Systemic stewardship

Responsible Investment manager survey

OCTOBER 2024

The importance of systemic stewardship

Welcome to one of four themed reports of our 2024 Responsible Investment survey of investment managers. In this report we focus on systemic stewardship, which has greater emphasis compared to our previous surveys.

So, what do mean by "systemic stewardship"? These are actions that are taken by investors to influence the outcomes for a whole system, with the objective of addressing systemic risks that have the potential to materially harm financial outcomes. This can include engaging with policymakers and regulators.

Why is systemic stewardship of this kind important?

Systemic stewardship is important to address systemic risks - these are risks that could cause the collapse of an entire financial system or entire market, as opposed to the risk associated with any one individual asset.

These risks cannot be diversified away as they do not just affect one company or holding, but instead can have a broader impact on the wider economy.

Such risks need to be addressed by a variety of stakeholders, including governments and regulators.

For example, achieving a successful net zero transition will not be possible if we only concentrate on the actions of investors and companies. We also require change to the rules and incentives that shape the actions that companies and investors take. Advocating for these changes is part of systemic stewardship.

What do our survey results show?

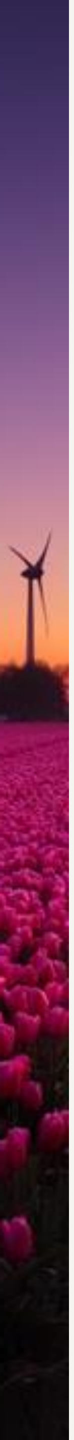
Our 2022 survey results revealed that **90%** of managers stated they engage with policymakers or regulators on market and/or industry-wide topics.

For our 2024 survey, we delved deeper into the specifics of this type of engagement, to get a feel for whether it is sufficiently focusing on reducing systemic risks. Are managers truly doing enough to influence systemic change and achieve sustainable financial outcomes on behalf of their clients?

Our 2024 survey reveals that, while there is evidence that managers engage with policymakers and regulators to some extent, execution falls short:

- **Notable lack of engagement aimed at driving changes** across the whole market, with a significant focus on engaging individual companies instead.
- **Many managers lack publicly available governance frameworks for policy advocacy**, which hampers transparency and accountability.
- **Engagement with policymakers is often sporadic**, with a preference for publishing thought pieces over more proactive actions like writing letters to policymakers and regulators.

All statistics in this report relate to the managers that responded to our surveys. See page 11 for survey details.



Role of asset managers in systemic stewardship

The number of managers signing up for the Net Zero Asset Manager (NZAM) initiative has increased (**59%** have made the commitment as of 2024, compared to **34%** in our 2022 survey report). But it is important to remember that meeting the NZAM goals is contingent on governments meeting their own climate commitments.

This interdependence underscores the need for systemic stewardship, where asset managers use policy advocacy as a tool to promote governmental and regulatory frameworks that support long-term stability and sustainability of the financial system – in this case through supporting the net zero transition.

So what do we expect managers to do to reduce the systemic risks that affect their clients' portfolios?

- Seek change across the market to address systemic risks (such as climate change), not just at individual company level.
- Be transparent in their policy advocacy by having publicly available policy positions and ensuring that any trade association memberships are consistent with these positions.
- Focus on policy advocacy actions that can more directly lead to real world change.
- Use policy advocacy to address systemic issues, not just to address governance topics or financial sector regulation.

Need for stronger systemic stewardship

Although there are signs of progress, with the survey results indicating commitment to engagement and policy advocacy, we believe managers, like the rest of us, need to take more action. To effectively address systemic risks, they must broaden the focus of their policy engagement and significantly ramp up their engagement efforts on real-world issues.

In relation to climate change, we believe investors must push for stronger, more ambitious policies to bridge the gap between current levels of ambition and the urgent need for action. That is why, alongside our assessment of managers' systemic stewardship approach, LCP is:

- **carrying out our own policy advocacy on climate change, focusing on five asks** which we believe are in the best interests of our clients (see p10)**;**
- **asking asset owners to lend their support** to our climate policy advocacy by signing up to our five policy asks; and
- **encouraging buy-in providers and Liability Driven Investment managers** (as major lenders to the UK government) **to enhance their climate policy advocacy.**

Policy advocacy and whole market approach

We asked managers to describe their stewardship style on a scale of 1 to 5, with 1 representing promoting changes at individual companies and 5 signifying they are seeking changes across the whole market.

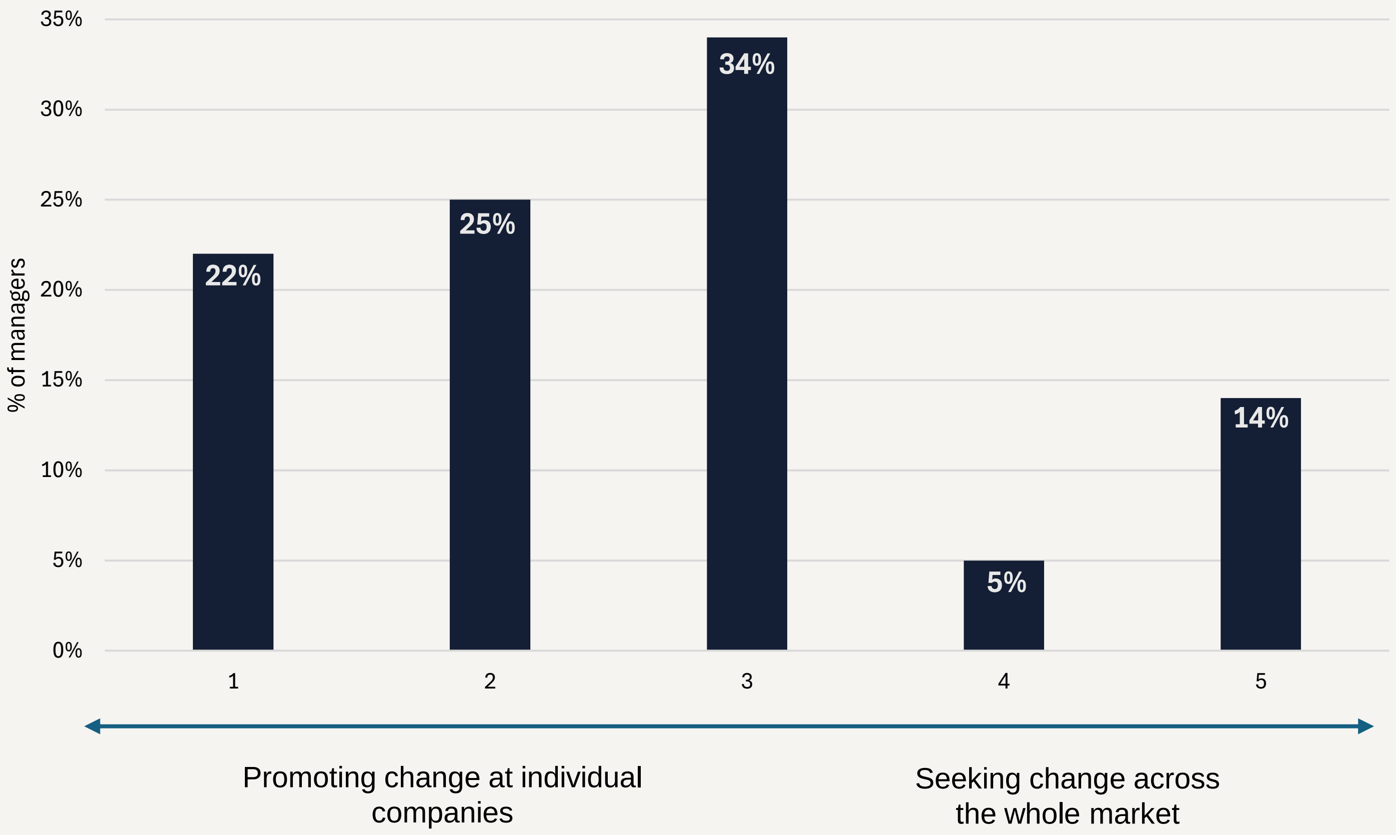
Expanding beyond individual company focus

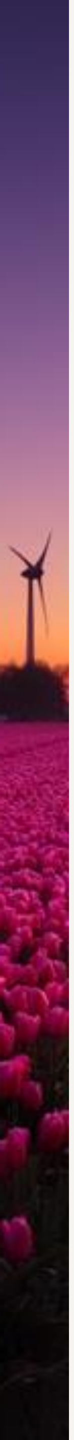
The results reveal that most managers tend to target individual companies more in their stewardship approach.

Only **19%** of managers were more focused on seeking change across the whole market (see figure 1).

While individual company engagement is important, the need for a broader approach, encompassing systemic issues that affect the whole market, cannot be overlooked.

Figure 1. Managers and their stewardship style





Policy frameworks that are transparent and public

We asked managers whether they had a publicly available governance framework for policy advocacy and **45%** of the managers who responded confirmed that they do (see figure 2). It is disappointing that the majority of managers do not.

Importance of a transparent policy framework

Having such a framework is important for transparency of approach, engagement priorities and accountability.

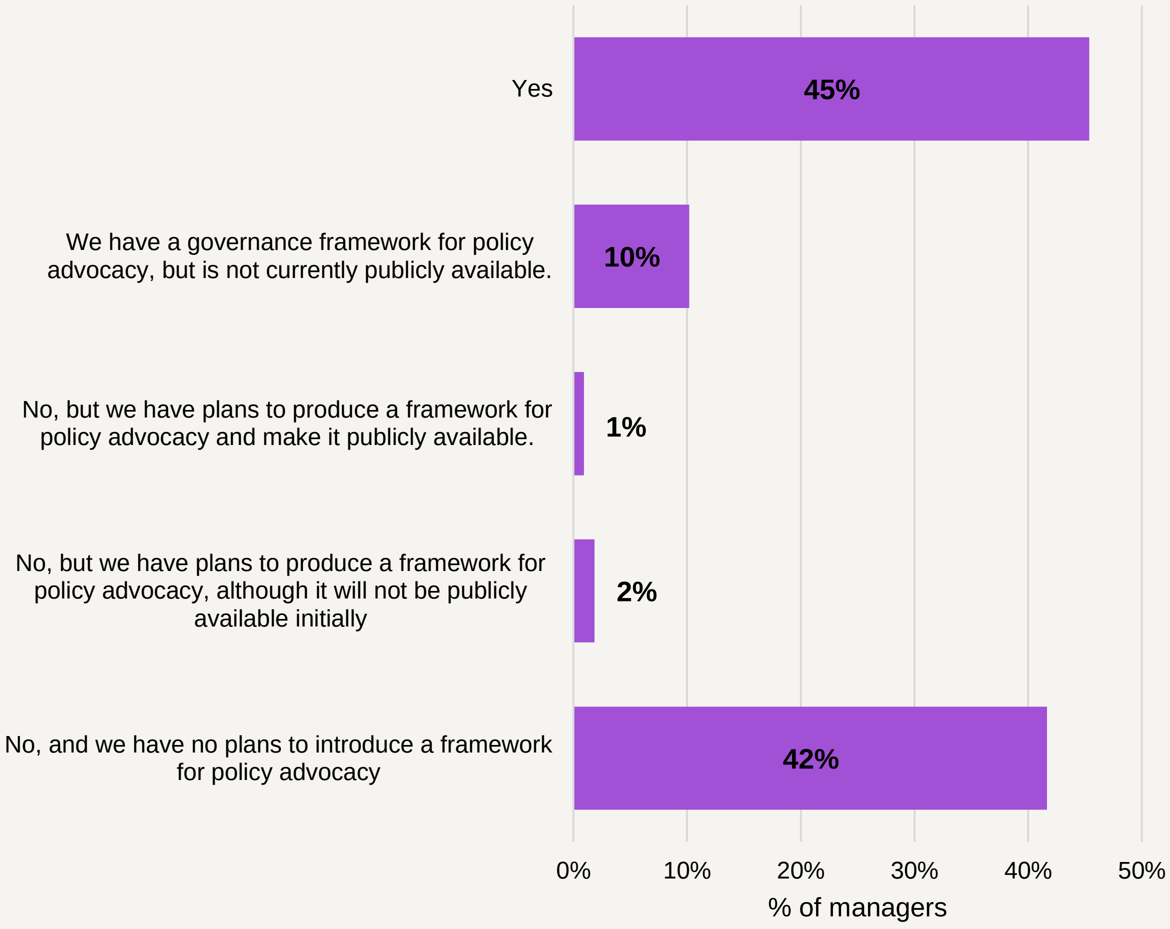
It's perhaps concerning that such a large proportion of managers have no policy. It may mean that there is no policy advocacy taking place, which suggests an important gap in their approach to stewardship, or that there is low transparency and challenges for asset owners in holding managers accountable for their approach.

Ensuring alignment with trade associations

Another crucial aspect of policy advocacy work is the alignment of the manager's policy positions with those of the trade associations it belongs to.

While a substantial number of managers undertake regular or ad hoc reviews of their trade associations' policy positions, a concerning **21%** lack any review process. This could lead to inconsistencies in approach, undermining the effectiveness of managers' policy advocacy.

Figure 2. Do you have a publicly available governance framework for policy advocacy?



How often are managers carrying out policy advocacy?

We asked the managers how often they engage with policymakers. For this purpose, we defined "rarely" as a few interactions per year, "occasionally" as a few interactions per month, and "frequently" as several interactions most weeks.

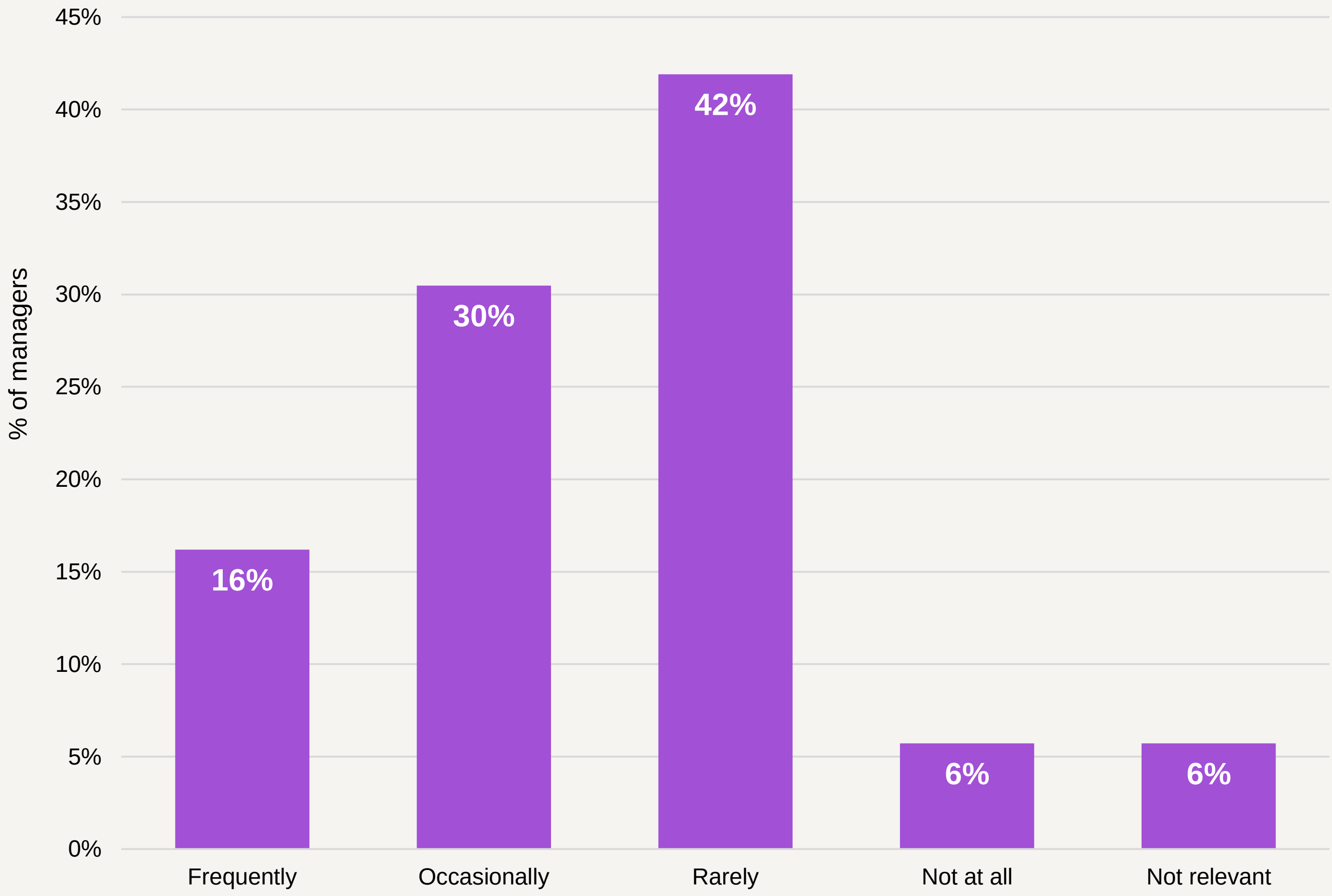
Insufficient engagement with policymakers

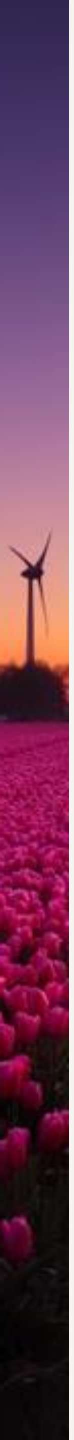
The results indicated that only **16%** of managers engage frequently and **30%** engage with policymakers occasionally (see figure 3).

This suggests a relative lack of interest in driving systemic change.

Tackling systemic risks such as climate change requires effort from governments as well as companies, with investors playing a crucial role to bridge that gap. In this context, the frequency of managers' engagement with policymakers and regulators is disappointing.

Figure 3. How often investment managers engage with policymakers and regulators on market and/or industry-wide topics and systemic issues such as climate change





How are managers carrying out policy advocacy?

Indirect versus direct policy engagement strategies

For managers that do engage with policymakers and regulators, it is important to understand how this engagement is conducted to assess its likely effectiveness.

The most common systemic stewardship action by managers that responded was publishing thought pieces, whereas the least common was letters to policymakers.

In the case of listed equities, **51%** of managers publish thought pieces, while only **37%** write letters to policymakers (see figure 4). This trend was the same across all the asset classes we included in our survey. This may indicate **managers' preferences for more passive and indirect forms of engagement** – this may be less confrontational, but also less impactful in driving policy changes. **Are these actions genuinely designed to influence policy, or are they more about maintaining visibility and appearing active in the space?**

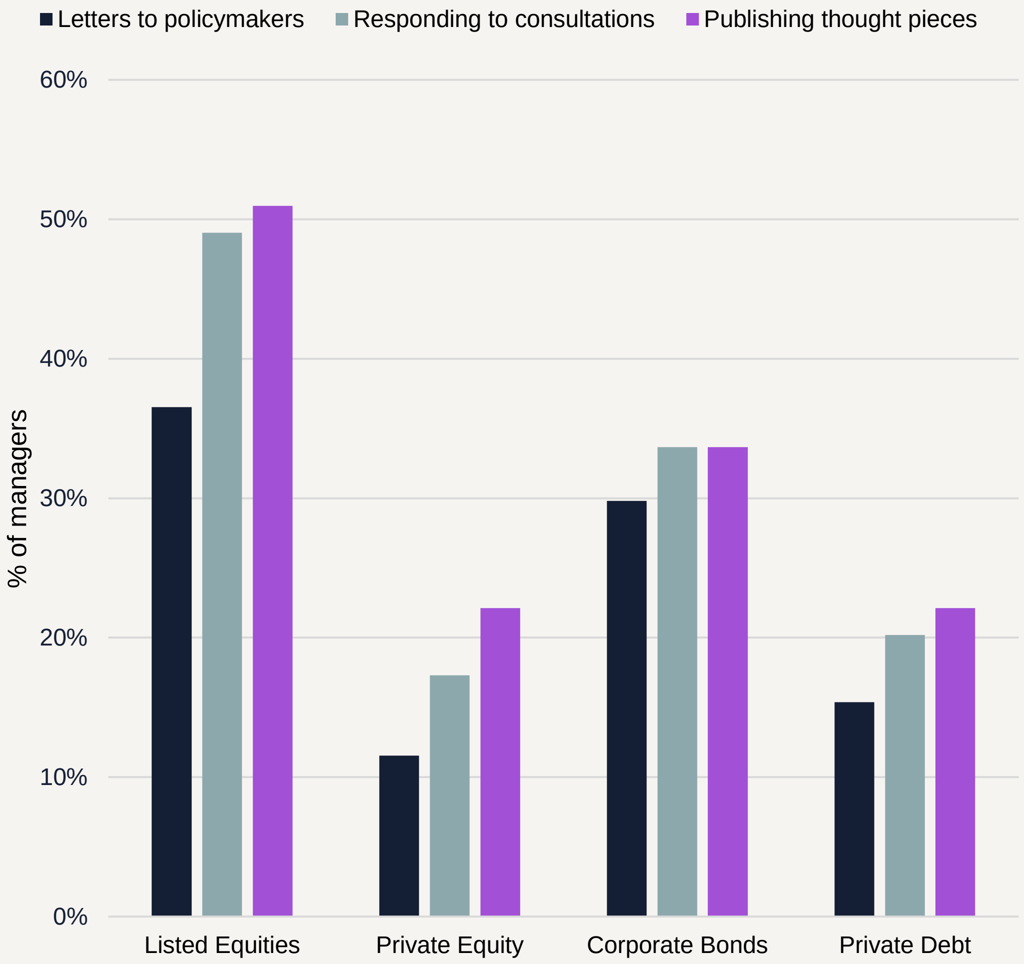
Asset class differences in systemic stewardship

Overall, **a higher proportion of listed equity managers conduct systemic stewardship actions compared to other asset classes**, followed by corporate bonds. This trend is not surprising given the visibility and scrutiny that listed equities and, to a lesser extent corporate bonds, typically receive.

Listed equities are arguably more sensitive to economy-wide performance, making systemic risks more immediate and significant for these assets, which may also explain the higher engagement in policy advocacy. In contrast, private assets could be more sheltered from broad economic fluctuations by their nature.

However, we believe there is a need for more proactive and impactful policy engagement strategies across all sectors to ensure that systemic risks are adequately addressed, regardless of asset class.

Figure 4. How are managers carrying out policy advocacy?



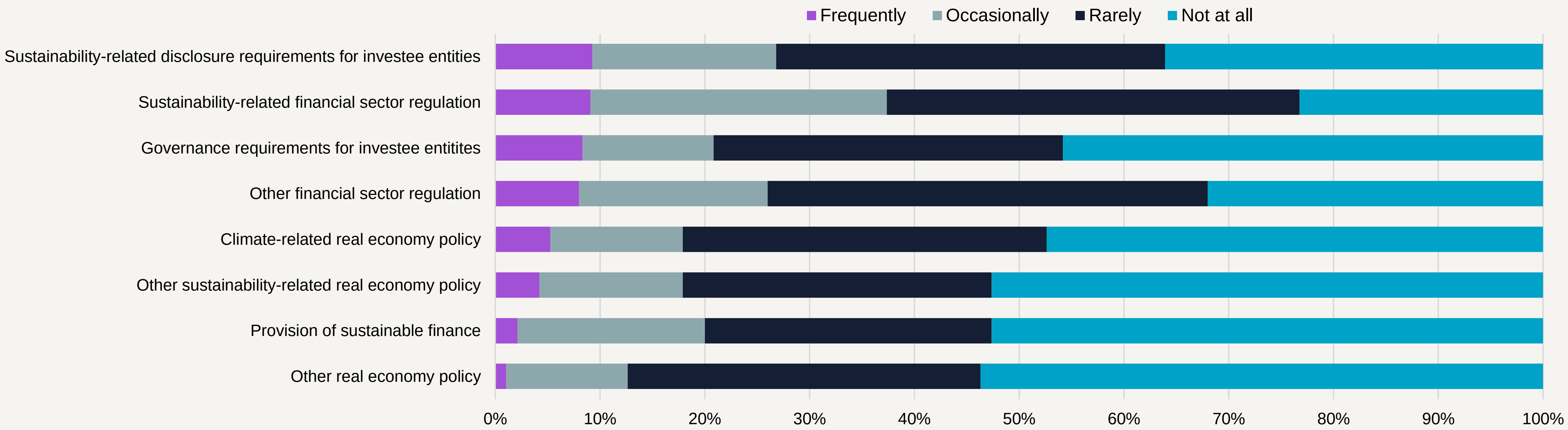
Themes for managers' policy advocacy

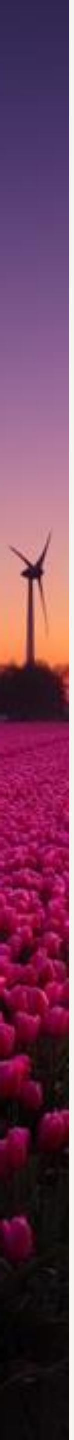
We asked managers which themes they covered, and how often, as part of their policy advocacy work. A relatively low proportion of managers (less than **10%**) frequently engage on any of the topics we asked about.

For managers that engage frequently or occasionally, the primary focus is on areas related to governance and financial sector regulation. Engagement on provision of sustainable finance and real economy policies is much lower on the priority list for most managers - less than **6%** are frequently engaging on each of these topics (see figure 5).

While financial sector changes are important, real economy changes are needed just as much, if not more, to mitigate systemic risks such as climate change. **Are managers prioritising regulatory concerns that have an immediate impact on their operations over longer-term solutions to systemic risks?**

Figure 5. How often are managers engaging on various policy advocacy themes?





Systemic stewardship and climate change

Climate change poses significant systemic risks for investors, with the most significant risks being from physical impacts in higher warming scenarios. The main way of avoiding these is by achieving net zero emissions as early as possible and this necessitates coordinated action from both governments and companies.

A systemic stewardship approach is therefore a necessary part of addressing climate risk. In particular, we believe managers should be engaging with policymakers to encourage efforts to close the gap between emissions reductions under the current policy environment and the reductions required to achieve global net zero emissions by 2050.

Engagement in policy for net zero: progress and gaps

In our survey, we asked managers what tools and approaches they expect to use to achieve net zero and any corresponding interim targets.

We set out a detailed analysis in the climate report of our 2024 RI survey – it is noteworthy that, of the **70%** of managers that are working towards net zero for all or some assets, **59%** expect to engage with policymakers and regulators to promote system-level decarbonisation.

This level of engagement is encouraging but there are still many managers that are failing to take this important action.

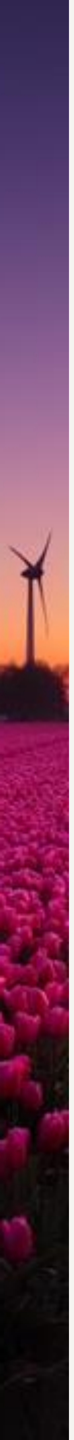
Policy advocacy: the underutilised tool in climate risk management

Investors are increasingly understanding that a successful net zero transition requires consideration of nature (in the context of ecosystems and biodiversity) and social issues (often referred to as a just transition, seeking to distribute the benefits and negative impacts of the net zero transition more equitably across society).

We asked managers whether they were taking steps to support these two aspects of the transition to net zero. Based on the managers' responses, policy advocacy remains the least favoured approach of the four approaches we asked about (the other three being investment decisions, engagement and thought leadership).

Of managers that responded, **54%** use policy advocacy to support a nature positive transition and **52%** to support a just transition.

We recognise that these topics are relatively new considerations for investors. While many managers are not currently engaging with these important aspects of managing climate risk, we hope that they will soon develop a more comprehensive approach that acknowledges the importance of taking a holistic approach to the financial risks of climate change.



How can we help?

To address climate change, systemic stewardship is essential. That’s why we have developed a set of five climate policy asks.

These policy asks guide our own systemic stewardship activity at LCP, as we want to use our influence to drive forward the best possible climate outcomes for our clients and the beneficiaries 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 asset owners to support the following policy asks.**

Our climate policy asks

1. Climate regulations for investors should aim for real-world impact, not just disclosures.
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

We recently invited asset owners to support these asks, and 49 asset owners with assets totalling £184bn have already done so*.

* Except the fiduciary duty ask, which has the support of 41 asset owners with assets totalling £153bn.

Please visit our website or get in touch to find out more

Supporters as at 22 October 2024

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

Climate change

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 100 and 119 managers. The percentages quoted are for the managers answering the specific question.

Contact us

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

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

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

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