impact of our strategy and choices.

KPI: Level of emissions across operations

Over the year to 31 March, our location-based energy usage (ie excluding the impact of renewable tariffs) and carbon emissions were as follows:

	2023-2024		2022- 2023		2017-2018	
	MWh	tCO_2e	MWh	tCO_2e	MWh	tCO_2e
Gas	60.7	11.1	63.1	11.5	36.8	6.8
Total Scope 1	60.7	11.1	63.1	11.5	36.8	6.8
Electricity	653.0	135.2	635.2	122.8	621.1	218.4
Total Scope 2	653.0	135.2	635.2	122.8	621.1	218.4
Business travel in employee-owned cars	54.2	12.4	50.9	11.9	59.2	14.1
Other scope 3 items					Not quantified	
Total Scope 3	54.2	12.4	50.9	11.9	59.2	14.1
Total	767.9	158.7	749.2	146.2	717.1	239.3
Intensity Ratio – Per Person	0.722	0.150	0.805	0.157	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 2024, rather than 31 December 2023, given that this is the reporting period for which the data has been collected.

For further details on our own business approach to net zero, please see our impact report:

LCP's impact

Commitments 7 and 8

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

During 2023, we were part of a number of industry groups as well as NZICI, including the Investment Consultants Sustainability Working Group (ICSWG), and the Institutional Investors Group on Climate Change (IIGCC). As part of these groups, we have collaborated on topics relevant to the net zero.

Case study

As climate change is a systemic risk, we have been working with regulators for several years to try and ensure that regulations and policy continue to evolve to enable and promote a transition to a low carbon economy. In 2023 we considered how we could involve our clients in this process to add weight to the discussions, especially across the pensions industry.

This has led to the development of our climate policy asks detailed on page 6.

With the support from our clients who have signed up, we will be referring to our policy asks and the weight of sentiment behind them when we engage with policy makers, to help drive change. In particular, pushing regulators to focus on real world actions that facilitate the net zero transition and enable asset owners to invest to support the transition.

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. For example, we have regular discussions with the Pensions Regulator (TPR) where we've shared our experiences from advising clients on TCFD governance and reporting, and the real-world actions that our clients can take.

We regularly take part in consultations relating to ESG, climate change and net zero. During 2023, this included responding to:

- The Department for Work and Pensions (DWP) call for evidence to help improve the skills and capability of pension trustees and remove barriers to making effective investment decisions, with some of our focus on incorporating climate considerations.
- The DWP call for evidence to support the development of innovative policy options to increase protection for DB members while supporting wider economic initiatives and investment in productive asset classes.
- The Financial Conduct Authority's (FCA) consultation proposing a voluntary, standardised and comprehensive 'vote reporting template' for asset managers to communicate to asset owner clients on their voting activity.

Our CEO has also spoken publicly on fiduciary duty and climate change at a number of events.

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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.