How ESG issues are reflected in our investment advice

LCP INSIGHT CLARITY ADVICE

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We are a signatory of the Principles for Responsible Investment and support integration of environmental, social and governance (ESG) considerations into investment practices.

+ *We support the six Principles for Responsible Investment*

The UN-supported Principles for Responsible Investment (PRI) recognise that institutional investors have a duty to act in the best long-term interests of their beneficiaries. LCP shares the belief underlying the Principles, namely that ESG issues affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time).

Signatories publicly commit to adopt and implement the following Principles where consistent with their fiduciary responsibilities:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

As investment advisers, we do not manage any assets ourselves. As such, we promote these Principles to our clients and aim to support our clients in meeting the Principles.

LCP believes that the successful implementation of the Principles will improve investors' ability to meet commitments to beneficiaries as well as better align their investment activities with the broader interests of society. This document summarises how LCP supports the Principles, other than Principle 2 which is covered by our statement of support for the UK Stewardship Code.

We help our clients meet their investment objectives

Our clients include pension scheme trustees, charity trustees, insurers and the sponsoring employers of pension schemes. Many of them are long-term asset owners, holding investments in equities (company shares), government and corporate debt, and other asset classes such as property. They appoint external investment managers to manage the assets on their behalf, often through pooled funds. They rely on their managers to identify which ESG issues are relevant to particular assets, take account of ESG issues as appropriate when deciding which individual securities to buy and sell, and exercise ownership rights such as voting at company AGMs.

We provide advice and support to our clients in setting investment policy and strategy, selecting and appointing managers, and regularly reviewing investment processes and performance. We do not manage any assets ourselves. When providing investment advice, we don't have a single "house view" – our clients have individual requirements, so we consider their goals and needs and tailor our services accordingly.

Our clients typically invest their assets to meet long-term liabilities such as paying benefits to pension scheme members. To do this efficiently, they seek to maximise the long-term returns on their assets whilst managing and maintaining investment risk at an appropriate level. The generation of long-term sustainable investment returns depends upon stable, well-functioning and well-governed environmental, social and economic systems. We therefore believe it is important that ESG issues are considered throughout the investment chain and so we incorporate them in our advice to clients.

We reflect ESG issues in our investment advice

ESG is relevant throughout much of the investment advice we give to clients (see diagram). The approach we take, and the emphasis we place on ESG, varies according to client preferences. However, ESG is integral to our investment manager research (see next section), so as a minimum ESG considerations are reflected in our views of investment funds and products, and hence influences our advice on manager selection and review exercises.

Investment beliefs	We help our clients to reach a consensus view on the financial relevance of ESG factors and use this as the basis of their ESG policy.
Investment strategy	We take account of our clients' views on ESG factors when advising on investment strategy, including consideration of ESG-related products where relevant.
Manager selection	When putting forward investment managers for selection exercises, we consider the managers' approaches to ESG factors and the fit with our clients' objectives.
Manager oversight	We can help our clients review how their managers incorporate ESG factors by providing updates on our manager research and facilitating clients' own discussions with managers.
Communication	We assist our clients with documenting their approach to ESG factors and, where appropriate, communicating it to beneficiaries and other stakeholders.

Our Responsible Investment Panel provides strategic oversight of LCP's ESG-related activities, reporting into LCP's Executive Committee (ExCo) which is ultimately responsible for our work in this area. All of our investment partners and consultants are able to advise clients on ESG matters, with access to specialist support as required. We have a responsible investment champion for each asset class, to assist with assessing managers' ESG approaches when conducting manager research.

We consider ESG issues when researching investment managers

Every two years we invite the investment managers in our research programme to complete a responsible investment survey. Our survey covers managers' approach to ESG issues, plus their active ownership (stewardship) practices such as voting at AGMs and engaging with the management of companies they invest in.

The box below shows the characteristics that score highly on the ESG-related parts of the survey. We supplement the managers' responses with discussions at our regular research meetings with managers, enabling us to take account of subsequent developments and fund-specific considerations.

Our expectations of managers

Managers with the following characteristics score highly when we assess their ESG credentials:

+ ESG integrated throughout investment process
+ All relevant staff receive ESG training
+ Specialist staff provide in-depth ESG expertise as required
+ Senior management are accountable for ESG integration
+ ESG considerations affect buy/sell decisions
+ Voting and engagement used as a tool to improve investment performance
+ Robust policies on issues like climate-related risk, executive pay, boardroom responsibilities and diversity
+ Evidence of collaborating, as appropriate, with other investors
+ Signatory or member of relevant codes and initiatives

We believe that stewardship can enhance investment performance by encouraging companies to act in the long-term interests of their shareholders (eg pension schemes) and their ultimate beneficiaries (eg pension scheme members). As such, we are a signatory of the UK Stewardship Code and support the adoption of stewardship best practices by trustees and their investment managers. More information on how we support the seven principles of the UK Stewardship Code and reflect them in our client advice can be found on our website.

We assign a responsible investment score between 1 (week) and 4 (strong) for each manager, covering both their ESG and stewardship practices, adjusting the score for individual funds as appropriate. We incorporate this score in our overall product grading for most asset classes, directly impacting whether they are recommended to clients. The default weight for our responsible investment score is 10% for equities and fiduciary management and 5% for most other asset classes except LDI, gilts and cash.

For more information on our latest responsible investment survey, see our responsible investment survey report.

We provide feedback to managers on request, highlighting areas where we would like to see improvements. In this way, we use our influence as advisers to many clients to raise responsible investment standards across the industry.

We provide clients with their own managers' scores, for example as part of their ongoing investment monitoring, and support them in discussions with managers. We can supplement the scores with the detailed underlying research data, which is particularly useful for clients wishing to explore specific aspects in more depth.

In addition to considering ESG and stewardship issues across all of the funds we research, we review various specialist funds for clients who wish to place particular emphasis on ESG issues. These include:

+ Actively and passively managed funds that invest in a broad range of global equities but only include companies that meet threshold levels of ESG practices;
+ Passive equity funds that incorporate a climate or ESG "tilt" to reduce their exposure to climate risks or increase their exposure to good ESG practices; and
+ Specialist equity funds that invest in solutions to environmental and social challenges.

We inform our clients about ESG topics

We provide training for our clients on ESG and stewardship matters, through our events programme, trustee training courses and bespoke sessions for individual clients. For example, one of our main 2018 conferences featured a talk and panel discussion on ESG and the other started with a keynote speech on climate change. Our publications include a Guide to E, S, and G in investment; an Investing Responsibly magazine; an educational Guide to climate-related risks for DB and DC pension schemes; and a series of guest blogs and videos in which investment managers talk about Responsible investment in practice.

We help our clients keep abreast of ESG developments through our weekly Pensions Bulletins, quarterly investment updates and bi-annual Vista magazines. In particular, our quarterly investment updates include an ESG section covering topical stories, companies in the news, and questions for clients to ask their managers. We provide more detailed updates to clients on request, tailored to their specific requirements. For example, we can provide annual reviews of their managers' ESG practices and quarterly summaries of their managers' voting activity.

We encourage consideration of ESG issues throughout the investment chain

The sections above describe how we encourage clients and investment managers to incorporate ESG considerations in their investment practices. In addition, we respond to relevant consultations and are supportive of initiatives that facilitate consideration of ESG – such as the Association of Member Nominated Trustees' Red Line Voting initiative which offers one way of helping clients implement ESG voting policies for their UK equity holdings.

LCP is open to collaborating with other organisations on ESG topics. One way we do this is through our representation on relevant industry groups. Members of our Responsible Investment team belong to the Institute and Faculty of Actuaries (IFoA) Resource and Environment Board and the IFoA Resource and Environment Research and CPD Subcommittee. Our Head of Responsible Investment was heavily involved in the IFoA working party that produced A Practical Guide to Resource and Environment Issues for Pensions Actuaries and three supporting reports.

Want to find out more?

If you would like further information, please contact your usual LCP adviser or one of the people below.

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

Paul Gibney
Partner
+44 (0)20 7432 6653
paul.gibney@lcp.uk.com

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

Nigel Dunn
Senior Consultant
+44 (0)20 7432 7795
nigel.dunn@lcp.uk.com

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

At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy and employee benefits.