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BY EMAIL ONLY

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Dear CEO

Net zero emissions through investment management
LCP's expectations of investment managers

At LCP, we firmly believe that achieving the goals of the Paris Agreement on climate change is in the best interests of our clients and their beneficiaries. This requires achieving net zero global greenhouse gas emissions no later than 2050. We are committed to working with others throughout the investment system – including our clients and, you, their investment managers – towards this goal. This is why I am writing CEO to CEO.

This letter sets out our current view of best practice for achieving net zero emissions through investment management. It updates our previous note on this topic.

We encourage our clients to align their investment strategy with net zero global greenhouse gas emissions by 2050 and to have a publicly stated ambition to deliver on that target. We help them do this through selecting investment managers, and investing in mandates, with credible targets consistent with net zero. Our research views include an assessment of each investment management product's climate risk management and net zero alignment. Since 1 April 2022, managers have needed to be signatories of the Net Zero Asset Managers initiative for their products to be eligible for LCP to give them a "buy" rating.

Climate risk is financial risk

We expect managers to appropriately manage climate-related risks and opportunities for our clients' assets. This includes those arising from both the transition to a low carbon economy and the physical impacts of climate change. And it's not just about risks to individual assets; we also expect investment managers to play their part in mitigating systemic climate risk. We trust you share our view that investment managers need to be:

- **aligning portfolios** with net zero pathways[1] (to the extent possible given their mandates and duties towards clients);
- **encouraging** portfolio companies, or other investee entities, to **set and meet net zero targets**; and
- **advocating for system-level changes** that increase the chances of reaching net zero global emissions no later than 2050.

We would welcome a discussion about any areas where you have a different view.

To be clear here on two specific points:

The focus should be on real world emissions reductions: The aim is to rapidly reduce global net emissions. That means engaging with companies, leaseholders and other stakeholders to get real emission reductions; and seeking profitable investments in companies or other assets that assist with emissions reduction or removal.

Reductions in portfolio emissions is not the driving objective: Selling portfolio assets (or companies selling emissions-intensive divisions) so that you, the investment manager, and our clients no longer hold them is unlikely to achieve a substantial real-world reduction in emissions. We recognise that approach may increase the cost of

[1] Consistent with a 50% reduction in global emissions by 2030 and net zero global emissions by 2050.

capital encouraging that business to change, but any effect is likely to be small. Therefore, greater focus and resources should be allocated to ensuring that companies align with net zero pathways.

These expectations are reflected in our research grading framework, with products that have a greater focus on engagement and real world emissions reductions achieving higher grades. A more detailed list of our expectations of investment managers is set out in the Appendix. Whilst we do not expect managers to meet these in full today, we do expect to see improvements in all areas over time.

Of course, investment managers must always act consistently with their duties towards our mutual clients. We recognise that there could be conflicts between short-term and long-term interests which may constrain the actions that can be taken. However, we expect the actions outlined in this letter to be in our clients' best interests over the longer term, and to help manage short-term and long-term financial risks.

Yours sincerely

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Appendix - Investment managers meeting net zero targets

To protect the long-term best interests of our clients, we expect and encourage all investment managers to:

Commit to net zero emissions across your assets under management:

- **join the Net Zero Asset Managers initiative** to support the goal of net zero greenhouse gas emissions by 2050;
- **rapidly increase** the proportion of mandates which are managed in line with achieving net zero global emissions no later than 2050;
- **encourage all clients to give you the mandate to act** by including a net zero target in your mandates;

Align investment holdings with net zero pathways:

- **seek rapid real world reductions in emissions**, **focusing on alignment of holdings** with net zero pathways[2] rather than overly focusing on reductions in portfolio emissions;
- **assess alignment of holdings** using the alignment maturity scale developed by the Paris Aligned Investment Initiative (PAII)[3], adapted appropriately for the asset class;
- seek to increase the proportion of assets under management which are **invested in climate solutions** (supporting both mitigation and adaptation goals), including these assets within individual mandates as appropriate;
- invest and engage in a way that supports a **just transition** and **nature-positive** outcomes;

Undertake high quality stewardship:

- use effective voting (where applicable) and **robust engagement with investee entities** to encourage achievement of net zero emissions no later than 2050 (including through the use of appropriate incentive structures) and management of physical climate risks;
- **set clear expectations for each engagement**, track progress, and follow a pre-agreed escalation process if you are not making sufficient progress with an engagement;
- **undertake policy advocacy** in support of net zero global emissions no later than 2050 and adapting efficiently to temperature rises, advocating for system-level changes that increase the chances of achieving these goals;
- **collaborate with others to increase the effectiveness** of engagement and develop harmonised net zero methodologies for use across the investment industry;

Adopt high reporting standards that support convergence across the industry:

- **provide high quality portfolio-level reporting** to all clients each quarter, that includes alignment of assets, investments in climate solutions, data on the portfolio's scope 1, 2 and 3 emissions intensity, attribution of changes in these portfolio emissions intensities over time[4], progress of holdings against their individual emissions reduction targets, engagement examples, and progress against your engagement milestones;
- **work with investee entities** to improve the quality and coverage of climate-related data.

Follow good practice for your own firm:

- **set net zero emissions targets for your firm's own operations**.
- keep any use of emissions **offsets to a minimum**, in relation to both assets under management and your firm's own operations, and follow high quality, recognised principles for any carbon offsetting;
- **publish and adhere to a climate action plan** for meeting the commitments made.

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[2] Consistent with a 50% reduction in global emissions by 2030 and net zero global emissions by 2050.
[3] Whereby holdings are categorised as achieving net zero, aligned, aligning, committed to aligning, or not aligned, as set out in the Net Zero Investment Framework.
[4] For example, the split between changes in emissions intensity due to changes in emissions, changes in EVIC, new data coverage, trading in the portfolio.