LCP powering possibility

Climate change

Responsible Investment manager survey

OCTOBER 2024

Are managers helping clients achieve their climate goals?

Welcome to one of four themed reports of our 2024 Responsible Investment survey of investment managers. In this edition we focus on climate change.

Climate change is one of several system-wide risks that could significantly impact the global economy. Since our 2022 survey, there has been a significant increase in focus on climate change and the potential impact on investments.

Unfortunately, the investment management industry (like many others) appears to have low expectations of success on the journey to net zero. More than 80% of responders to our 2024 survey expect either average temperature rises to exceed 2°C (ie a failure of the Paris Agreement) or for the economy to suffer through a disorderly transition to a low carbon economy (although ultimately keeping temperature rises below 2°C).

Most positively, we see an increased focus on climate change coming through from the responses to our survey. In particular:

- **Material increase in Net Zero Asset Manager (NZAM) signatories** – an increase to **59%** in 2024, up from 34% of respondents in 2022.
- **Significant improvements in reporting against Net Zero alignment**, aided by industry standard frameworks being developed (and evolved – for example, the Net Zero Investor Framework from the IIGCC[1] released its version 2.0 this year).
- Proportion of asset managers who are working towards net zero for some of their assets has increased from 59% to **70%**.

[1]Institutional Investors Group on Climate Change, as part of the Paris Aligned Investment Initiative

We are also seeing greater focus on nature and a just transition.

Whilst there are positive signs, there is still a lot of work to be done.

So what can investment managers do?

- **Effective and consistent climate reporting** especially using climate alignment maturity scales so that investors can see how well their whole portfolios are aligned to net zero (measured on a consistent basis).
- **Greater focus on stewardship and engagement to drive change** at the individual asset level (see our RI survey report on stewardship).
- **Drive policy change by engaging with regulators and policy makers** (see our RI survey report that focuses on system-wide stewardship by investment managers).

Investment managers have plenty of room to up their game in these areas.

Asset owners want to see the results through reporting that demonstrates improved investment practices and stewardship **that translate into real-world change.**

What do managers think are the most likely climate scenario outcomes?

We presented managers with three climate scenario outcomes and asked which one they believe is the most likely.

57% of managers that expressed an opinion believe that we are most likely to have a disorderly transition with global average temperatures kept below 2°C above pre-industrial levels, and a further 17% believe a failed transition is likely (with global average temperatures rising to more than 2 degrees above pre-industrial levels) (see figure 1).

Given these outcomes represent material financial risks for investors, we would expect these managers to be taking significant steps to mitigate these risks, including targeting net zero pathways through their investments.

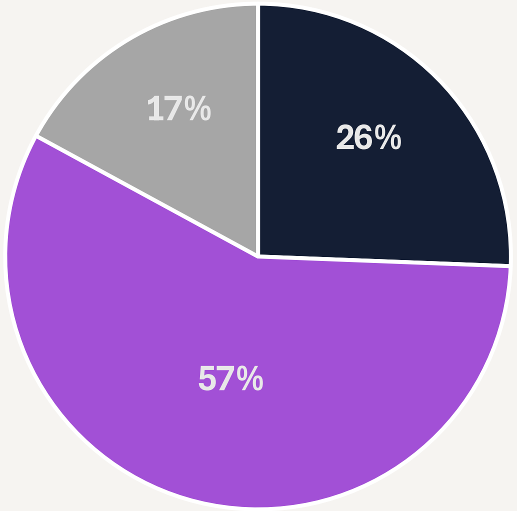
What commitment are managers making to target net zero?

We regard signing up to the **Net Zero Asset Managers** (NZAM) initiative as a minimum standard to indicate that managers are serious about addressing the systemic financial risks from climate change.

Despite many managers believing that we will likely have a disorderly or a failed transition, **over 40% of managers are not NZAM signatories**. Although this represents a significant increase in signatories since our 2022 survey, this is still disappointing.

We believe managers should be proactively managing climate-related risks and opportunities in their clients' portfolios, over both the short and long term. To this end, it's concerning that **36%** of managers don't have a policy statement that includes their approach to incorporating climate change across all asset classes.

Figure 1: Which of three climate scenarios do asset managers think is most likely?



Percentage of managers who are NZAM signatories

59% in 2024 *34% in 2022*

All statistics in this report relate to the managers that responded to our surveys. See page 9 for survey details.

More managers are working towards net zero, but are they on track to achieve it?

A growing number of investment managers are discussing net zero, both proactively or in response to asset owner expectations. To manage systemic financial risks to client portfolios, this discussion needs to lead to actions that help achieve net zero greenhouse gas emissions in the real world.

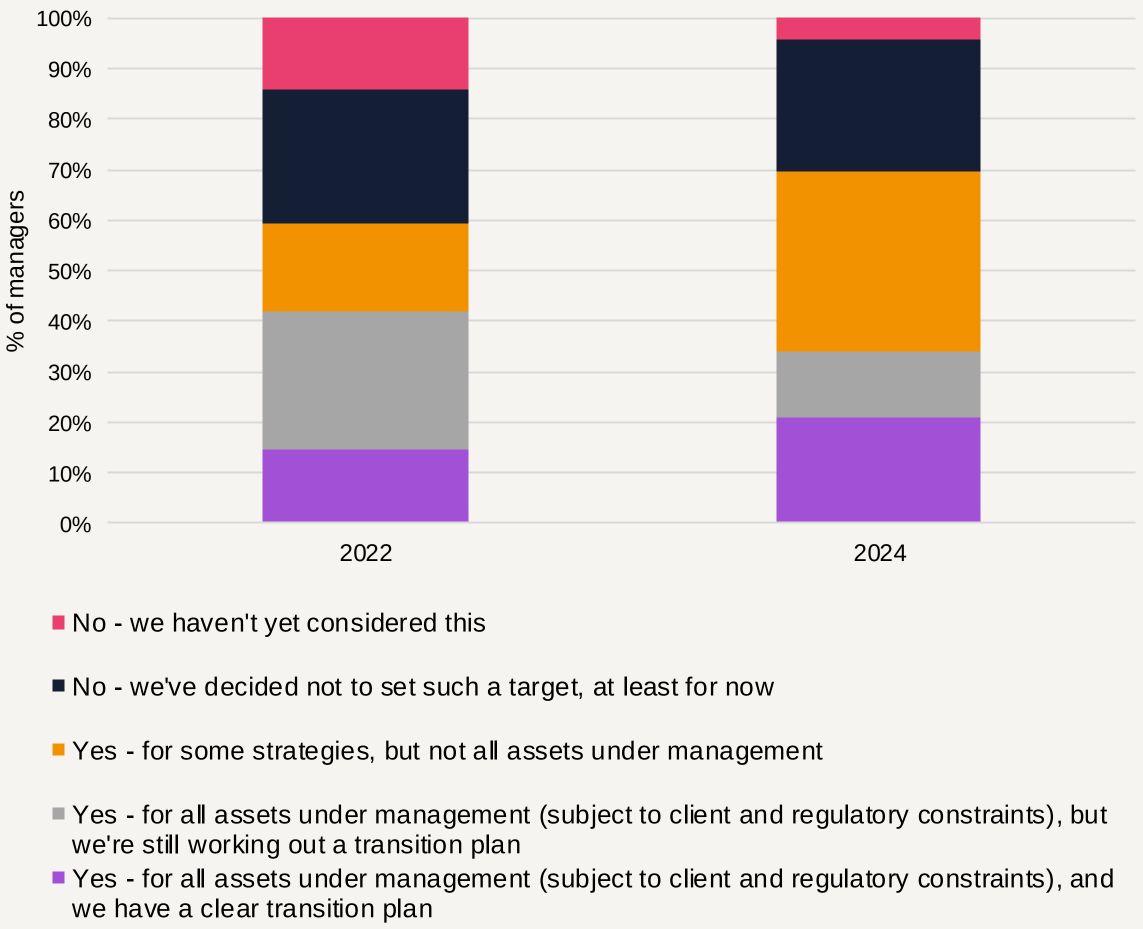
Managers' contribution towards meeting the goals of the Paris Agreement

70% of managers are **working towards net zero for at least some assets under management,** up from **59%** of managers in our 2022 survey (see figure 2).

Whilst this is an encouraging picture overall, the proportion of managers that are working towards net zero for all assets under management has actually reduced since 2022, while the proportion of managers that has decided not to set a net zero target has not changed. Of the managers who are working towards a net zero target, around half are doing so for only some of their strategies.

It is clear that there is still a lot of work to be done by investment managers to ensure that they are effectively contributing towards meeting the goals of the Paris Agreement. This is supported by another result from our survey - of the **70%** of investment managers that said they were working towards net zero for some or all strategies, only **56%** said that they are currently on track to achieve their net zero targets. Most of the others (**40%**) responded that it was hard to say at this stage.

Figure 2: Proportion of managers currently working towards net zero for assets under management



Manager reporting is limited, and alignment metrics are undervalued

Managers are experiencing increasing pressure from both regulators and their clients to improve the standard of their climate-related reporting. This is important for managers to show that they have appropriate data to manage climate risk in their portfolios.

Despite this, **only a minority of managers (33%) anticipate that by the end of 2024 they will be able to provide scope 1 and 2 emissions metrics covering at least 50% of their portfolio value for all strategies**. For metrics related to alignment with Paris Agreement goals, the proportion is even lower at **19%** (see figure 3).

This prompts a critical question – "how are managers really incorporating climate risk into their portfolio decisions?"

The IIGCC provides a framework for assessing the alignment of a company, or other asset, to net zero and assigning one of five alignment categories[2].

Of the listed equity and fixed-income managers, about half can report against the IIGCC alignment maturity scale (**52%** for listed equities and **45%** for corporate fixed income) for at least some of their strategies. This is still relatively low, although we hope that this increases over time.

Disappointingly, a significant minority of managers (**28%** for listed equities and **17%** for fixed income) have **no plans** to develop this reporting method (see figure 4).

[2]The IIGCC's five alignment categories are: not aligned, aligning to a net zero pathway, achieving net zero, committed to aligning and aligned to a net zero pathway

Figure 3: Proportion of strategies for which managers expect to be able to provide investors with climate-related metrics, covering at least 50% of the value of the portfolio, by the end of 2024

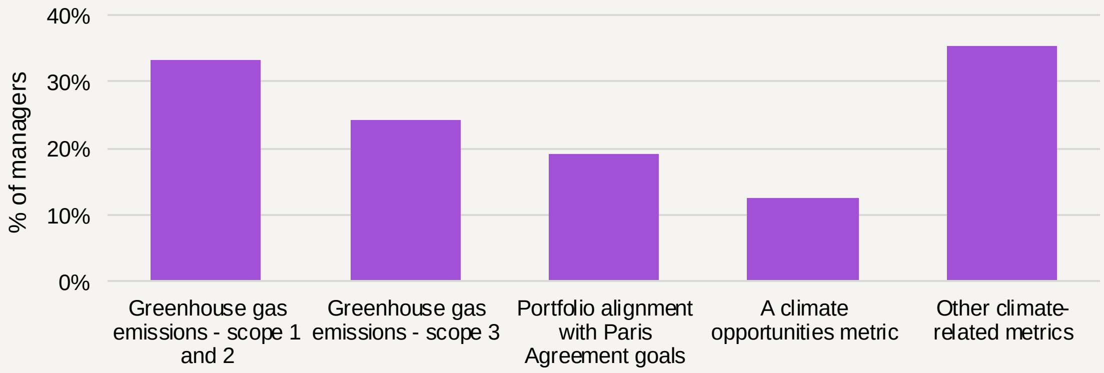
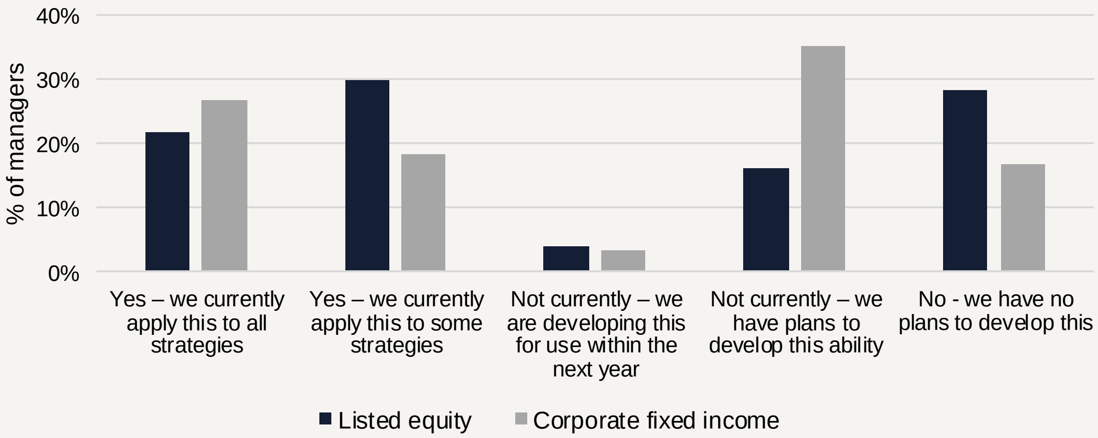


Figure 4: For strategies that invest in listed equities or corporate fixed income, can managers report against the IIGCC alignment maturity scale to clients?



Tools for achieving net zero

What are managers' tools and approaches to achieve net zero?

Of the managers that confirmed they are working towards net zero, the most popular approach was **engagement with companies or other issuers** (**93%**), perhaps unsurprisingly.

A relatively high proportion (**84%**) expect to use and promote science-based target approaches by issuers, and in fact that was the next most popular approach[2].

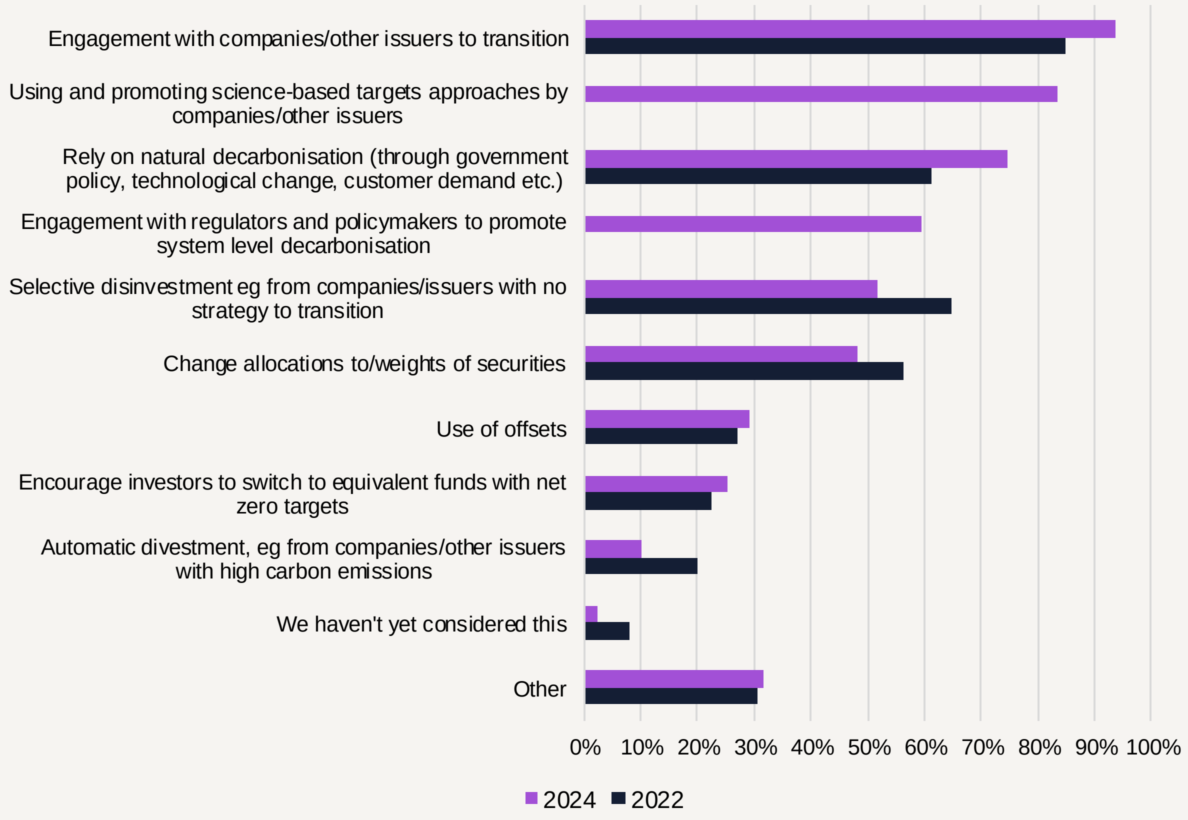
However, just **59%** expect to engage with policymakers and regulators to promote system-level decarbonisation (see figure 5). Since the policy and regulatory environment needs to move towards supporting action by companies and issuers (and indeed investment managers and asset owners too), this is disappointingly low.

Some approaches have decreased in popularity since our 2022 survey. Managers appear to be moving away from disinvestment (both automatic and selected) and from changing security weights in their portfolios. In the context of managers preferring to engage with companies and issuers, this makes sense, because doing so requires 'a seat at the table'.

[2]The following approaches were added as options to the 2024 survey, but were not present in the 2022 survey:

- Using and promoting science-based targets approaches by companies/other issuers
- Engagement with regulators and policymakers to promote system level decarbonisation

Figure 5: Tools or approaches managers expect to use to achieve net zero and corresponding interim targets



Nature-positive and just transition

We believe investors should broaden their focus when addressing climate change and ask "**are there other, related systemic risks that we should consider as part of a successful transition to net zero?**".

There are two related issues that we believe are important to consider:

- **nature-positive transition**, ie considering nature as part of the climate transition, which could include everything from a "do no harm to nature" approach when addressing climate change, to active enhancement of ecosystems and increasing biodiversity to help address climate change
- **just transition**, focusing on sharing both the benefits and the negative impacts of the net zero transition in a more equal way across society.

We asked managers whether they were taking steps to support these aspects of the transition to net zero. The picture is similar for both areas.

Engagement is the most popular approach to supporting these aspects (**82%** for nature positive and **85%** for just transition), whilst policy advocacy is less popular (**54% and 52%** respectively) (see figures 6 and 7).

Thought leadership (**65%** for nature positive and **63%** for just transition) and making investment decisions (**60% and 65%** respectively) were more popular than policy advocacy.

We might conclude that managers are taking the easier steps, and less direct action. However, this could be a sign that it is still early days for building an approach that considers these additional aspects that are so crucial to the success of the transition to net zero.

Figure 6: Are managers supporting the need for a nature positive transition?

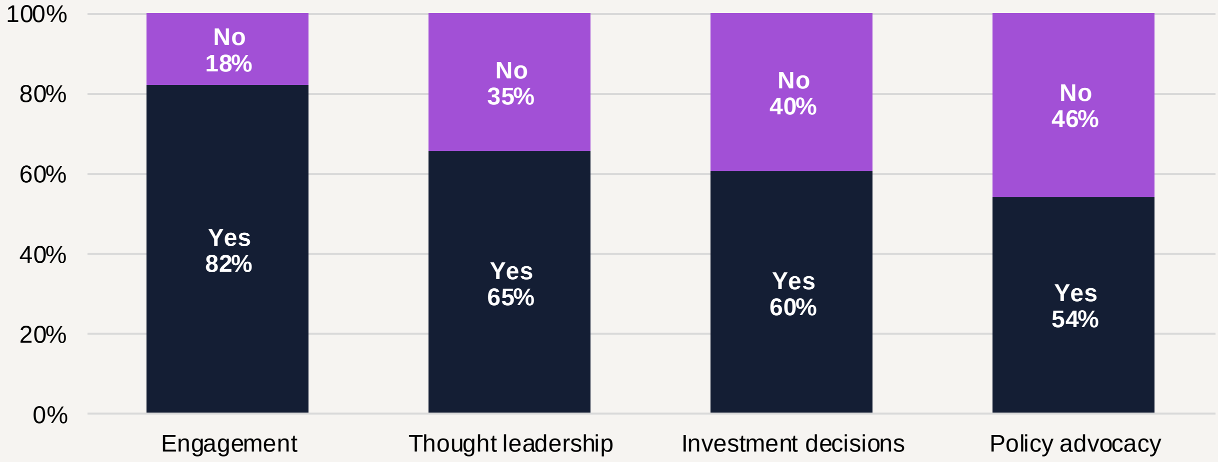
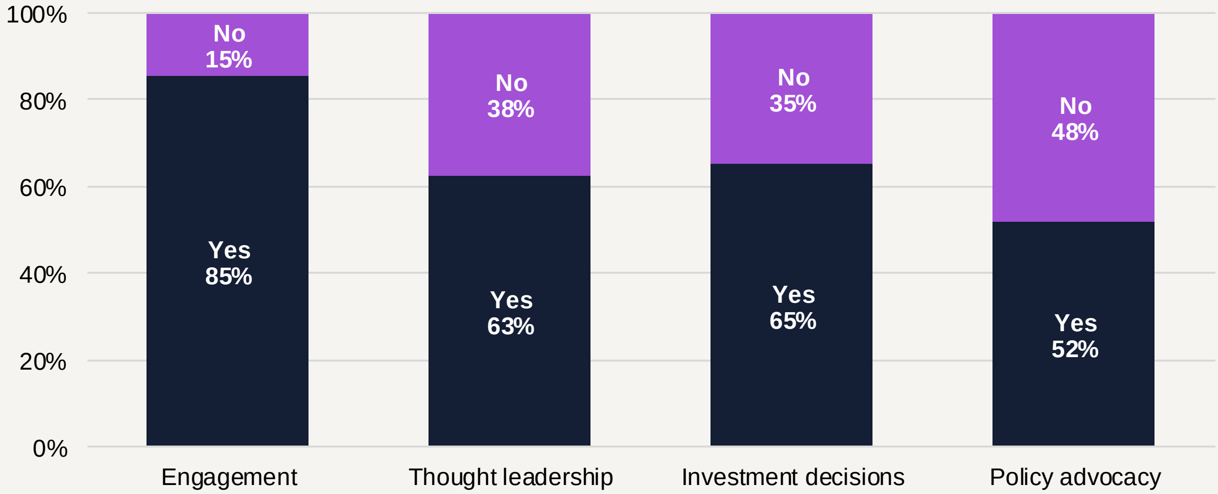
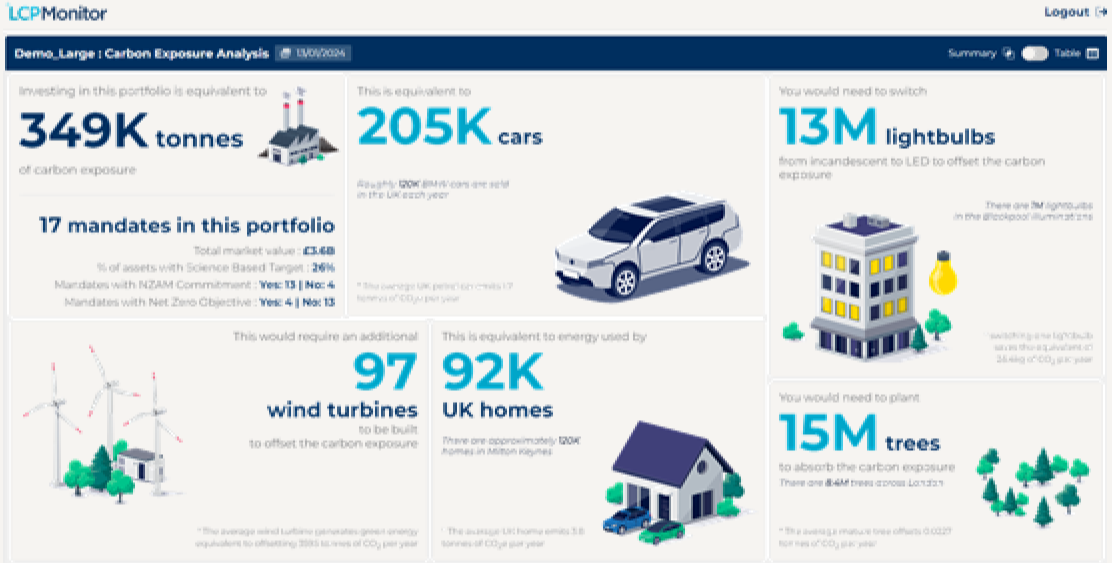


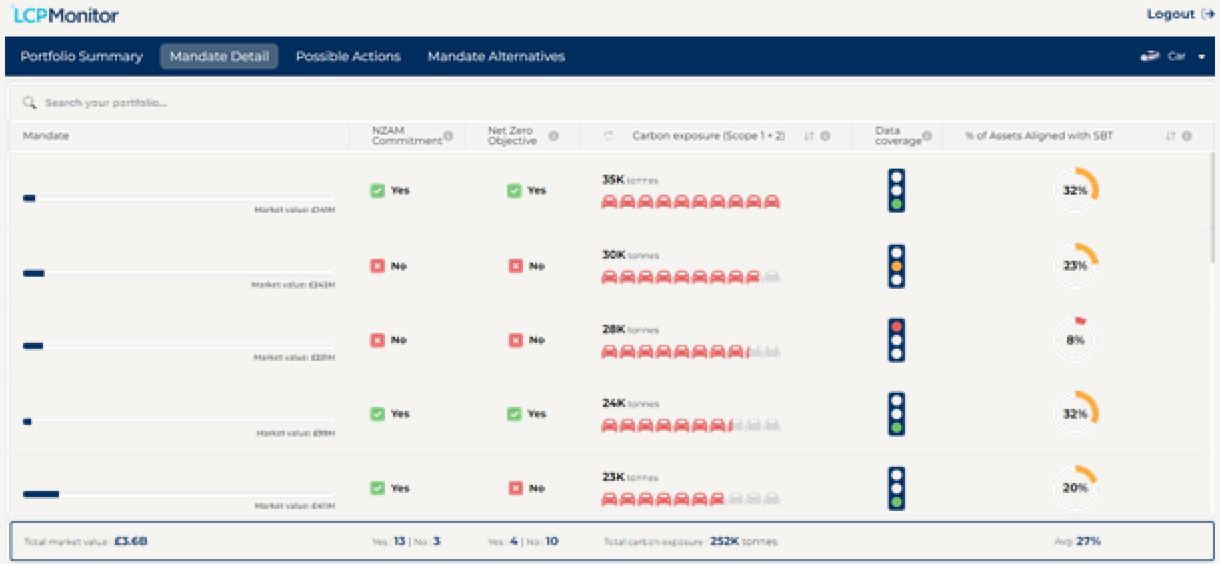
Figure 7: Are managers supporting the need for a just transition?



How can we help?

We have developed an interactive tool to help asset owners consider the effectiveness of their investment managers on climate change and compare them to other managers. This is enabling asset owners to question their investment managers in a more focussed way and consider whether the managers' approach to climate change is consistent with their own investment beliefs and objectives – if not, the tool shows alternative managers they might use.





Please get in touch to find out more

How did we carry out our survey?

This is one of four reports with results from our seventh responsible investment survey of managers. You can find our other three reports on climate, stewardship and systemic stewardship here:

ESG foundations

Stewardship

Systemic stewardship

We invite a wide selection of investment managers to complete an in-depth survey about responsible investment roughly every two years. It covers:

- their approach to environmental, social and governance issues; and
- their stewardship practices, such as exercising voting rights, engaging with company management and policy advocacy.

This year we have four separate reports summarising the findings. Some of the questions are the same as our previous surveys. We have also asked a number of new questions. In particular, our expectations of how managers approach systemic risks have evolved, so this year we have introduced more questions relating to systemic stewardship and made this the subject of one of our four reports.

Our survey covers the managers' firm-wide approach to RI. However, there are usually differences in implementation between different funds and strategies offered by the manager.

In our consulting to clients, our opinion on a particular strategy integrates the survey results with specific research into the RI approach of that strategy. In this way, we incorporate the important firm-wide aspects of a manager's responsible investment approach into our view on particular strategies that they manage. RI is a standard agenda item in our meetings with managers, where we probe what they do in practice.

119 investment managers completed our 2024 survey. Around half of the responses are from UK-based investment managers, including the major institutional UK managers. Managers completed the survey between April and June 2024.

We make comparisons with the survey results from our 2020 report (148 managers responded between August and September 2019) and our 2022 report (146 managers responded between August and September 2021).

Some managers did not answer every question in the survey. Results in this report are based on responses from between 82 and 119 managers. The percentages quoted are for the managers answering the specific question.

Contact us

Sapna Patel
Principal
+44 (0)20 7432 0679
sapna.patel@lcp.uk.com

Simon Coomber
Partner
+44 (0)1962 872671
simon.coomber@lcp.uk.com

Laetitia Anstee-Parry
Senior Consultant
+44 (0)20 3824 7309
laetitia.anstee-parry@lcp.uk.com

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

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