Getting behind the spin

LCP Responsible Investment Survey

January 2020

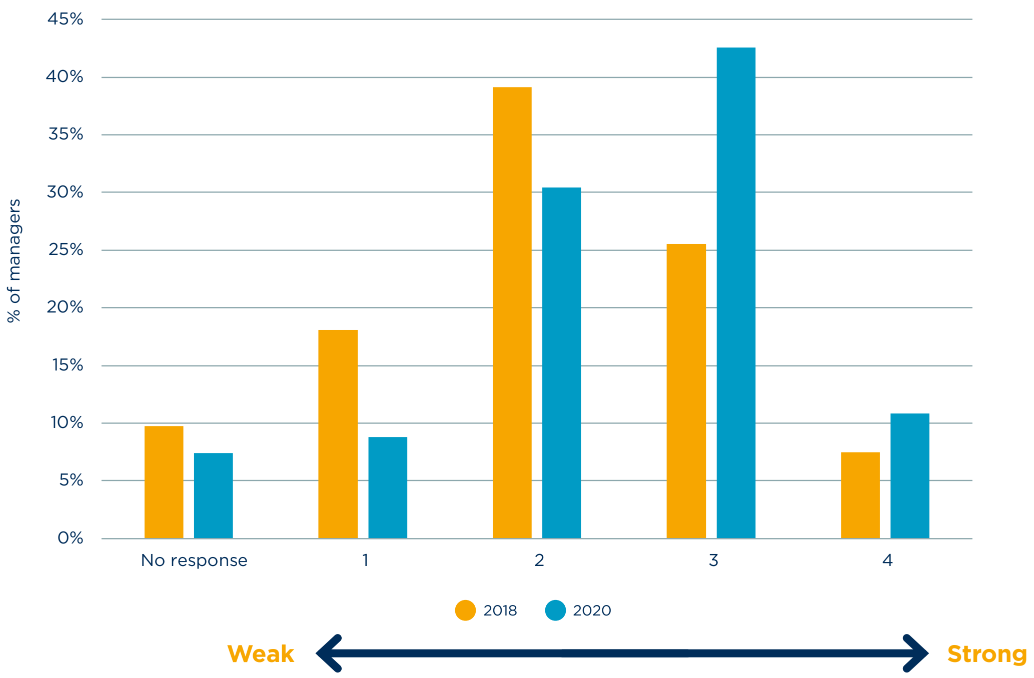
At a glance

Average scores increase, but there's further room for improvement

- **A record 137** investment managers completed our survey.
- Average scores have improved since our 2018 survey.
- More managers achieved the top score of 4, but many did not.

RI is an important part of LCP's investment manager research due to the wide variations we see in approaches and outcomes.

Manager-level scores from LCP RI survey



Most managers are now PRI signatories*

66% **in 2016**

78% **in 2018**

88% **in 2020**

Managers offer hundreds of specialist ESG funds

61% **offer a specialist fund**

Actively managed 'sustainable' equity funds are the most common

Board-level accountability for responsible investment is now the norm

34% **in 2018**

81% **in 2020**

Explicit consideration of ESG factors is not universal

30% of managers do not systematically consider ESG factors for all asset classes

* Principles for Responsible Investment

At a glance
continued

Managers are taking steps to address ESG data quality

54% of managers say they make extensive adjustments to the ESG data they obtain from third parties

But **16%** of managers don't adjust the data at all

Gaps in portfolio-level ESG analysis are a concern

Managers carry out such analysis for only 60% of asset classes*. By focusing on ESG risks at the security level, they risk missing portfolio-level risks arising from a concentration of ESG exposures.

*Action on climate-related risk is worryingly weak**

Only **49%** say it's a key engagement topic

Just **44%** systematically consider it at security level before investment

14% don't consider it

Many managers lack engagement policies on key ESG topics

52% **have a policy on climate change**

40% **have a policy on boardroom roles and diversity**

23% **have a policy on fair pay and benefits**

Voting practices are generally strong

On average, equity managers:

exercise 95% of votes

vote against management or abstain at least once at 33% of AGMs

Asset owners need to hold their managers to account

- **Ask questions** about RI when you meet your managers
- Speak to your usual LCP contact to see your **managers' scores**
- **Encourage your managers to improve**

* Figures calculated as a proportion of the total number of asset classes offered across the managers (ie a manager offering two asset classes has twice the weight of a manager only offering one).

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Introduction

This is our fifth biennial RI survey

Responsible investment has been at the forefront of many investors' minds over the last couple of years, partly driven by societal trends, but also reflecting a more widespread recognition that considering ESG factors and exercising stewardship can have a positive impact on investment returns. There seems to be growing confidence amongst the industry in these approaches, and the vast majority of managers now say they assess ESG factors and exercise stewardship.

We analyse each manager's responses and assign the manager a score between 1 (weak) and 4 (strong).

How much of this positivity is marketing spin and to what extent is responsible investment truly embedded in managers' approaches?

Every two years we invite a wide selection of investment managers to complete an in-depth survey about responsible investment (RI). It covers:

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

We analyse each manager's responses and assign the manager a score between 1 (weak) and 4 (strong). This report summarises the findings from our fifth biennial RI survey. We invited **148** investment managers to complete our survey this time and **137 (93%)** did so, nearly all the major institutional investment managers in the UK.

Our questions and scoring are largely consistent with our 2018 survey so we can compare results, while we have also added some new questions to reflect the fact that RI has moved on since then.

About the survey

Most managers completed the survey in August and September 2019.

All comparisons are with the 2018 survey results except where otherwise stated. 120 out of 133 managers (90%) responded to that earlier survey. 116 managers responded to both surveys.

For most questions, a small number of managers did not respond. The percentages quoted are for the managers answering the specific question, so the number of respondents is usually slightly lower than the 137 managers (120 in 2018) who completed the survey. The voting questions were only posed to the 104 managers (92 in 2018) who said they offer equity strategies.

We amended the format of some questions in light of experience from the 2018 survey, which we believe has enabled us to elicit more representative responses this time. Some of the 2018 figures may have understated the true picture where the aims of the questions were less clear than in our 2020 survey.

Introduction
continued

RI expectations have increased since our 2018 survey

Public sentiment has shifted in the last two years in relation to ESG issues. **So many issues that were previously seen as fringe concerns are now mainstream discussion topics** – you only have to think of the war on plastic, diversity in the workplace, climate change, zero-hours contracts. As these stories unfold and start to affect the financial performance of companies (some positively, some negatively), they are having an impact on investors' financial returns. As a result, responsible investment considerations are now widely accepted as part of investors' fiduciary duties.

In addition, these issues are growing in importance to investors' clients and beneficiaries. As attitudes change and scrutiny increases, investors are likely to become more mindful of their own internal practices and place greater emphasis on ESG factors in their investment policies, so as to improve alignment with their organisational purpose and stakeholder priorities. For example, charities are increasingly conscious of their supporters' expectations in this area while some pension schemes are more closely scrutinising their sponsoring employers' sustainability strategies. There may be reputational risks for investors that ignore these considerations.

Another key factor is regulation. This is a significant driver for pension schemes trustees, who are now required by law to set out their policies in relation to ESG issues, including climate change. The Pensions Regulator has made it clear that trustees have an important role in overseeing their managers' ESG approach and in encouraging stewardship throughout the whole length of the investment chain. Pension schemes and life insurers must publish their engagement policies and report annually on their implementation, and all insurers are subject to the Prudential Regulation Authority's recent supervisory statement on climate change.

Responsible investment is now widely accepted as part of investors' fiduciary duties.

Introduction
continued

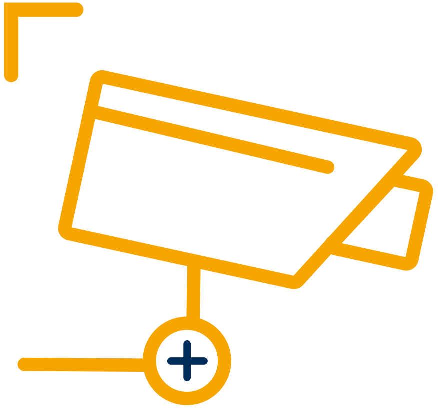
Asset owners need to oversee their managers' RI practices

Our research shows that investment managers vary significantly in their RI approaches, with some having much more comprehensive and effective methodologies than others. **Asset owners cannot therefore just take the marketing messages at face value and assume that their managers are adopting sound RI practices.** They should explicitly consider ESG and stewardship when selecting new managers and monitoring existing ones and be prepared to switch if they are not satisfied with an incumbent manager's RI approach.

Our RI survey helps our clients with this manager oversight. The scores that we assign managers from their responses to our survey show how good the managers are at taking account of ESG issues and exercising stewardship, and the underlying analysis indicates whether there are concerns that might need to be addressed.

However, asset owners' manager assessment shouldn't end there. Our survey covers the manager's general approach to RI. However, there are usually differences in the implementation of this approach between different funds offered by the same manager. We therefore supplement the survey results with research into the RI approaches of individual funds, which we use to assign an RI score (on the same 1 to 4 scale) to each fund we research. RI is a standard agenda item in our meetings with managers, where we probe what is done in practice and form a view on the investment team's commitment to RI.

In addition, we suggest **asset owners engage with their managers**, with the help of their adviser, to **hear first-hand how ESG factors are integrated into portfolios and how stewardship is being exercised on their behalf.** Dialogue with managers provides an opportunity to address any concerns and encourages managers to continue improving. This should lead to better financial performance and help safeguard the long-term sustainability of the environmental, social and economic systems on which investment markets depend.



Our RI survey helps our clients with this manager oversight.

Responsible investment milestones since our 2018 survey

January 2018
A men-only fundraising dinner in London for the Presidents Club charity attracted fierce criticism after revelations about sexual harassment of hostesses

March 2018
European Commission publishes an ambitious Sustainable Finance Action Plan to reorient capital flows towards sustainable investment and manager financial risks from ESG factors

August 2018
Greta Thunberg held her first 'school strike for the climate' outside the Swedish parliament

November 2018
Jeff Fairburn stepped down as CEO of the housebuilder Persimmon following the public outcry over his £75m pay package

January 2019
Greggs' year got off to a profitable start as its new vegan sausage roll proved phenomenally popular

April 2019
Prudential Regulation Authority publishes a supervisory statement setting out how it will regulate banks and insurers on managing the financial risks from climate change

May 2019
Cambridge Analytica filed for bankruptcy following its controversial involvement in elections and the scandal surrounding its use of Facebook's personal data

May 2019
Britain's electricity grid had its first coal-free week since the industrial revolution

June 2019
Amendments to EU's Shareholder Rights Directive come into force, requiring investment managers and institutional investors to be more transparent about their stewardship practices

July 2019
The UK Government publishes its Green Finance Strategy and promises to at least match the ambition of the three key objectives of the EC's Sustainable Finance Action Plan

October 2019
Deadline for UK occupational pension schemes to update their Statements of Investment Principles to include policies on financially material considerations (including ESG factors including climate change), non-financial factors and engagement

October 2019
Financial Reporting Council publishes the UK Stewardship Code 2020 which substantially raises the bar in terms of investment managers' and asset owners' stewardship practices

What we look for in managers

Managers with these characteristics score highly in our survey

Commitment to RI
(pages 10 to 12)

Are a signatory or member of relevant codes and initiatives

People
(pages 14 to 15)

Have senior management accountable for ESG integration

Include ESG as part of investment professionals' job description

Give all relevant staff ESG training

Have specialist staff providing in-depth ESG expertise as required

Investment process
(pages 17 to 21)

Integrate ESG throughout the investment process

Ensure ESG considerations affect buy/sell decisions

Consider multiple sources of ESG data, taking steps to ensure its quality and robustness

Undertake analysis of ESG risk exposure at the portfolio level for all asset classes

Incorporate systematic consideration of climate-related risk for all asset classes

Stewardship
(pages 23 to 26)

Use voting and engagement as a tool to improve investment performance

Form their own view on voting decisions, exercise all votes, are willing to vote against management and report to investors regularly on voting activity

Have robust policies on issues like climate-related risk, fair pay, boardroom responsibilities and diversity

Can provide evidence of collaborating, as appropriate, with other investors, for example, participating in joint engagement activities

The results: commitment to responsible investment

More managers are publicly supporting responsible investment

The first thing we look for is whether managers have made public commitments to RI by signing up to relevant codes and organisations. Managers scored well in this area in our previous survey. Nevertheless, there has been a substantial improvement since 2018.

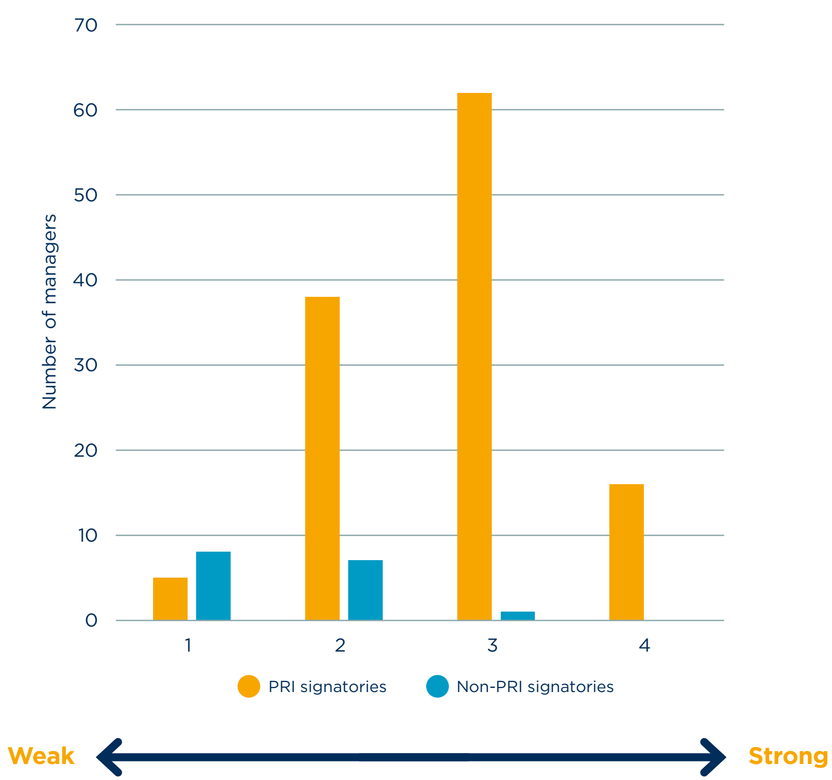
On average, respondents are signed up to **6 relevant codes and organisations** (compared to around 5 last time), with **23%** of respondents signed up to **10 or more** (compared to 14% last time).

The key code continues to be the UN-backed Principles for Responsible Investment (PRI), and most managers **(88%)** are now signatories. This has increased from 78% in our 2018 survey and 66% in the survey before that. **All but one of the managers who scored 3 or 4 in our survey are PRI signatories,** but many respondents did not score this highly despite being a PRI signatory. It is therefore clear that it is not sufficient for asset owners to insist that their managers are PRI signatories if they want confidence that strong RI practices are being implemented on their behalf.

The UK Stewardship Code is also important from our perspective. We expect firms that manage UK listed equities and have a significant UK presence to commit to this Code. **Almost all of the managers** in our survey who meet these criteria have made this commitment.

The Financial Reporting Council (FRC) classifies UK Stewardship Code signatories as Tier 1 or Tier 2 based on the quality of their statement of support. The number of signatories in our survey that have been classified as Tier 1 has increased from 83% two years ago to **87%**. This means that the vast majority of these managers have provided a good quality and transparent description of their stewardship approach and explanations of an alternative approach where necessary.

Manager-level scores from LCP RI survey



The results: commitment to responsible investment

continued

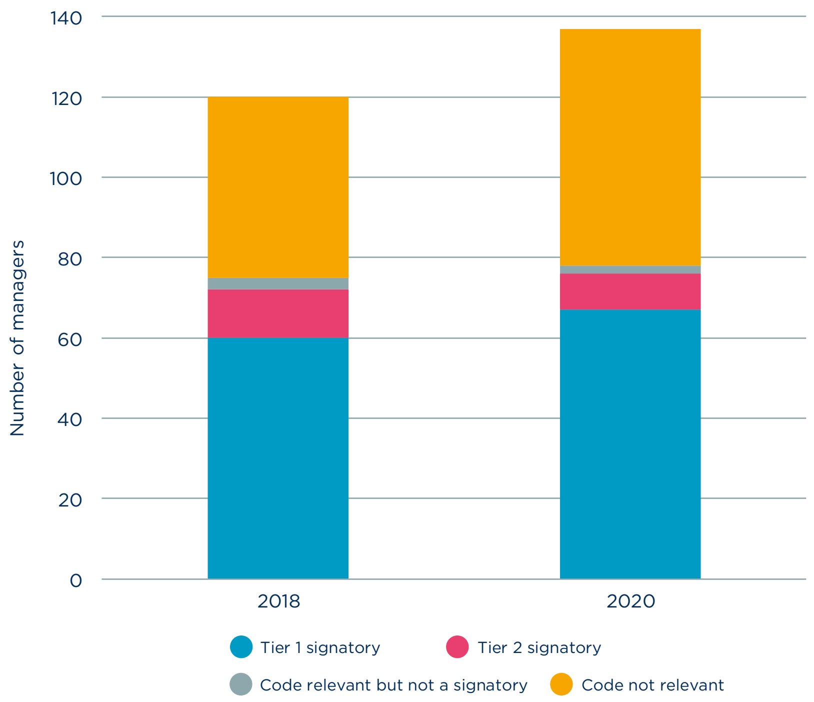
Changes to the UK stewardship regime

In October 2019, the FRC published a new version of its UK Stewardship Code. The Code has been completely rewritten and its scope extended from UK listed equities to all assets. Its six 'comply or explain' principles have been replaced by twelve 'apply and explain' principles and extensive reporting expectations. To become a signatory to the new Code, investment managers and asset owners will need to submit annual Stewardship Reports (approved by their governing body) to the FRC, with the first one due by 31 March 2021.

Alongside this voluntary Code, mandatory stewardship requirements have also increased. Following changes to the European Shareholder Rights Directive that took effect in June 2019, new legal requirements apply to investment management firms that are authorised by the Financial Conduct Authority as well as institutional investors such as insurers and pension schemes.

We expect these changes to drive improvements in stewardship practices across the UK investment industry and look forward to seeing the effects in our next survey.

UK Stewardship Code status of respondents (2012 version)



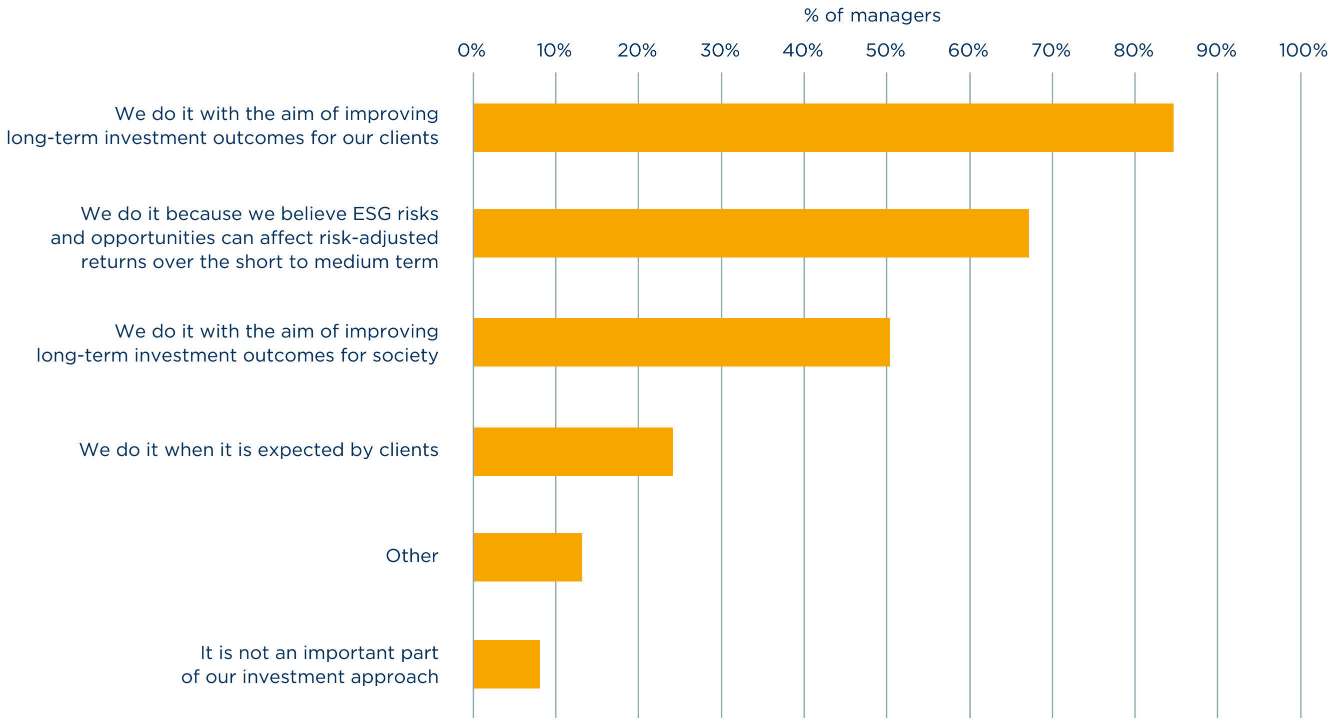
The results: commitment to responsible investment
continued

The main reasons why managers adopt RI practices are financial

What are managers' motives for considering ESG factors as part of the investment process? **85% of respondents** said they integrate ESG factors with the aim of improving long-term investment outcomes for their clients and **67%** said they do it because they believe ESG risks and opportunities can affect risk-adjusted returns over the short to medium term. **Only 8%** said ESG integration is not an important part of their investment approach. Interestingly, half of respondents said they integrate ESG factors with the aim of improving long-term investment outcomes for society.

Responses to an equivalent question for stewardship were similar.

Reasons why managers integrate ESG factors



LCP is a PRI signatory because we believe that successful implementation of the Principles will improve investors' ability to meet their commitments to beneficiaries as well as better align their investment activities with the broader interests of society.

We embed responsible investment into our client advice and manager research in ways that support our clients in fulfilling their own RI objectives and responsibilities. You can learn more about our approach through our ESG statement and PRI reporting.

Claire Jones
Principal and Head of Responsible Investment

The results: people

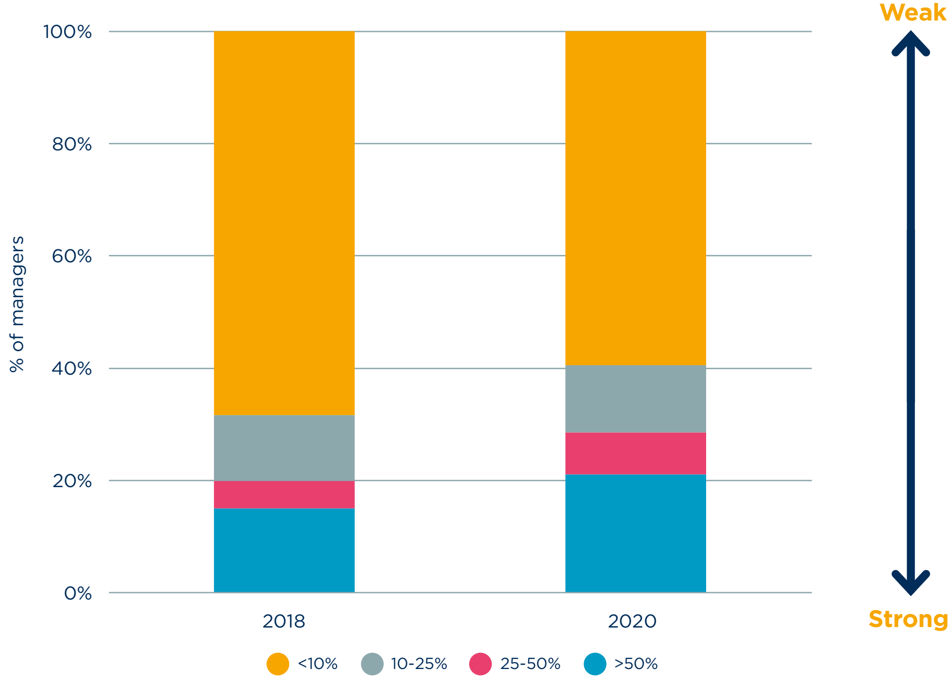
Senior accountability for RI has increased markedly, but few people have RI in their job descriptions

When reporting the results of our last survey, we expressed the view that a wide range of individuals should have responsibility for ESG issues and stewardship in order to ensure that consideration of RI matters is truly embedded in the process. This was an area where there was significant room for improvement for many managers and it seems as though they have indeed stepped up:

- The number of managers saying that responsibility for RI was shared widely among investment professionals has increased **from 52% to 85%**.
- There was much greater evidence of board-level accountability for RI, which has risen **from 34% to 81%**.
- **59% of CEOs** oversee and are held accountable for inclusion of ESG and stewardship in the investment process.

Although most managers indicated that responsibility for RI was shared widely among investment professionals, the majority of investment staff still do not have ESG or stewardship reflected in their job descriptions. **59%** of respondents say it is mentioned for less than 10% of their investment staff, an improvement from **68%** of respondents in 2018.

Proportion of a firm's investment professionals with RI mentioned in job description and/or performance objectives



The results: people

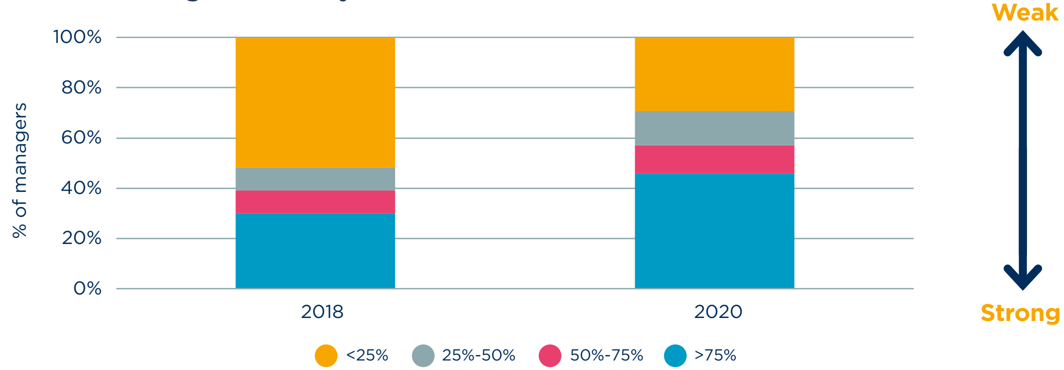
continued

RI training has increased and managers employ more ESG specialists

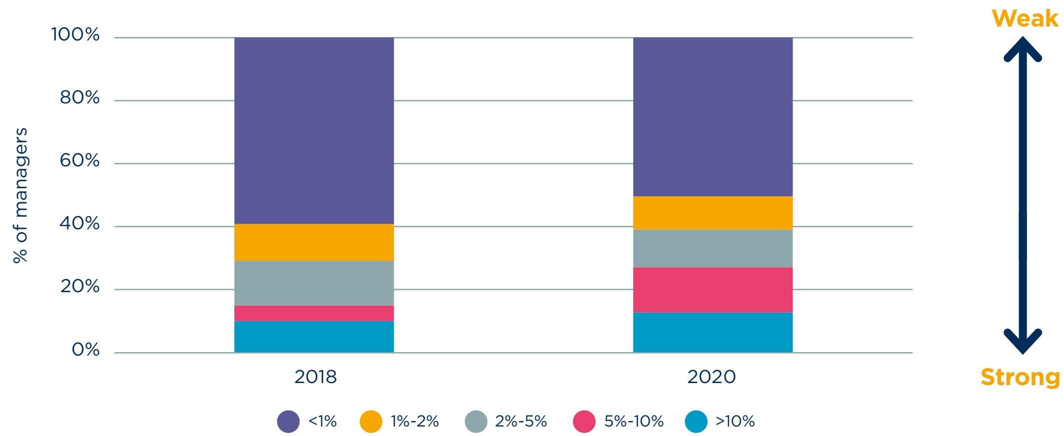
More investment professionals are receiving RI training. In our 2018 survey, only 30% of managers said that 75% or more of investment professionals had received at least two hours' training within the previous two years. That has now **increased to 46%**. At the other end of the scale, the proportion of managers for whom less than 25% of investment professionals have received this level of training has almost halved, from 52% to 29%. It should be noted, however, that two hours' training in two years is not much for such a wide-ranging and fast-evolving area.

Managers are using RI specialists to varying degrees, although there has generally been an increase in specialist staff. Many managers have few specialist staff: exactly half said that less than 1% of investment professionals are ESG or stewardship specialists[4], down from 59% in 2018. At the other end of the scale, **13% of managers (up from 10% in 2018) now employ more than 10% specialists.**

Proportion of a firm's investment professionals who have had at least two hours RI training in last two years



Proportion of a firm's investment professionals who are RI specialists



[4] For example, their role is at least 50% ESG or stewardship, or they hold a relevant qualification.

The way that ESG issues are considered will vary between the different funds offered by a manager, so this is an area we cover in our fund-specific manager research. We look for evidence that ESG factors are systematically included in investment analysis, that portfolio managers can talk knowledgeably and confidently about ESG topics and that ESG factors genuinely affect buy/sell decisions.

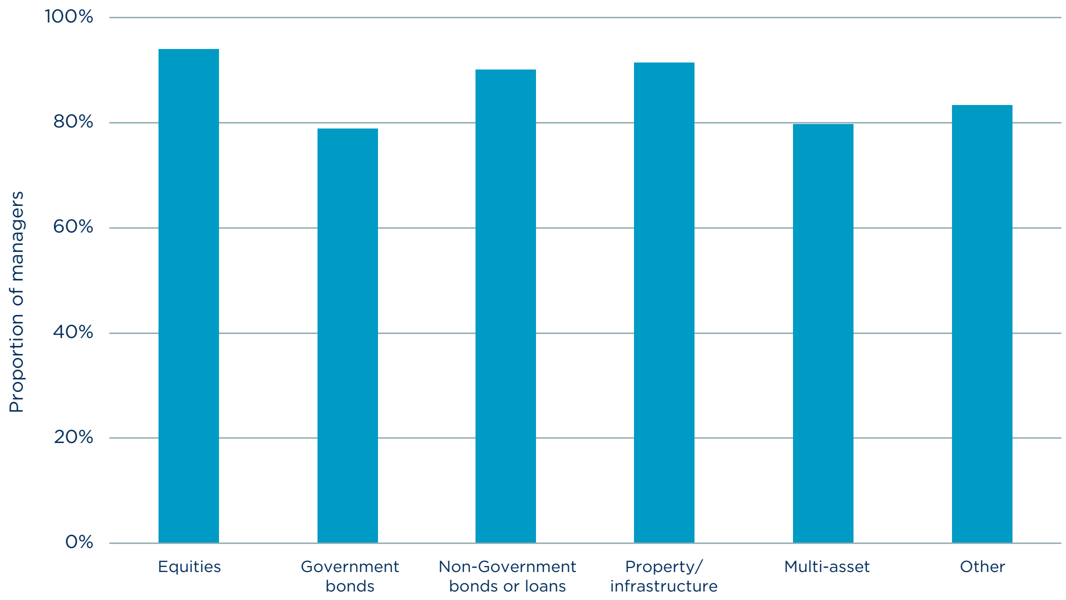
Paul Gibney
Partner

The results: investment process

ESG factors are being considered explicitly across most funds, but by no means all

We asked managers whether they explicitly consider ESG issues as an integral part of their investment process across six asset classes (equities, government bonds, non-government bonds and loans, property and infrastructure, multi-asset strategies, other). Although most investment managers now claim to be committed to responsible investment, **30%** of respondents do not systematically consider ESG factors as part of their investment process across all asset classes[5]. Although, as expected, this is an improvement from 2018 when it was 35%, it still represents a significant minority. Systematic consideration is least common for government bonds (not considered by **21%** of managers who offer that asset class) and multi-asset strategies **(20%)**.

Proportion of managers by asset class that explicitly consider ESG as an integral part of their investment process



[5] Asset classes which the manager does not offer were excluded when calculating this statistic.

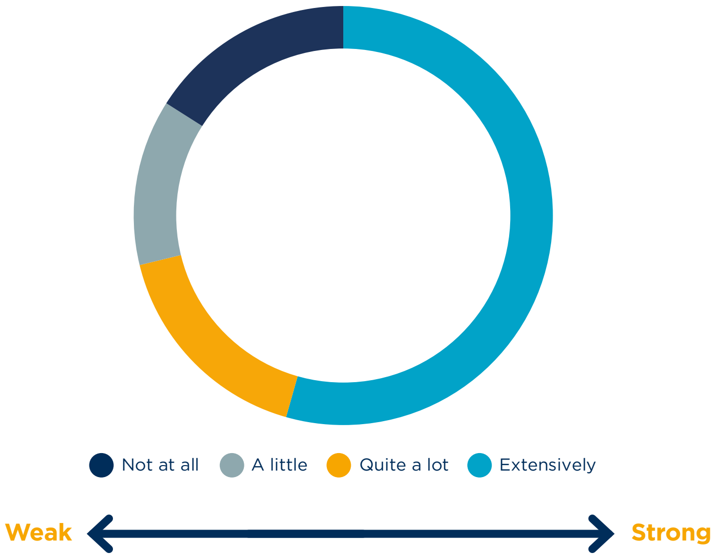
The results: investment process

continued

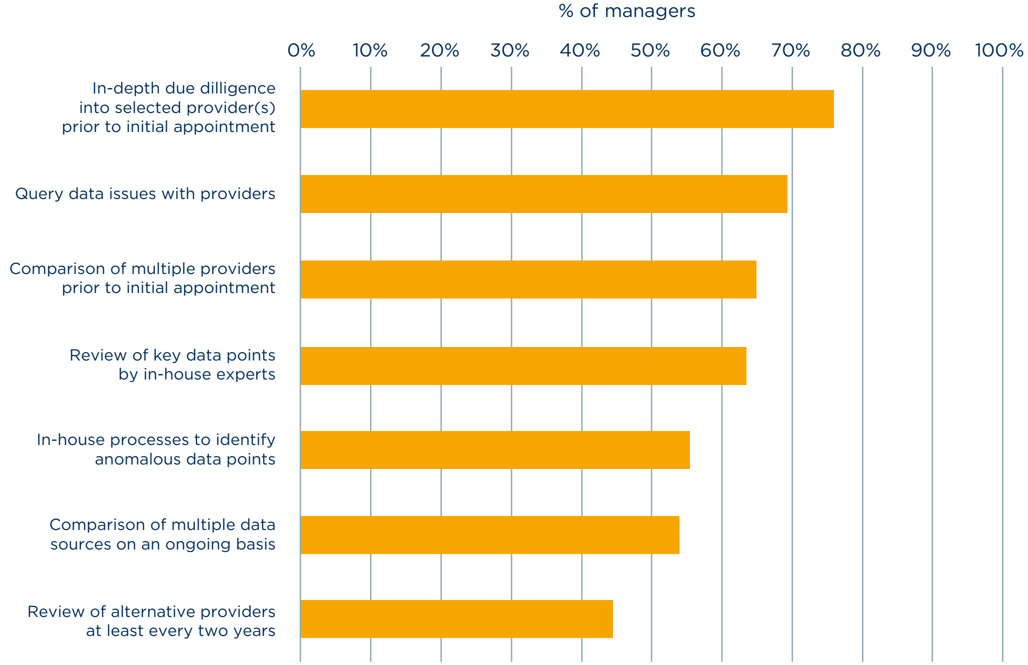
ESG data quality is being taken seriously by many managers

Time and again, the topic of ESG data comes up in our conversations with managers. The availability and quality of ESG data is often cited as a challenge associated with RI, with lack of consistency between data providers' ESG scores a particular concern. It is therefore encouraging that 54% of managers say they adjust data from third parties extensively, using it only as a supplement to their own proprietary research. By coincidence, 54% of managers also compare multiple data sources on an ongoing basis.

Extent to which managers adjust third-party ESG data using in-house analysis



Actions that managers take to ensure the quality of ESG data from third party providers

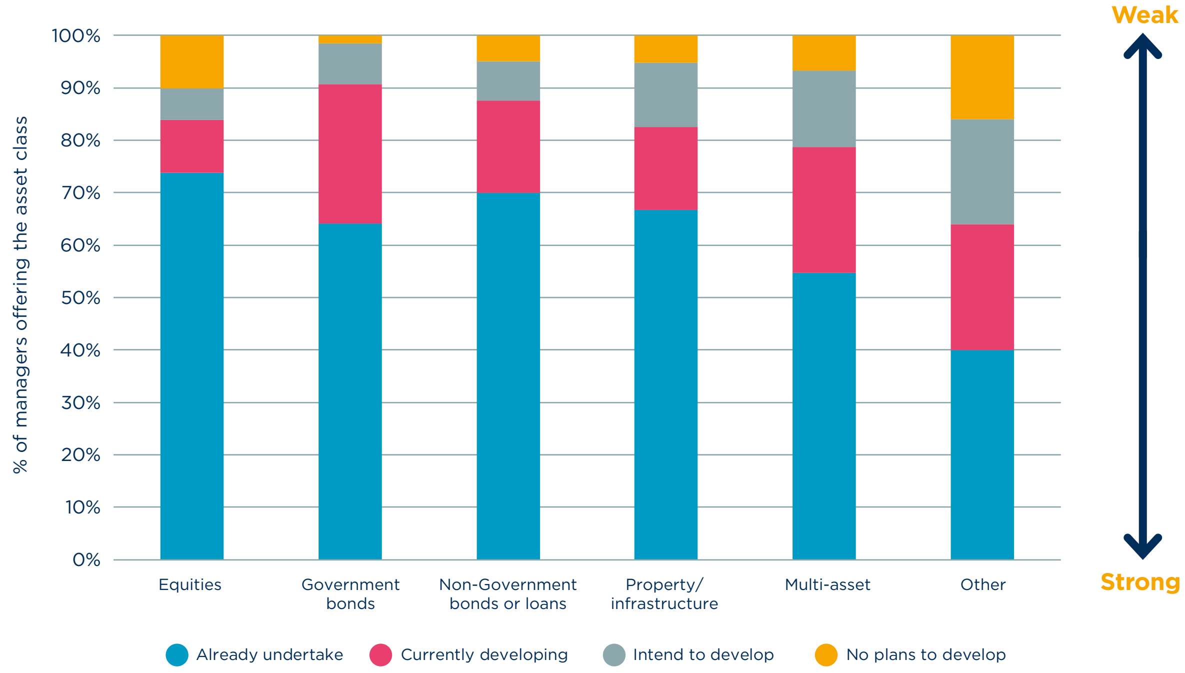


The results: investment process
continued

Gaps in portfolio-level analysis are still a concern

In many cases, managers are still not undertaking or developing analysis of portfolios' aggregate exposure to ESG risks. Across the managers who completed our survey, this was true for **23% of asset classes**[6] (down from 33%). This suggests that, for a significant minority of funds, consideration of ESG risks continues to be limited to security-level analysis – if it is carried out at all – so managers may miss portfolio-level risks arising from a concentration of exposure to ESG factors. This may be partly driven by the difficulty in obtaining consistent data noted above. However, we expect investors will increasingly want their managers to provide them with this information, to help them understand their overall exposure to ESG risks.

Portfolio-level analysis of ESG risks by asset class



[6] We asked respondents to say whether they carry out, or are developing, such analysis for the majority of strategies they offer, for each of six asset classes. On average, respondents said yes, they are already carrying out analysis, for 60% of the asset classes in which they offer strategies and are developing it for a further 17% of the asset classes.

The results: investment process
continued

Systematic consideration of climate-related risks is worryingly weak

In our previous survey, we noted that managers' responses to our questions about climate-related risks were surprisingly weak. The results for climate change continue to be worrying, given the widespread acknowledgement that it poses significant risks to the financial system and, indeed, to society as a whole. These risks arise both from the physical impacts of climate change and from the impacts of actions to limit climate change by transitioning to an economy with lower greenhouse gas emissions.

Climate-related risk is a focus for regulators and policymakers

Governments around the world are increasing their commitments to limit climate change by significantly cutting greenhouse gas emissions. In June 2019, the UK became the first major economy to legislate to reduce net emissions to zero by 2050. A few weeks later, a Green Finance Strategy was published which seeks to align private sector financial flows with clean, environmentally sustainable and resilient growth. The Strategy includes an expectation that all UK listed companies and large asset owners will report in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) by 2022.

The Bank of England is a prominent member of the international Network for Greening the Financial System, a group of central banks and supervisors contributing to the development of environment and climate risk management in the financial sector. The Prudential Regulation Authority has issued a supervisory statement setting out its expectations of banks and insurers in managing the financial risks from climate change, and the Pensions Regulator is due to consult in 2020 on climate guidance for trustees.

Climate change poses significant risks to the economy and to the financial system, and while these risks may seem abstract and far away, they are in fact very real, fast approaching, and in need of action today.

Sarah Breeden, Bank of England, April 2019[7]

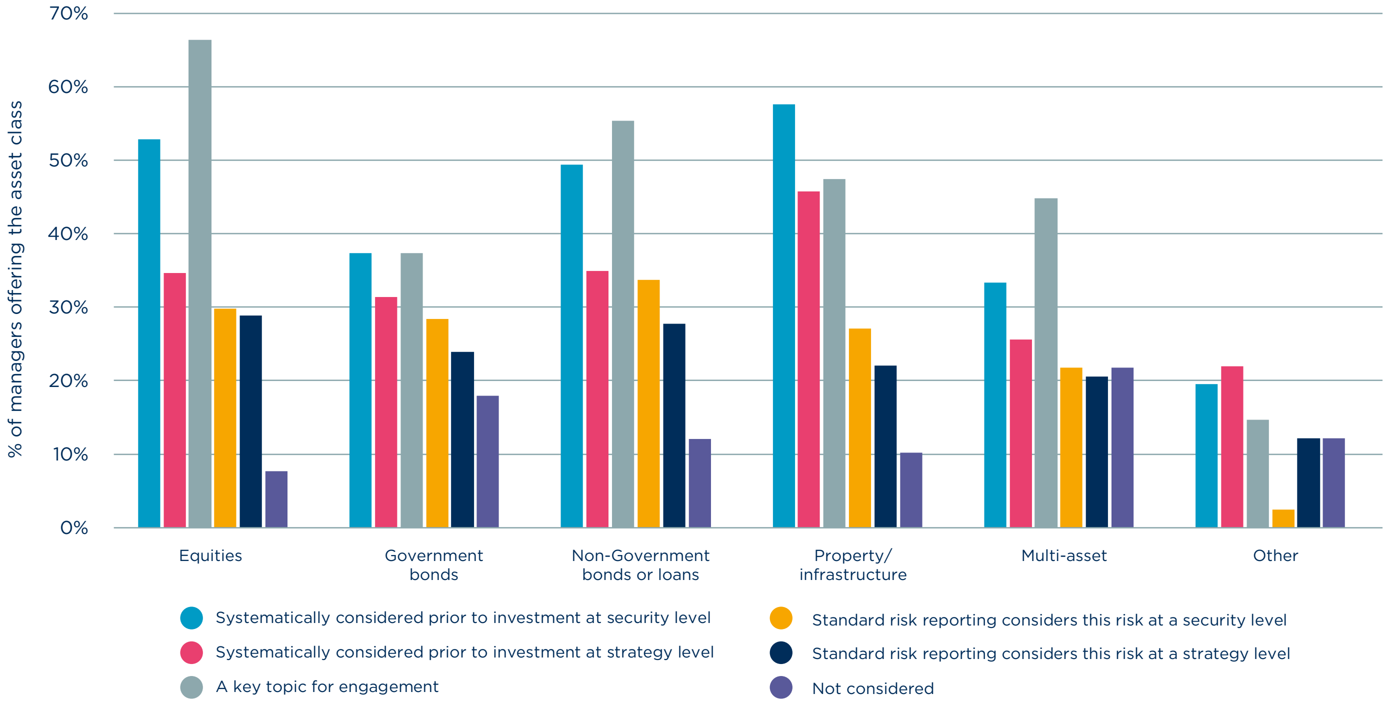
[7] Source: https://www.bankofengland.co.uk/speech/2019/sarah-breeden-omfif

The results: investment process

continued

We asked managers about five actions they can take to manage climate-related risks, which are relevant to most asset classes and investment styles and can be used in tandem with each other. **On average, they are only systematically undertaking 1.7 of the 5 actions per asset class** (up from 1.5 in 2018). The action most commonly undertaken is engagement, with climate change regarded as a key engagement topic in 49% of cases[8] (see the next section for more on engagement). **In 14% of cases, climate-related risks are not systematically considered at all**.

Actions taken to address climate-related risks



[8] Calculated as a proportion of the total number of asset classes offered across the managers (ie a manager offering two asset classes has twice the weight of a manager only offering one).

These days, it's hard to find an investment manager that doesn't say they are committed to responsible investment and many of them tell a good story. However, our survey results show that their claims shouldn't be taken at face value.

A worrying number are not undertaking basic actions such as considering portfolio-level exposure to ESG risks and systematically considering climate change prior to investing in a security. We highlight these concerns to our clients, to help them hold their managers to account for implementing responsible investment on their behalf.

Sapna Patel
Investment Consultant

The results: stewardship

Managers continue to do well on exercising voting rights

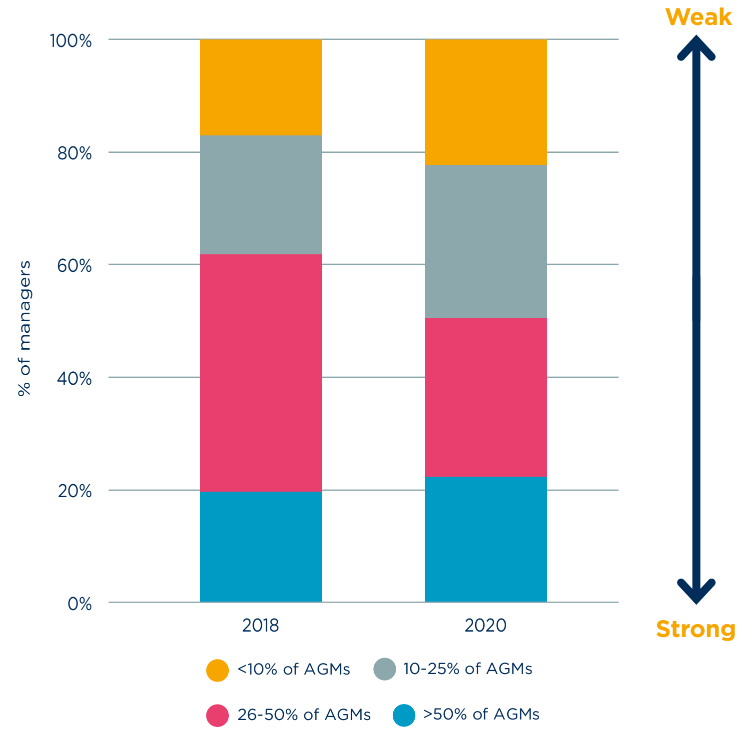
Voting rights are an important way in which shareholders can hold company management to account. Investors should therefore expect managers to vote on their behalf wherever practical. This is an area that is becoming more prominent with the perceived rise in shareholder activism – but how strong are managers' voting practices?

Equity managers continue to exercise a high proportion of voting rights **(95% over the year to 30 June 2019)**, a slight fall from our 2018 survey (97% over the year to 30 June 2017). The reasons that managers give for not exercising all of their votes include: the manager's holding being a very small proportion of the overall capital of the company; clients not exercising voting rights they control rather than the manager (eg for segregated portfolio); and managers believing they may sell the stock before the date of the shareholder meeting (regulation prevents them from voting if they sell).

A high proportion of managers are willing to vote against management or abstain where appropriate **(at least one vote at 33% of AGMs during the same period, compared to 34% in 2017)**. However, there continues to be a wide variation, with the managers' individual answers **ranging from 1% to 99% of AGMs**.

We generally view it positively that managers are willing to vote against management when necessary because it shows they are willing to express contrary views and suggests they have adopted a considered position on the motion, rather than just taking the easy option of always voting with management. This is particularly important for passive funds where managers have little choice over which stocks they hold and may not have enough resource to engage in dialogue with the management of every company. In contrast, some active managers with concentrated portfolios usually vote with management on the grounds that they only invest in companies where they have confidence in management.

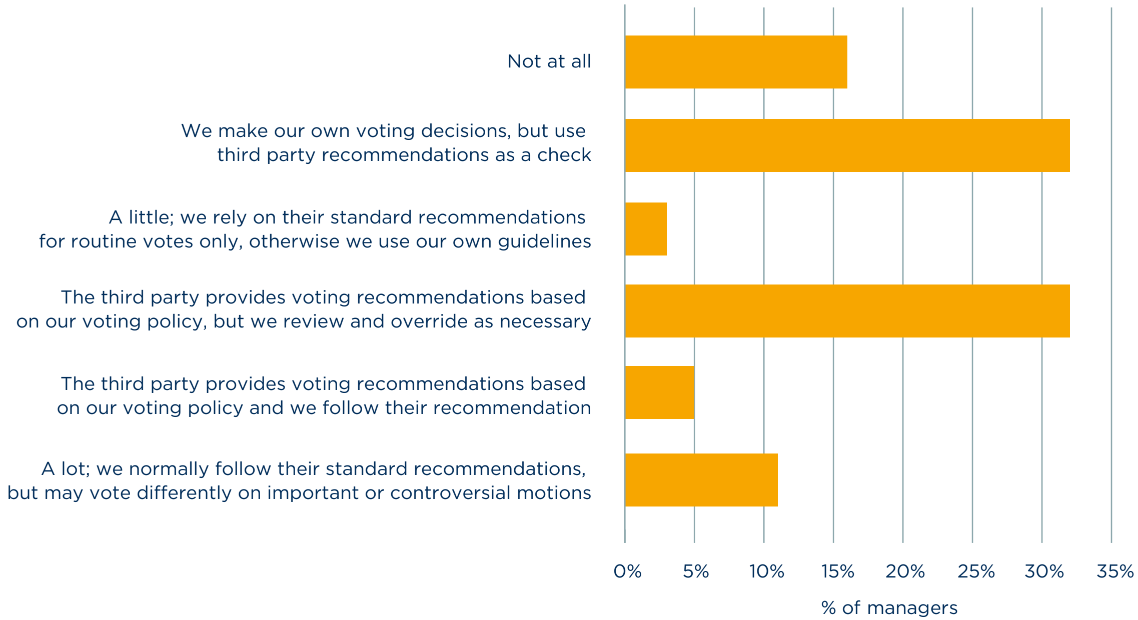
Proportion of AGMs with at least one vote against or withheld



The results: stewardship
continued

We asked equity managers to what extent they rely on recommendations from proxy voting advisers when voting. Proxy advisers have faced greater scrutiny and criticism recently due to alleged conflicts of interest and inaccuracies in their voting recommendations. The market is dominated by a small number of firms who have substantial influence over voting outcomes. Our preference is for managers to form their own view when deciding how to vote on a particular motion, taking into account their knowledge of the company, their position on the topic in question and any relevant engagement they've had with the company. Our survey revealed that **84%** of equity managers place only limited reliance on proxy voting advisers' recommendations[9].

Extent to which managers rely on voting recommendations from third parties



[9] We interpreted the first four answer options shown on the chart as limited reliance.

The results: stewardship
continued

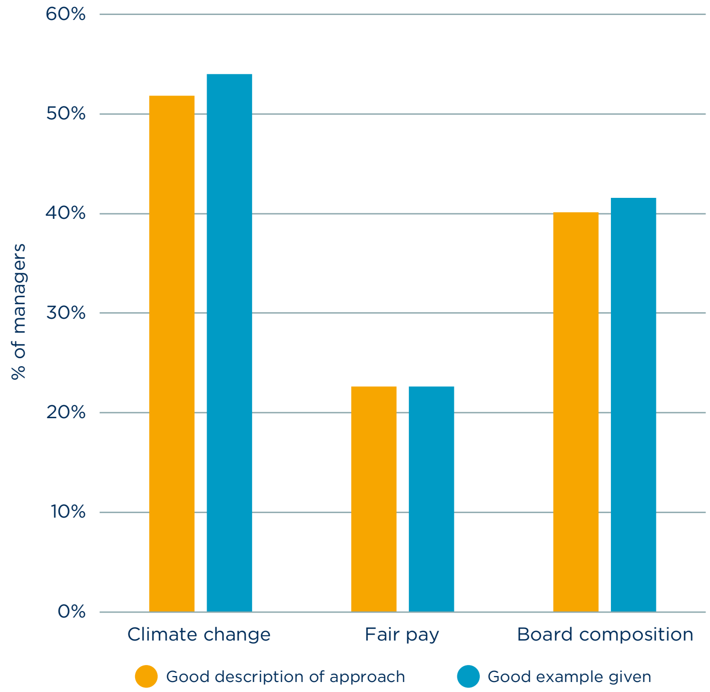
Answers are weaker for engagement topics, including climate change

We surveyed managers about their engagement practices for three topical issues: one environmental (E), one social (S) and one governance (G). As in our 2018 survey, we enquired about fair pay and benefits across the workforce (S) and boardroom roles and diversity (G), although for E we switched water scarcity to climate change, given the growing expectation that climate should be a particular area of focus. We asked managers to describe their approach to engagement on each topic (with investee companies, regulators or policymakers) and provide examples of action their organisation had taken.

The responses were disappointing, particularly given that stewardship is in the spotlight following the EU Shareholder Rights Directive amendments and the new edition of the UK Stewardship Code (see box on page 11).

- **Only 52% of managers** gave a reasonably detailed description of their approach on climate change and 54% gave a good example. This is barely a majority, despite the widespread pressure on institutions to respond to growing demands for a faster transition to a net zero carbon economy.
- For fair pay across the workforce, **just 23% of respondents** gave a reasonably detailed description of their approach (no change) and 23% gave a good example (down from 31%). This suggests managers are not responding adequately to the widespread public and political concern on this topic.
- **For board diversity, 40%** gave a reasonably detailed description of their approach (up from 31%) and 42% gave a good example (up from 39%). Again, this is surprisingly low, given the high-profile nature of the topic.

Engagement on topical issues



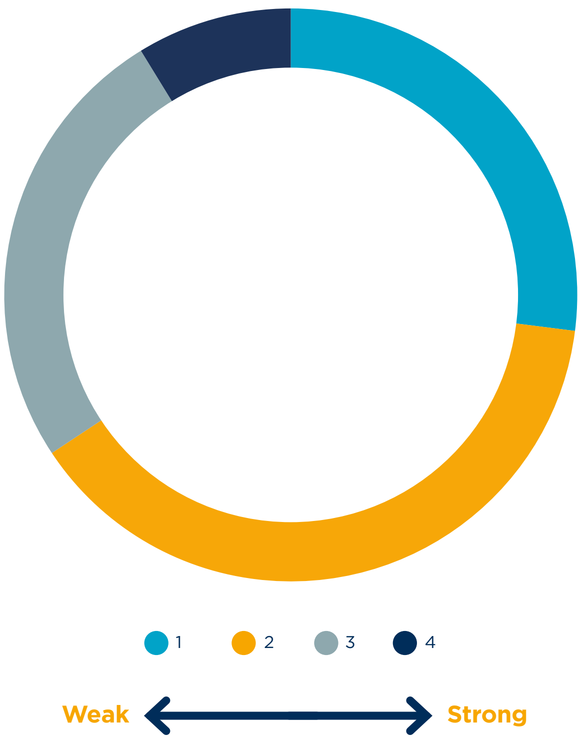
The results: stewardship
continued

Many managers seem to have limited involvement in collaborative initiatives

Collaborating with others is often regarded as a key RI activity and forms part of both the PRI and UK Stewardship Code principles. Working together can enhance investors' effectiveness by increasing the assets backing requests to companies, regulators and policymakers, ensuring consistency of feedback and requests to those parties, and spreading the engagement workload.

However, despite managers' public commitments to RI (see next section), many of them gave weak answers when we asked how frequently, and in what ways, they collaborate with other investors. Only one-third scored 3 or more out of 4.

Score (out of 4) for collaboration with other investors



Working together can enhance investors' effectiveness by increasing the assets backing requests to companies, regulators and policymakers, ensuring consistency of feedback and requests to those parties, and spreading the engagement workload.

The investment industry needs to respond to the challenges and expectations of modern society. Stewardship is a vital element of that response, enabling us to help create long-term value for our clients and their beneficiaries, whilst simultaneously providing sustainable benefits for the economy, the environment and society. LCP is preparing to meet this new stewardship challenge by signing up to the UK Stewardship Code 2020 and we call on others to do the same.

Clay Lambiotte
Partner and Head of Investment

What specialist ESG funds do managers offer?

Managers offer a wide range of specialist ESG funds

Over recent years, there has been a proliferation of specialist ESG funds and there are now many different options available. We asked managers which types of specialist ESG strategies they offer as pooled funds for each asset class (more details provided in the boxed area).

Together, they offer hundreds of specialist ESG strategies through pooled funds, across the six asset classes and seven types of funds we asked about.

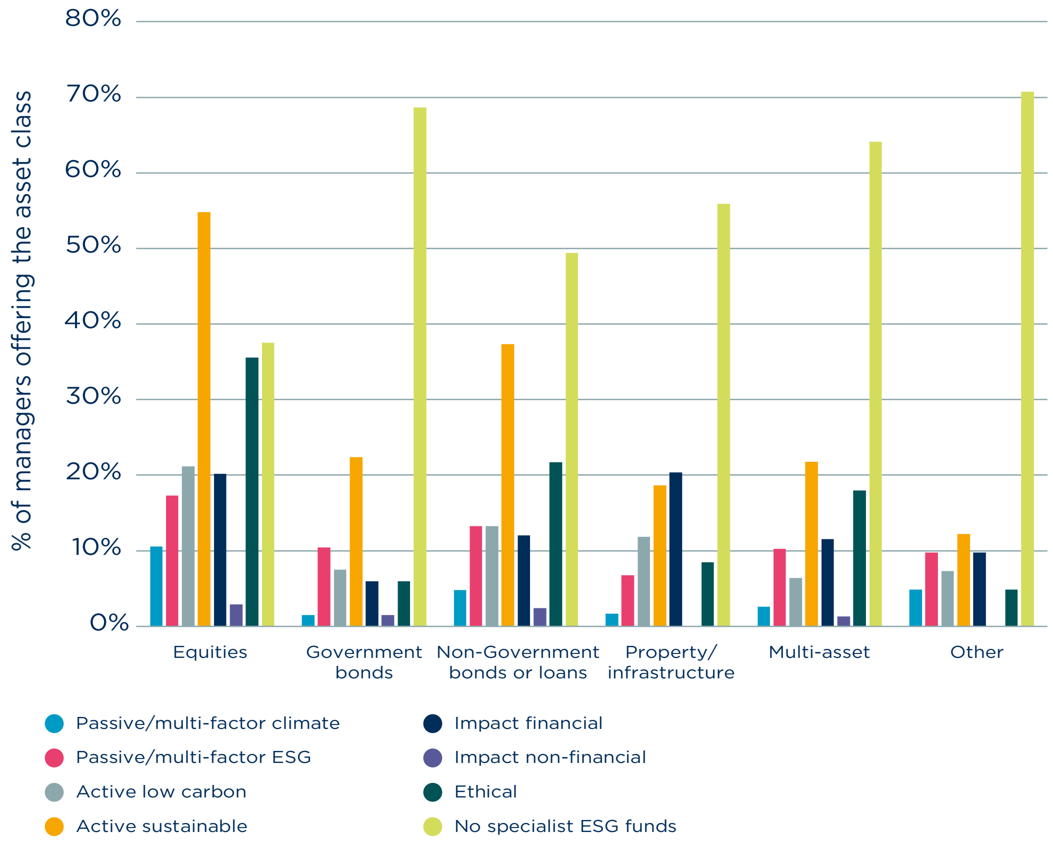
- The majority of managers **(61%) offer at least one specialist ESG strategy as a pooled fund.**
- **Equity managers are most likely to offer a specialist fund** (62%) followed by non-government bond managers (51%).
- For most asset classes, the most common type of specialist fund is actively managed 'sustainable' funds that only invest in securities that meet certain ESG standards.

We asked managers to report on the following categories of specialist funds for each asset class:

- passive (or multi-factor) funds that select or weight securities using climate metrics
- passive (or multi-factor) funds that select or weight securities using ESG metrics
- actively managed 'low carbon' funds that deliberately seek a lower exposure to climate-related risks
- actively managed 'sustainable' funds that only invest in securities that meet certain ESG standards
- 'impact' funds that seek to deliver positive social and/or environmental impacts alongside competitive financial returns
- 'impact' funds that seek to deliver positive social and/or environmental impacts with an expected reduction in financial returns
- ethical funds, eg funds that exclude stocks from 'sin' sectors.

What specialist ESG funds do managers offer?
continued

Types of specialist ESG strategies offered as pooled funds



Passive and multi-factor ESG funds

The specialist ESG funds for which we've seen most client interest are passive or multi-factor[11] funds that incorporate climate or other ESG metrics in their construction. Investors in conventional passive and multi-factor funds may see switching money into these as a relatively easy step towards more explicit integration of ESG factors into their portfolios.

Many of these funds use a 'tilted' approach whereby ESG metrics are used to adjust the weight of each stock in the portfolio, so that companies with better ESG characteristics are given a higher weight and conversely those with worse ESG characteristics are given a lower weight. Other funds use ESG metrics to select the stocks held, for example only investing in companies who meet minimum ESG standards.

[11] Funds that weight the underlying stocks by multiple factors such as quality, value, size, volatility and momentum, rather than just market capitalisation.

Although the managers' responses to this question are interesting, they are not included in our assessment of managers' RI practices. This is because our assessment relates to managers' practices across all strategies and we do not regard provision of specialist funds as a necessary behaviour to demonstrate RI excellence.

Despite the proliferation of specialist ESG funds coming to market, we see relatively few that are well-suited to the needs of our clients. That's why we're talking to investment managers about developing more suitable products.

We find they are keen to talk to us because, as an independent consultant, we are not in competition with them, and bring valuable insights about gaps in the market. This gives the managers confidence that the resulting products will be commercially successful, and our clients benefit from access to innovative ideas for a competitive fee.

Matt Gibson
Partner and Head of Manager Research

Conclusions and outlook

Further improvement, but still a long way to go

The vast majority of investment managers are now engaging with responsible investment. The response rate to our survey this year was high again and we are having more conversations with managers on RI than ever before.

As in our 2018 survey, there are a few managers that score highly across the board, but many still have a long way to go. This is not to say that they are not making progress, but the bar is being raised by the front-runners and so laggards will have to make substantial improvements to catch up.

We think it's important that you **engage with your managers** on this topic, to understand the approaches that they are taking on your behalf and encourage improvements. Most managers are now eager to talk about RI, recognising its increasing importance for investors. Whilst this is welcome, you shouldn't take their commitment at face value, but instead, with the help of your adviser, probe what is actually being done in practice for your portfolio and form a view on its appropriateness.

If you haven't yet seen the headline scores for your managers from this RI survey, or if you want to drill down into any of the underlying detail, please speak to your usual LCP adviser.

What's next for responsible investment?

Our survey has revealed several areas where we hope, and expect, to see progress before our next survey:

- ESG factors considered systematically across all funds
- Better analysis of ESG risks at portfolio level, with summary reports made available to clients
- Greater action to address climate-related risks
- Evidence of meaningful engagement on a wider range of ESG topics
- More substantive involvement in collaborative initiatives.

To learn more about responsible investment click here

Contact us

If you would like more information please contact your usual LCP adviser or one of our specialists below.

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