Trustees

Climate change progress for Nest's investments 2020/21

October 2021

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Executive summary

Nest Corporation as Trustee of the Nest Scheme believes it is important that Scheme members and other stakeholders have transparency around how we are considering climate-related risks and opportunities within the investments we make on behalf of our members

Here we share on our progress in the 2020/21 financial year, which ran from 1 April 2020 to 31 March 2021, against the climate change policy we announced in July 2020. This report supplements the summary in our '**Scheme annual report and accounts**' for 2020/21 and is in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

Governance

Our investment committee manages and monitors climate-related investment risks and opportunities as part of its remit of having responsibility for the Scheme's investment policy and strategy. In July 2020, the investment committee approved our first Scheme-wide climate change policy to guide our approach to assessing and managing climate-related risks and opportunities across our investment portfolios.

Strategy

We believe that climate change can affect the financial stability of companies and other assets in our portfolio, thereby limiting risk-adjusted returns on investments and also potentially reducing the pension pot value available to members at retirement. We consider both transition and physical risks resulting from climate change to be financially material. Over the next five years, we believe that some sectors of the global economy could see changes in their valuation because of climate-related risks. Over the long term, which we define as a decade or more from the present, we believe that physical risks could begin to predominate.

At the same time, the transition to a low-carbon economy brings climate-related investment opportunities, which we wish to access for our members.

In the short term, we have identified and committed to opportunities in renewable energy generation and green technology. In the long term, we believe negative emissions technologies such as carbon capture and storage will need to be developed to assist with the transition to a net zero global economy and may present investment opportunities.

Risk management

Our climate change policy sets an ambition to support the Paris Agreement's goal to limit warming to well below 2°C, with a target of 1.5°C. It aims to do this by reaching net zero emissions in the Scheme's portfolio by 2050 at the latest. The climate change policy involves asset allocation, manager selection and monitoring, stewardship and public policy.

Asset allocation and manager selection will be key to reducing the emissions financed in our portfolios. We estimate that, in line with global real-world emissions reductions for net zero, our financed emissions have to reduce from 2020 levels by around 50% by 2030 to meet net zero target by 2050.

We use climate 'tilts' to transition our investments, reducing our exposure to highly carbon-intensive companies and increasing our exposure to companies that are well-positioned for the transition to a low-carbon economy. The majority of the Scheme's portfolio is invested in equities, that is, shares in publicly traded companies, so these assets are where we first implemented our climate change policy. Shortly after the publication of the policy we moved our entire allocation of equities in developed markets within our default strategy for Scheme members into a climate-aware fund (CAF).

We have also developed new climate-aware fund management mandates for the Scheme's investments in emerging market equities and global investment-grade fixed-income assets.
Our transition into climate-aware investments in these areas was not completed at the end of the financial year, so we are not yet able to disclose their impact on the Scheme's portfolio emissions.

These three allocations – developed market equities, emerging market equities and global investment-grade fixed income – made up 61.5% of total Scheme assets as at 31 March 2021.

Our asset allocation strategy also employs selective investment exclusions and direct investment in climate-related opportunities. During 2020/21 107 entities were excluded from the Scheme's equities and fixed-income allocations due to their significant involvement in thermal coal production or power generation, oil sands or arctic exploration for oil or gas. We also appointed three new managers for private equity infrastructure, including one manager whose strategy is focused entirely on renewable energy infrastructure. These new mandates will enable the Scheme to benefit from transition opportunities.

In addition to these asset allocation decisions, we have set an expectation that all of our external investment managers will identify and manage climate-related risks and opportunities in the portfolios they manage for the Scheme and develop methodologies to align the portfolios with our net zero target. Following the development of our climate change strategy, we carried out a benchmarking exercise to assess our investment managers' policies and investment strategies with regard to the consideration of climate-related risks and opportunities. Following this exercise, we set time-bound objectives for each manager. As at 31 March 2021, just over half (51.5%) of these objectives have been met.

We believe we also have a role to play in reducing real-world emissions and increasing the likelihood of a smooth transition to net zero. One of the biggest avenues for us to drive change is through stewardship of the Scheme's assets. During 2020/21 we expanded our engagement activities through the global investor coalition Climate Action 100+ and other initiatives and started a new engagement project focused on banks' financing of fossil fuel enterprises and projects.

In early 2021 we updated our voting policy. This included setting higher expectations for companies' disclosures on climate-related risks, climate-related opportunities and greenhouse gas (GHG) emissions as well as tying executive remuneration to climate change risk management and assessing whether companies' lobbying is consistent with their public positions on climate change. Our voting records can be reviewed on **our website**.

The final pillar of our climate change policy is advocacy, which includes working with policymakers and peers to develop regulations and approaches to some of the key challenges facing the pensions industry, such as efforts to devise a common understanding of how to effectively align portfolios with global temperature targets. During 2020/21 we have focused our attention on developing stronger climate change disclosures for asset owners and companies and working with the industry to develop methodologies for aligning investment portfolios with temperature targets.

Metrics and targets

The disclosure of good quality metrics to assess climate-related risks and opportunities is a challenge for pension schemes. Investment managers still do not routinely report on portfolio emissions to their clients. This year we asked all of our investment managers to report to us on the financed scope 1, 2 and 3 emissions of the funds in which the Scheme is invested. As discussed in Section 4, a lack of consistency and gaps in data have meant that we have not been able to aggregate emissions across the Scheme's different asset allocations. For this reason, this year we report data for each investment mandate.

Despite data challenges, we are using this information to set decarbonisation targets for all of the Scheme's mandates. Analysing this data also gives us a better understanding of existing gaps and will allow us to more effectively work with investment managers to improve disclosures over time.

The data reported in the metrics and targets section has been obtained from the fund managers of each portfolio. Where fund managers have used third parties to estimate the data, this is stated in the source information. The draft report was shared with the fund managers for verification prior to publication. Nest assumes no responsibility for the accuracy of the data.

Looking ahead

We are pleased with the progress we have made in implementing our climate change policy so far. However, we also recognise that much work still needs to be done in the pensions industry. For this reason, climate change will continue to be a priority area for Nest and the Nest Scheme. Key projects planned for the 2021/22 financial year include:

- Undertaking the first annual review and update of our climate change policy in July 2021. There is an increasing sense of urgency around the potential risks and threats of climate change to the Scheme's investments and we will review our policy to see where we can do more. We will set objectives for the next three to five years with a focus on developing and improving metrics and targets we have able to track progress.
- Developing scenario analysis to assess the impact of climate change on our asset allocation decisions. Our work so far has focused on individual asset classes and allocations. In the coming year we want to expand on this to assess the impact of different climate change trajectories on our asset allocation decisions.
- Using the data we have obtained from our external investment managers to set short- to medium-term decarbonisation targets in line with our long-term net zero target. We aim to report on the trend in the metrics disclosed in this report from next year.
- Advocating for greater standardisation of disclosure requirements and how pension schemes assess their alignment with the goal of the Paris Agreement.
- Expanding our stewardship activities to focus on the banking sector's fossil fuel financing as well as other environmental issues linked to climate change, such as biodiversity.
- Escalating our engagement with and, where appropriate, divesting from companies which have not made significant progress on the milestones for addressing climate-related risks set out in our climate change policy.
- Increasing the Scheme's investment in renewable energy infrastructure and continuing divestment from certain fossil fuel activities.

Introduction

The warming of the planet caused by greenhouse gas (GHG) emissions poses serious risks to the global economy and will have an impact across many economic sectors in which the Nest Scheme is invested. The majority of Scheme members will be invested in the Scheme for decades. For this reason, climate-related risks and opportunities are likely to play out over a long-time horizon and have an impact on Scheme members' pension pots. The Board and employees of Nest Corporation as Trustee of the Scheme see consideration of climate change as a key part of our fiduciary duty to members. For this reason, we have embedded consideration of climate change into our investment strategy.

It is important to the Trustee that Scheme members and other stakeholders have transparency around how we are considering climate risks and opportunities. To support this, starting with this publication, we are reporting our progress against our climate change policy on an annual basis against the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).[1]

The TCFD was set up by the Financial Stability Board to improve and increase reporting of climate-related financial information. It recommends that all organisations, including those in the financial sector, provide climate-related financial disclosures in their mainstream annual report and accounts. In line with these recommendations, this annex to the '**Scheme annual report and accounts**' is structured into four sections corresponding to the four thematic areas of the TCFD framework.

From October 2021, disclosures in line with the TCFD recommendations will become a statutory requirement for large pension schemes in the UK. To align with the upcoming regulations as much as possible, we have used the Department for Work and Pensions' (DWP) draft statutory guidance on governance reporting of climate-related risks to guide our disclosures for this year's report.

This report covers our activities to address and manage climate-related risks and opportunities in our investment process during the 2020/21 financial year, which ran from 1 April 2020 to 31 March 2021. Further information on our broader responsible investment activities can be found in our **2020/21 responsible investment report 'Investing for the future'** and on **our website**. Further information on our operational carbon footprint and environmental activities can be found in the **'Corporation annual report and accounts'** for 2020/21.

In Section 1, 'Governance', we describe the governance of climate-related risks and opportunities, including the oversight by the Trustee and the day-to-day management of these risks.

Section 2, 'Strategy', covers the climate-related risks and opportunities that we have identified over different time horizons and the impact they could have on the Scheme.

In Section 3, 'Risk management', we discuss how we identify, assess and manage climate-related risks and opportunities.

Section 4, 'Metrics and targets', discloses the metrics and targets we use to manage and monitor climate-related risks and opportunities across the Scheme's portfolios.

1 **https://www.fsb-tcfd.org/**

Section 1

Governance

Describe the Trustee's oversight of climate-related risks and opportunities

Nest, the National Employment Savings Trust, was established by the UK government in 2010 to support the introduction of auto enrolment into workplace pensions. The Nest Scheme is run as a master trust by Nest Corporation with the purpose of providing pensions and other benefits to Scheme members.

All investment decisions are overseen by the Trustee through our investment committee, a group of Board members and independent investment specialists that meets at least quarterly to formally review investment operations and decisions.

Our investment committee manages and monitors climate-related investment risks and opportunities as part of its remit of having responsibility for the Scheme's investment policy and strategy. The committee also has been delegated responsibility for our climate change policy and strategy.

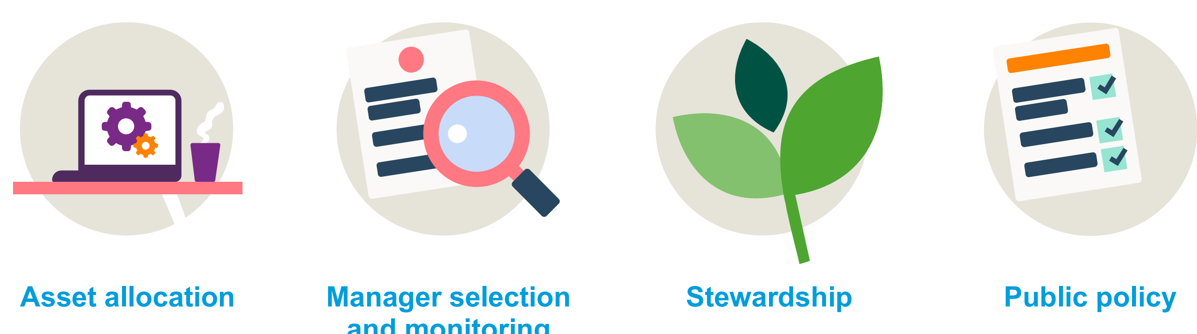
The investment committee receives quarterly updates on any significant responsible investment activity from the chief investment officer and bi-annual updates on the metrics and progress towards targets used to monitor this activity as described on page 22. It also annually reviews our climate change policy.

Describe management's role in assessing and managing climate-related risks and opportunities

Nest Invest is Nest Corporation's wholly owned investment subsidiary which was authorised by the Financial Conduct Authority (FCA) as an occupational pension scheme firm in January 2020. Nest Invest can act on behalf of Nest Corporation to provide regulated advice, arrange deals and provide instructions to investment managers with regard to investment funds in the Scheme's portfolio.

The day-to-day management of the Scheme's assets is performed by external professional investment managers and, from time to time, Nest Invest. External investment managers are monitored regularly and their performance is reported quarterly to the investment committee. These managers' activities are defined and constrained by detailed agreements which include our expectations for how they manage Scheme assets in light of climate-related risks and opportunities.

Overseen by the chief investment officer, the investment team manages the implementation of our climate change policy across four key pillars:



The investment team holds quarterly asset allocation and investment manager monitoring meetings during which key issues and themes, including climate change, are discussed. Members of the team also regularly meet with our external investment managers to discuss climate-related issues.

Section 2

Strategy

Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long term

Climate-related risks

We consider both transition and physical risks resulting from climate change to be financially material.

Transition risks are risks anticipated to arise from the transition to a low-carbon economy. For example, the introduction of new carbon pricing regulations by governments could increase companies' costs of production.

Physical risks include acute risks of more frequent or severe extreme weather events, such as flooding or droughts, as well as chronic risks of permanent environmental change, such as rising sea levels.

These risks are not limited to the environment. They will also have socioeconomic impacts.

The transition to a low-carbon economy will lead to a decline of highly carbon-intensive industries, affecting jobs and local communities. Physical risks may directly impact some of our assets and the ability of the companies in which the Scheme is invested to continue to deliver value in all their business activities. Physical risks can also create wider socioeconomic problems like food insecurity.

In the short term, which we define as over the next five years, we believe that some sectors of the global economy could see changes in their valuation because of climate-related risks. For example, highly carbon-intensive companies may face withdrawal of financing for projects such as coal power generation.

In the medium term, which we define as over the next decade, we believe transition risks will be key. As at the time of writing this report, 129 governments around the world have announced net zero emissions targets covering 73% of global GHG emissions.[2] In order to meet these targets and the goal of the Paris Agreement to limit warming to well below 2°C, the Intergovernmental Panel on Climate Change (IPCC) has said that, globally, carbon emissions will need to be reduced by around 45% between 2010 and 2030 at the latest.[3]

Drastic emissions reductions require drastic policy action. Some forecasters anticipate a gradual transition, while others believe abrupt changes in response to climate-related events are more likely. The Principles for Responsible Investment (PRI) work on 'The inevitable policy response' project assumes several sudden and significant policy shifts in key countries by 2025, when the next round of climate pledges against the Paris Agreement are due to be submitted.[4]

We believe it is important to model both possible medium-term paths – a gradual transition and abrupt changes.

Over the long term, which we define as a decade or more from the present, we believe that physical risks could begin to predominate. In particular, chronic shifts in climate patterns may lead to more regular extreme weather events.

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[2] Climate Action Tracker, 'Warming projections global update' (2021), **climateactiontracker.org/documents/853/CAT_2021-05-04_Briefing_Global-Update_Climate-Summit-Momentum.pdf**

[3] Intergovernmental Panel on Climate Change (IPCC), 'Special report: Global warming of 1.5°C' (2018), **ipcc.ch/sr15**

[4] PRI Association, 'The inevitable policy response 2021: Forecast policies' (2021), **unpri.org/inevitable-policy-response/the-inevitable-policy-response-2021-policy-forecasts/7344.article**

Climate-related opportunities

At the same time, the transition to a low-carbon economy brings climate-related investment opportunities, which we wish to access for our members. In the short term, we have identified opportunities in renewable energy generation and green technology, where the cost of production has continued to fall, making these products and services increasingly attractive to consumers. As a result, we started investing directly in renewable infrastructure, focusing initially in developed markets. Our activities in this area are outlined on page 15.

We have reviewed a range of research to identify general trends in climate-related opportunities over a longer time horizon.

In the medium term, we believe opportunities are greater in decarbonising initiatives than in offsetting. As part of our overall investment strategy, we developed climate-aware strategies for investment in equities which 'tilt' an investment fund's holdings so that more of the fund is invested in companies in renewable energy and green technology and less of the fund is invested in companies with a high carbon intensity. Our progress in implementing these climate-aware investment funds as part of our asset allocation is discussed on page 15. We also engage in stewardship to encourage the companies in which the Scheme is invested to explore climate-related opportunities.

In the long term, we believe negative emissions technologies such as carbon capture and storage will need to be developed to ensure a net zero global economy. These could present investment opportunities. We are currently engaging with investee companies to understand how they are transitioning to a low-carbon future, including what research and development they are conducting around low-carbon manufacturing processes and the types of offsetting they are proposing to reach their own net zero targets.

We monitor and assess specific opportunities as they emerge.

Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning

Our duty to serve every employer with auto enrolment duties, and their workers, is written into the Nest Order as a public service obligation, like the one the BBC or the NHS has. Millions of Nest Scheme members will be invested with us for decades. Over this time horizon, we believe that climate change will present significant investment risks to their pension pots.

In 2020/21 we developed our first Scheme-wide climate change policy to guide our approach to assessing and managing climate-related risks and opportunities across our investment portfolios. It was designed as an overarching policy to guide all areas of our investment process. The policy does not cover the impact of climate change on our own corporate operations. These are managed in line with the UK's Greening Government Commitments[5] and reported in our 'Corporation annual report and accounts'.

Both transition and physical risks have the potential to affect the financial stability of companies and other assets in our portfolio, thereby limiting risk-adjusted returns on investments and, potentially, the pension pot value available to members at retirement. If we do not take these risks into account in our investment strategy, our goal to help members enjoy a bigger pension in a better world could be adversely impacted. So too could our reputation as a good-quality pension provider among employers choosing workplace pension schemes for their workers. In addition, if members have less trust and confidence in our investment approach, they might choose to opt out of pension saving altogether. We are also mindful of the broader impact, beyond the effect on their retirement saving, that climate change may have on our members. Changes in the climatic system and the economic cost of adapting to a warmer planet will shape our members' lives in the coming years. The transition to a low-carbon economy may also have disruptive effects on workers and communities. We consider these in developing our future business development, strategy and financial planning.

5 gov.uk/government/collections/greening-government-commitments

Describe the resilience of the organisation’s strategy, taking into consideration different climate-related scenarios including a 2°C or lower scenario

As part of our climate change policy, we have asked all of our external investment managers to work on developing strategies to align the portfolio they manage for Nest Scheme members with limiting warming to 1.5°C. Several of our investment managers are analysing a range of scenarios for their portfolio.

We began discussing our goals and needs with potential suppliers to deliver analyses to assess the impact of different scenarios, including 1.5°C, 2°C and 4°C+, at the Scheme level. We will be reporting the results of this exercise in our 2021/22 climate change progress report against the TCFD framework.

We also undertake qualitative assessments of the resilience of the Scheme’s overall portfolio. For example, in early 2021 we carried out research into climate-related transition risks arising from an announced change in policy after the new US administration came into government. Our research considered how the policy change could affect our exposure to US energy companies.

Section 3

Risk management

Describe the organisation's process for identifying and assessing climate-related risks

We identify climate-related risks and opportunities through a combination of research conducted internally, research and trends identified by our external investment managers, research procured or received from external data providers and engagement with a range of industry groups. We assess all environmental, social and governance (ESG) risks and opportunities using a four-stage decision-making and prioritisation framework:

- **Identify and prioritise:** We carry out research to determine which issues are relevant and of interest to our members. We then assess the market-wide and real-world impact of each identified issue, drawing on our engagement with industry groups as well as industry codes and standards to meaningfully understand and address the issue. We also define our objectives for the issue at this stage.
- **Implement:** We develop an evidence-based policy for each issue and inform our external investment managers of it. We incorporate each issue into our voting and engagement standards and activities and take asset allocation decisions as appropriate.
- **Monitor:** We have established a number of internal committees to regularly discuss our climate-related investment activities and review our progress against our objectives and targets. Members of our investment team also meet with our external investment managers and engage with the companies that the Scheme is invested in. We track our progress against pre-defined milestones. Where progress is slow, we consider escalation options.
- **Review:** Our climate change policy is reviewed annually. Progress on metrics and targets is reviewed bi-annually by our investment committee. We also regularly survey our members on their interests and priorities.

Describe the organisation's processes for managing climate-related risks

In managing climate-related risks, we consider:

- the emissions associated with the Scheme's overall portfolio
- how we can decarbonise the portfolio to meet our net zero target
- the role we can play in contributing to a smooth transition to a low-carbon economy, which will minimise both transition and physical risks

Our climate change policy covers four distinct areas of the investment process: asset allocation, manager selection and monitoring, stewardship and public policy.

Asset allocation

We have committed to decarbonise our whole portfolio by 2050 at the latest in line with the net zero target set out in our climate change policy.

We are mindful that methodologies are still being developed to assess portfolio alignment with specified temperature goals across asset classes. We are actively involved in financial industry forums for developing frameworks for portfolio temperature alignment, including through the Institutional Investors Group on Climate Change's net zero investment framework.[6]

In addition, we have been working with our external investment managers to develop new strategies aligned with our net zero target.

[6] iigcc.org/resource/net-zero-investment-framework-implementation-guide

Our progress in 2020/21

- **Developed market equities:** We completed moving our entire allocation of developed market equities in our default strategy for Scheme members, the Nest Retirement Date Fund series, into a climate-aware fund (CAF). This CAF is managed for us by UBS Asset Management.

  Our developed market equities CAF systematically increases or decreases investment in companies based on an assessment of their contribution to climate change. The assessment is built on a glide path model that plots a company's carbon footprint trend with the required carbon emissions reduction targets implied by the International Energy Agency's (IEA) 'Sustainable development scenario'[7] pathway for the company's sector. Weightings will vary and be adjusted over time, based on how companies are transitioning to a low-carbon economy.

  We are working with UBS to align this CAF to a 1.5°C pathway. More detail on the methodology can be found at the website for the underlying fund with UBS.[8]
- **Emerging market equities:** We developed a new climate-aware strategy for investment in emerging market equities. The strategy, which addresses a range of ESG risks, tracks a customised index which we created in collaboration with the fund manager, Northern Trust Global Investments. It 'tilts' investment in companies based on a score calculated on three key components: energy efficiency, alternative energy and green building. The energy tilt of the fund means we will reduce investment in companies in emerging markets that have large oil or gas reserves or a high carbon intensity while also increasing investment in companies pursuing renewable energy and green technology.
- **Global investment-grade bonds:** Our global investment-grade credit fund, which is managed by Wells Fargo Asset Management has been transitioned to meet the criteria of the EU's Climate Transition Benchmark.[9] The investment-grade bonds portfolio is managed so that the weighted average carbon intensity remains at least 30% below the portfolio's benchmark. We also require that this portfolio decarbonises by 7% per year from its 2020 level.
- **Infrastructure equity:** We believe that investment in private markets continues to present opportunities to deliver good risk-adjusted returns for our members while supporting companies and projects which are contributing to a low-carbon transition. In March 2021 we announced a new partnership with Octopus Investments Ltd to invest directly in green infrastructure sites in the UK and Europe. We expect to have committed £250 million to this mandate by the end of 2021.

  We also selected CBRE Caledon Capital Management as investment manager for a global core and core-plus infrastructure mandate and GLIL Infrastructure LLP as manager for a UK infrastructure portfolio. Both of these infrastructure equity portfolios will have exposure to renewable energy infrastructure and a strong directive to manage climate-related transition and physical risks.[10]

To date, our work on asset class-based portfolio tilts has focused on public markets where data coverage and quality is much better. We have also been engaging with our private markets managers on improving the data coverage and quality of the Scheme's investments to better understand climate-related risks and opportunities in these assets. We will continue to review and update the methodologies underlying our existing investment mandates, evolving our criteria over time so that each investment manager's portfolio continues to move towards delivering the goals of the Paris Agreement.

We will continue to explore a variety of practices for identifying options to reach net zero emissions in other asset classes. Again, this will allow us to reduce our exposure to fossil fuels and increase our exposure to companies that are contributing positively to the low-carbon transition.

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7 iea.org/reports/world-energy-model/sustainable-development-scenario

8 ubs.com/uk/en/asset-management/institutional-investors/investment-capabilities/passive-etfs/index-funds/climate-aware-solution.html

9 EU climate benchmarks and benchmarks' ESG disclosures | European Commission (europa.eu)

10 As at 31 March 2021, we had not yet started investing in our new infrastructure equity mandate. As a result, it is not included in Section 4, 'Metrics and targets', below. We will report on it in our 2021/22 climate change progress report against the TCFD.

Our approach is to invest more capital in best-in-class companies in all sectors and regions. We generally believe that long-term ownership, using stewardship to help bring about change in the companies in which the Scheme is invested, will deliver stronger financial outcomes for Scheme members and positive real-world impact.

However, there are some business activities that we do not believe can be aligned with the goals of the Paris Agreement. These activities include thermal coal production and power generation, oil sands and arctic drilling for oil or gas. During 2020/21 we started to exclude from our portfolios any companies deriving more than 20% of their revenue from these activities. During 2020/21 we excluded 107 entities. By 2025 we will phase out investment in companies with any revenue from them where the company has not committed to a full, accountable phase-out by 2030 at the latest.

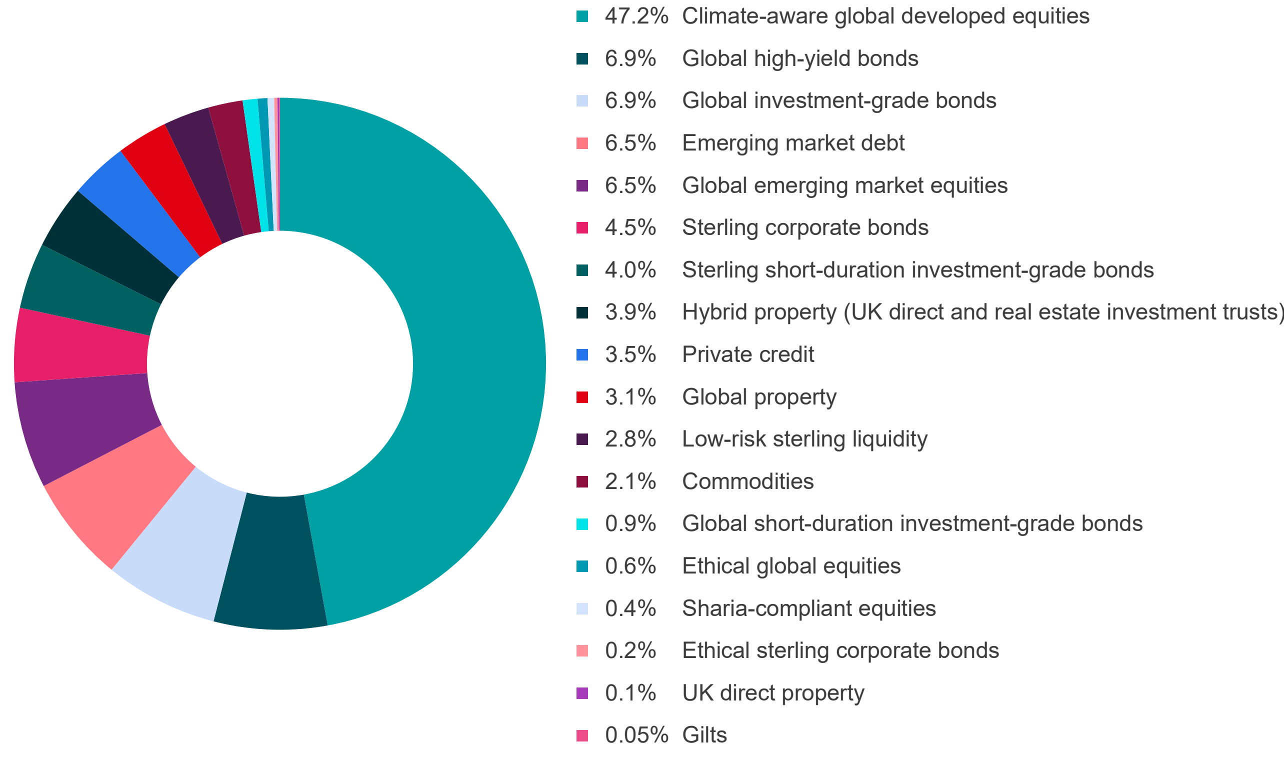
We will continue to assess how the companies the Scheme is invested in contribute to climate change and monitor companies' alignment with the goals of the Paris Agreement. Companies which we consider to be making insufficient progress towards the Paris Agreement or in recognising how climate change will impact their business may be excluded from our portfolio.

Manager selection and monitoring

Asset allocation and manager selection and monitoring are closely linked. The Nest Scheme's total portfolio is made up of different asset classes and individual portfolios managed by external investment managers.

In order for our whole portfolio to be aligned with the goals of the Paris Agreement, we need to work towards aligning all of the underlying investment funds which are the building blocks of our portfolio.

Exposure to asset classes as at March 2021*



*Figures shown to 1 decimal place and may be affected by rounding

In December 2020 we wrote to all of our existing external investment managers to set out our expectation that they will work towards aligning the portfolio they manage for the Scheme with a 1.5°C global warming limit. Specifically, we formulated three key expectations for all investment managers over the next three years:

- **Reporting:** We expect our investment managers to report on the climate-related risks and opportunities in the portfolio they manage for the Scheme using the TCFD framework. This includes reporting on their portfolio's carbon intensity and conducting climate change scenario analyses.
- **Reducing emissions:** We expect our investment managers to develop a strategy to align their portfolio with the 1.5°C global warming limit. This includes analysis of how they could halve emissions by 2030.
- **Voting:** We expect our investment managers to exercise their voting rights and engagement resource to positively influence the companies in their portfolio to transition to a low-carbon economy.

These expectations are now a requirement of our standard tender process for new investment mandates, and managers that cannot demonstrate their commitment to meeting these expectations will not be selected. As mentioned above, we ran a selection process for three private equity infrastructure mandates during 2020. Climate change was a key consideration during the selection process and several managers were screened out as we did not believe that their approach was sufficient to meet our climate change objectives.

Our progress in 2020/21

As part of this process, we assessed all existing investment managers' climate change policies against a benchmarking system which we developed. We then wrote to all investment managers to set time-bound, mandate-specific objectives for each in addition to the three topline expectations outlined above. We expect all objectives to be met by 2023 at the latest.

Specific objectives have been tailored to each mandate and asset class. They cover topics such as improving data coverage and quality and developing an escalation process for engagement on climate change.

In total, we set 66 objectives across 23 portfolios and 13 fund managers.[11] As at 31 March 2021:

51.5%

34 of our objectives had been met

13.6%

9 of our objectives were on track

18.2%

12 of our objectives were in progress

16.7%

11 of our objectives had not progressed

We are meeting with our investment managers at least bi-annually to discuss progress. Where a manager is not progressing on their climate change objectives, they will be placed on a watch list as part of our manager monitoring progress. Continued lack of progress could lead to termination of a mandate.

Stewardship

We believe that stewardship is a powerful tool that investors can use to influence companies to shift to low-carbon approaches. It also provides a means for protecting our members' pension pots. In our climate change policy, we committed to the following:

- **Engagement:** We engage with companies on how they are transitioning to meet the goals of the Paris Agreement and how they will manage the impact of this transition on their stakeholders, workers and the wider community. We do this through direct engagement as an investor and a partner, and through our participation in coalitions such as Climate Action 100+. Our investment

[11] This does not yet include infrastructure equity.

managers also engage with companies on our behalf and report on engagement progress on a quarterly basis

- **Disclosures and reporting:** We support all shareholder resolutions, where reasonable, that call on companies to disclose more information on how they manage climate-related risks and opportunities. We vote against management where companies do not make adequate disclosures on climate-related risks and opportunities, or if they fail to appropriately link their executive pay policies to climate-related key performance indicators.
- **Milestones:** We review our voting and engagement standards on climate change annually. For every stewardship activity we undertake, we will set time-bound milestones on which we expect the company to deliver over a short (less than three years) or medium (three to five years) time horizon.

Where engagement is unsuccessful, in that we consider a company to be progressing insufficiently or too slowly towards alignment with the goals of the Paris Agreement, we will consider divesting. This will usually only take place after several escalation options have been explored, such as engaging collectively with other investors, co-filing a shareholder resolution, voting against management or speaking at the annual general meeting (AGM).

Our progress in 2020/21

- **Engagement:** During the 2020 AGM season we voted for a number of shareholder resolutions asking companies to align their strategies with the goals of the Paris Agreement. These included resolutions at the AGMs for Barclays Bank, the French oil and gas company Total and Australian oil exploration company Woodside Petroleum. We voted against the election of the chair or another board member at four companies because of a lack of progress on climate engagement objectives. An example of this was our vote against the re-election of the CEO at ExxonMobil as the company has made little progress in setting emissions reduction targets despite engagement by investors.

  This year, we also expanded our engagement on climate change with the banking sector and have joined the Institutional Investors Group on Climate Change initiative on aligning the banking sector with the goals of the Paris Agreement. Most discussion of climate action to date has focused on high-impact sectors such as energy, heavy industry and transportation, but banks will necessarily play a pivotal role in helping to fund the low-carbon transition. We have engaged with Barclays, HSBC and JPMorgan and plan to broaden our engagement with multinational banks in 2021/22.

  Our developed market equities investment manager UBS is engaging with 29 companies as part of Climate Action 100+, leading the engagement with eight companies.

  Our investment managers also engage on our behalf directly and through collaborative initiatives. We track this engagement where information is available.
- **Disclosures and reporting:** We have increased our scrutiny of companies' disclosures and pay practices with regard to climate change. We are also looking more closely at companies' lobbying activities and industry associations for potential misalignment with their public positions on climate change and the Paris Agreement.

  We have set out baseline reporting requirements on climate change for all companies, not just those in climate-sensitive sectors. We expect all companies to disclose their scope 1, 2 and, where available, scope 3 GHG emissions. We also expect companies to consider how climate change might affect their business and disclose their assessment of climate-related risks and opportunities in line with the TCFD's recommendations.
- **Milestones:** In early 2021, ahead of the annual AGM season, we updated our voting policy in line with the commitments made in our climate change policy. The engagement activities highlighted above have helped to spur transition towards a low-carbon future. For example, following engagement by Nest and other investors, HSBC committed to bringing a management resolution to its 2021 AGM that will set targets for phasing out its financing of coal power and thermal coal mining. More holistically, the resolution will align the bank's business with the goals of the Paris Agreement.

Public policy

We have committed to contribute actively to public discourse on climate-related risks and opportunities. This includes addressing how climate change will affect the pensions industry and the global economy and continuing to exchange views and work with our peers in the financial sector on climate change issues, both directly and through industry groups such as the Institutional Investors Group on Climate Change.

We aim to use our influence as one of the UK's largest pension schemes by membership to improve disclosures on climate-related risks and opportunities in line with the TCFD's recommendations. We are also using our voice to encourage policymakers to set additional net zero emissions targets as well as credible strategies, such as carbon pricing, to achieve them.

Our progress in 2020/21

Over the past year a key focus among large asset owners and listed companies in the UK has been implementing the government's green finance strategy commitments,[12] which include mandatory TCFD disclosures like this report. We engaged extensively with DWP on developing regulation around this. We have published **our responses** to the DWP's consultations on our website.

We engaged with The Pensions Regulator (TPR) on its new climate change strategy. We also responded to the Department for Business, Energy & Industrial Strategy (BEIS) post-pandemic economic growth inquiry and consultations at the European level on topics such as improving the information reported against the Non-Financial Reporting Directive (NFRD).

We have further been active in a number of industry groups, including Climate Action 100+, the Institutional Investors Group on Climate Change, the UK Sustainable Investment and Financial Association and the UK pension schemes roundtable. We are particularly proud to have been involved in the **Paris-Aligned Investment Initiative**[13] and contributed to the development of the Net Zero Investment Framework. We're now working with industry peers to develop a framework for setting portfolio alignment targets. As part of this initiative, we have also signed up to the '**Net zero asset owner commitment**'.[14]

Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management

Our responsible investment team is responsible for identifying and managing climate-related risks for the Nest Scheme.

This team works closely with the investment risk team. Together, these teams have developed a dashboard to keep track of climate-related risk data across the Scheme's investment funds. The dashboard is shared quarterly with the entire investment team.

Climate-related risk exposures are discussed at quarterly asset allocation meetings.

As part of our commitment to become a net zero asset owner,[15] we have also set a target for reducing our operational GHG emissions, including setting targets for scope 1 and 2 emissions. Our targets are in line with the UK's Greening Government Commitments and with achieving global net zero emissions as an organisation by 2050 or sooner.

[12] gov.uk/government/publications/green-finance-strategy

[13] parisalignedinvestment.org

[14] parisalignedinvestment.org/media/2021/03/PAII-Net-Zero-Asset-Owner-Commitment-Statement.pdf

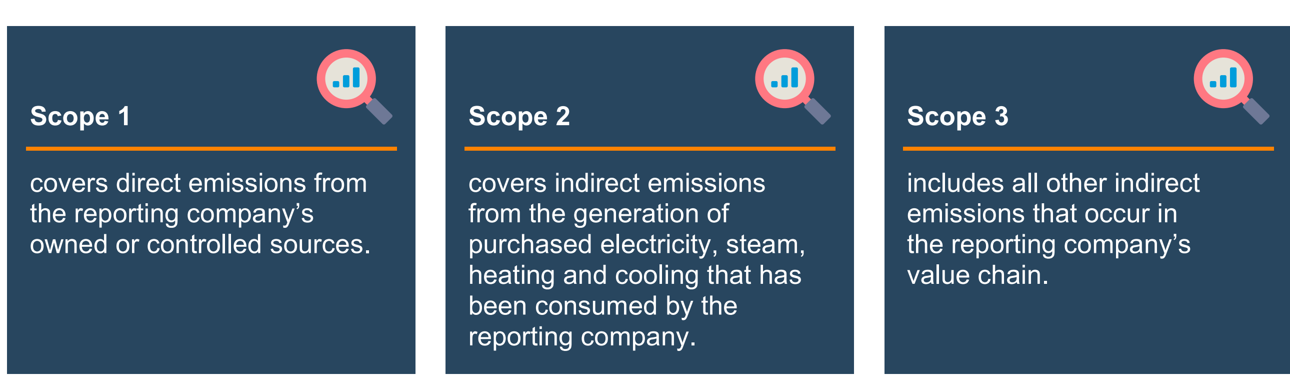
[15] https://www.parisalignedinvestment.org/media/2021/03/PAII-Net-Zero-Asset-Owner-Commitment-Statement.pdf

Section 4

Metrics and targets

Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process

This year we requested information on individual portfolio-level carbon emissions from all investment managers for the first time. We asked our investment managers to report to us on scope 1, 2 and 3 GHG emissions in tonnes of carbon dioxide equivalent (tCO_2e) emissions across our building block funds and calculated these emissions per million pounds (tCO_2e/£m) or per million dollars (tCO_2e/$m) invested or financed. We follow the GHG emissions accounting and reporting standard[16] developed by the Platform on Carbon Accounting Financials to measure tCO_2e emissions related to the Scheme's investments.



Scope 3 data for pension schemes' investments has been acknowledged by Government to be challenging. Trustees of schemes in scope have therefore been exempted from obtaining Scope 3 emissions data in the first year that they are subject to the requirements. [17].

For equity and bond portfolios, the GHG emissions accounting and reporting standard recommends that investors account for a portion of the annual emissions of the financed company determined by the ratio between the amount invested and the value of the financed company, also known as the enterprise value including cash (EVIC).

For some portfolios where there is limited information on the enterprise value of holdings, we use weighted average carbon intensity (WACI) instead. This measure uses company revenues, which is widely available, as the attribution factor.

We have found that data coverage and quality vary across asset classes. Many companies still do not report scope 3 emissions. Gaps in reporting are sometimes filled by data providers that estimate scope 3 emissions based on a company's activities. In order to be transparent, we have provided scope 3 data where available. However, this data should be interpreted carefully due to the gaps in reporting and the potential for double-counting emissions when aggregating company emissions across the entire Scheme portfolio.

In private markets there are also some gaps in reporting on scope 1 and 2 emissions. For example, we have been engaging with BNP Paribas Asset Management with the aim of improving disclosures for the portfolio of mid-market private loans that it manages for us.

Due to these data gaps, and because emissions metrics come from different data providers, we currently only track and report this data at the individual portfolio level. In addition, because there is a lack of a common framework for measurement, we disclose emissions avoided from our investments

[16] carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf

[17] Governance and reporting of climate change risk: guidance for trustees of occupational schemes – part 2, paragraph 11.

in renewable energy assets but we do not subtract avoided emissions from total emissions identified. We are looking to address these topics in future reports. We will also be using this data as a starting point for setting further mandate-level decarbonisation targets that are in line with our long-term goal of net zero emissions by 2050. These will be regularly reviewed and ramped up over time as net zero pathways for different asset classes become clearer. We will report our progress in our annual report against the TCFD framework.

We also monitor and disclose our external investment managers' stewardship activities including the outcomes of our engagement and voting.

Finally, our investment managers report additional metrics that are relevant to their mandates, such as the proportion of 'green' bonds, which are used to finance climate-related projects, in our fixed income portfolios.

The data reported in the metrics and targets section has been obtained from the fund managers of each portfolio. Where fund managers have used third parties to estimate the data, this is stated in the source information. The draft report was shared with the fund managers for verification prior to publication. Nest assumes no responsibility for the accuracy of the data.

Disclose scope 1, scope 2 and, if appropriate, scope 3 GHG emissions and the related risk

Equities

Developed market equities

Developed market equities made up 47.2% of our total portfolio as at 31 March 2021. In the third quarter of 2020, we consolidated the developed markets equity exposures into a single segregated climate-aware strategy managed by UBS Asset Management as noted above. The benchmark for the fund is the FTSE All World Developed (ex Tobacco) Index.

Table 1: Emissions

	Total fund emissions (tCO_2e)			Fund carbon intensity (tCO_2e/£m)		
	Scope 1	Scope 2	Scope 3	Scope 1	Scope 2	Scope 3
Fund	399,806	151,891	907,069	32.8	12.6	69.2
Benchmark	860,826	178,087	946,329	61.7	15.3	77.2
Relative	–53.6%	–14.7%	–4.1%	–46.8%	–17.6%	–10.4%

Source: UBS Asset Management, Trucost and Factset data as at 31 March 2021

Table 2: Engagement on climate change

Number of companies engaged	Percentage of fund value engaged	Percentage of fund scopes 1 and 2 emissions engaged
46	1.5%	14.5%

Source: UBS Asset Management data as at 31 March 2021

Table 3: Other metrics

Number of companies with net zero targets	Percentage of fund value with net zero targets
115	14.7%

Source: UBS Asset Management and Science Based Targets initiative data as at 31 March 2021

Table 4: Performance against fund objectives

	CO_2 annual growth rates	Renewable energy exposure (relative to benchmark)	Scope 1 CO_2 intensity (relative to benchmark)	Coal energy in gigawatt hours (GWh) (relative to benchmark)	Fossil fuel reserves (tCO_2) (relative to benchmark)
Target	–4%	+30%	–50%	–30%	–30%
Fund	–3%	+8%	–64%	–44%	–39%
Benchmark	+1%				

Source: UBS Asset Management, Trucost, Refinitiv, Asset4 and IEA data as at 31 March 2021. Target metrics related to renewable energy, coal energy and fossil fuel exposures used in the tilting process are based on transformed rank data. Fund metrics are based on raw data measured in unit of energy, for example gigawatt hour (GWh) or equivalent tonnes of CO_2. Carbon intensity scope 1 emissions are measured using company's revenue as the denominator.

Emerging market equities

Emerging market equities made up 6.5% of our total portfolio as at 31 March 2021. The allocation was fully invested in the Northern Trust Emerging Markets Custom ESG Equity Index Fund managed by Northern Trust Asset Management. The benchmark for the fund is the MSCI Emerging Markets Index.

We are in the process of transitioning this mandate to a climate-aware index. We will report on the impact this has on fund emissions in our 2021/22 report against the TCFD framework.

Table 5: Emissions

	Total fund emissions (tCO_2e)		Fund carbon intensity (tCO_2e/£m)	
	Scopes 1 and 2	**Scope 3**	**Scopes 1 and 2**	**Scope 3**
Fund	218,643.67	883,560.40	227.31	683.51
Benchmark	283,575.00	1,187,402.44	313.94	856.52
Relative	–22.9%	–25.6%	–22.2%	–20.2%

Source: Northern Trust Asset Management and MSCI data as at 31 March 2021

Table 6: Engagement on climate change

Number of companies engaged	Percentage of fund value engaged	Percentage of fund scopes 1 and 2 emissions footprint engaged
42	22.2%	29.1%

Source: Northern Trust Asset Management data as at 31 March 2021

Table 7: Other metrics

	Fund	Benchmark	Relative
Companies with fossil fuel reserves	4.0%	6.8%	41.2%

Source: Northern Trust Asset Management and MSCI data as at 31 March 2021

Corporate fixed income

Investment-grade corporate bonds

Investment-grade corporate bonds made up 7.4% of our total portfolio as at 31 March 2021. The allocation is managed by Wells Fargo Asset Management and comprises both global investment-grade and global short-duration investment-grade bonds. The benchmarks for the fund are the Barclays Global Aggregate-Corporate Index and the Barclays Global Aggregate Corporate 1–5 Year Index.

Table 8: Emissions

	Total fund emissions (tCO_2e)			Fund carbon intensity (tCO_2e/£m)		
	Scope 1	**Scope 2**	**Scope 3**	**Scope 1**	**Scope 2**	**Scope 3**
Global investment grade bonds						
Fund	116,219	18,545	119,696	101	16	104
Benchmark	906,046	163,727	913,076	101	18	102
Relative	–87.2%	–88.7%	–86.9%	0%	–11.1%	1.9%
Global short-duration investment-grade bonds						
Fund	9,208	2,304	14,712	64	16	102
Benchmark	323,259	68,291	404,379	89	19	112
Relative	–97.2%	–96.6%	–96.4%	–28.1%	–15.8%	–8.9%

Source: Wells Fargo Asset Management, Trucost, Factset and Bloomberg data as at 31 March 2021

Table 9: Engagement on climate change

	Number of companies engaged	Percentage of fund value engaged
Global investment-grade bonds	12	2.2%
Global short-duration investment-grade bonds	7	1.6%

Source: Wells Fargo Asset Management data as at 31 March 2021

Table 10: Other metrics

	Percentage of green bonds in fund
Global investment-grade bonds	6.9%
Global short-duration investment-grade bonds	2.0%

Source: Wells Fargo Asset Management data as at 31 March 2021

High-yield corporate bonds

Global high-yield developed market bonds made up 6.9% of our total portfolio as at 31 March 2021. This allocation is managed by J.P. Morgan Asset Management. The benchmark is the ICE BofA Non-Financial Developed Markets High Yield Constrained Index.

Table 11: Emissions

	Total fund emissions (tCO_2e)		Fund carbon intensity (tCO_2e/$m)	
	Scopes 1 and 2	**Scope 3**	**Scopes 1 and 2**	**Scope 3**
Fund	204,498 (coverage 80.1%)	1,053,438 (coverage 79.8%)	139.3 (coverage 80.3%)	717.6 (coverage 79.4%)
Benchmark	283,267 (coverage 76.4%)	1,282,085 (coverage 75.7%)	193 (coverage 77.2%)	873.3 (coverage 75.7%)
Relative	–27.8%	–17.8%	–27.8%	–17.8%

Source: J.P. Morgan Asset Management and MSCI data as at 31 March 2021

Sterling corporate bonds

Sterling corporate bonds and sterling short-duration investment-grade bonds made up 6.4% of our total portfolio as at 31 March 2021. This allocation is managed by Royal London Asset Management.

The data in this table aggregates the Scheme's holdings in the RLPPC UK Corporate Bond and the Royal London Investment Grade Short-Dated Credit funds based on fund values as at 31 March 2021. The benchmark data merges the benchmarks for each fund (iBoxx Sterling Non-Gilt All Maturities Index and ICE BofA 1–5 Year Sterling Non-Gilt All Stocks Index, respectively) in the same proportion as the fund values (70% to 30%) as at the same date.

For this fund, the proportion of holdings where enterprise value was available was below 50%. We are therefore reporting using WACI instead (see page 22).

Table 12: Emissions

	Weighted average carbon intensity (tCO_2e/£m)
Fund	91.1 (coverage 89.6%)
Benchmark	118.1 (coverage 86.4%)
Relative	–22.9%

Source: Royal London Asset Management and MSCI data as at 31 March 2021

Table 13: Engagement on climate change

Number of companies engaged	Percentage of fund value engaged	Percentage of fund scopes 1 and 2 WACI engaged
11	6.4%	27.4%

Source: Royal London Asset Management and MSCI data as at 31 March 2021

Additional metrics

The investment manager estimates the percentage of asset value derived from revenues considered to be ‘green’ or ‘brown’. Green activities include renewable energy, energy efficiency, sustainable agriculture or water, green building and pollution prevention. Brown activities include oil and gas (in any part of the value chain), coal mining and coal-based generation of electricity.

Warming potential represents an estimate of the global temperature rise associated with the emissions of a single entity or group of entities. Here we provide warming potential aggregated across the fund.

Table 14: Additional metrics

	Warming potential (degrees C)	Percentage value of revenue from green activities	Percentage value of revenue from brown activities
Fund	3.69 (coverage 50.3%)	18.2%	7%
Benchmark	3.89 (coverage 54.0%)	21.2%	10%
Relative	0.2	–14.4%	–31.6%

Source: Royal London Asset Management and MSCI data as at 31 March 2021

Emerging market debt

Emerging market debt made up 6.5% of our total portfolio as at 31 March 2021. This allocation is managed by Amundi Asset Management. To calculate the emissions for debt held by sovereign nations, Amundi considers countries’ consumption-based emissions from the final use of goods and services in the national economy. This calculation includes imported emissions but excludes exported emissions.

Table 15: Emissions

	Total fund emissions (tCO_2e)		
	Scope 1	**Scope 2**	**Scope 3**
Fund	384,468,852,174	61,855,347,826	151,431,243,478
	Fund carbon intensity (tCO_2e/£m)		
Fund	131.4	21.2	51.8

Source: Amundi and Trucost data as at 31 March 2021

Property

Global and UK hybrid property made up 7.1% of our total portfolio as at 31 March 2021. This allocation is managed by Legal & General Investment Management (LGIM).

LGIM was only able to provide absolute scope 1 and 2 emissions for multi-let buildings where they own the common parts of the building. This figure was 4,275.4 tCO_2e.

Commodities

A segregated account comprised of a mix of commodity futures and equity made up 2.1% of our total portfolio as at 31 March 2021. This segregated account is managed by CoreCommodity Management. The benchmark is the Bloomberg Commodity Index Total Return Index.

Table 16: Emissions

	Total fund emissions (tCO_2e)		Fund carbon intensity (tCO_2e/£m)	
	Scopes 1 and 2	**Scope 3**	**Scopes 1 and 2**	**Scope 3**
Fund	1,993,968 (coverage reported 18% estimated 82%[18])	203,114 (coverage reported 10% estimated 90%)	5,541	564
Benchmark	2,215,239 (coverage estimated 100%)	N/A	6,156	N/A
Relative	–10.0%	N/A	–10.0%	N/A

Source: CoreCommodity, Bloomberg and MSCI data as at 31 March 2021

Liquidity

Liquid assets made up 4.9% of our total portfolio as at 31 March 2021. Of this allocation, 2.8% was held in the BlackRock Sterling Liquid Environmentally Aware Fund (LEAF) and 2.1% in the BlackRock ICS Institutional Sterling Ultra Short Bond Fund managed by BlackRock Inc.

Table 17: Emissions

	Scopes 1 and 2 WACI (tCO_2e/\$m sales)	Scopes 1 and 2 fund footprint (tCO_2e/\$m capital)
LEAF	4.83	1.87
Sterling Ultra Short Bond Fund	39.11	11.91

Source: BlackRock Inc and MSCI data as at 31 March 2021

Private markets

A diversified private credit fund comprised of commercial real estate debt, infrastructure debt and small and medium-sized enterprise (SME) debt made up 1.4% of our total portfolio as at 31 March 2021. This allocation is managed by BNP Paribas Asset Management. While there is good coverage of emissions for commercial real estate and infrastructure debt, SMEs rarely report this data. We are engaging with BNP Paribas about how it can use its influence to encourage better reporting.

[18] All emissions linked to futures contracts are estimated by the manager.

Table 18: Emissions

	Absolute emissions, scopes 1 and 2 (tCO_2e)	Absolute emissions scopes 1, 2 and 3 (tCO_2e)	Emissions intensity, scopes 1 and 2 (tCO_2e/£m financed)	Emissions intensity, scopes 1, 2 and 3 (tCO_2e/£m financed)
Commercial real estate debt	2,000 (coverage 100%)	3,000	23	32
Infrastructure debt	7,000 (coverage 100%)	38,000	106	591
Small and medium-sized company debt	20 (coverage 2%)	N/A	9	N/A

Source: BNP Paribas Asset Management, Iceberg Data Lab and company disclosure data as at 31 March 2021

An infrastructure fund managed by BlackRock Inc made up 1.2% of our total portfolio as at 31 March 2021. Unfortunately, there is currently a lack of standardisation and data coverage for GHG emissions data in the infrastructure industry, particularly among infrastructure debt lenders and in the case of scope 3 emissions. To address this, BlackRock is developing a real assets climate strategy to provide a more comprehensive framework for assessing climate-related risks and opportunities. We anticipate that this will increase our climate-related disclosures and quantifiable carbon metrics, including reporting on scopes 1 and 2 GHG emissions, in the future.

To date, BlackRock has been able to source emissions information for the renewables and waste-to-energy assets in the fund.

Table 19: Emissions

	Percentage of fund-committed capital	Annual energy produced, stored or transported (MWh)[19]	Renewable energy capacity added (MW)	GHG emissions avoided annually (tCO_2)[20]
Renewable assets[21]	26%	626,022	653	100,507
		Absolute scope 1 emissions (tCO_2e)	**Absolute scope 2 emissions (tCO_2e)**	**Absolute scope 3 emissions (tCO_2e)**
Waste to energy[22]	13%	2,023,726	16,941	453,999

Source: BlackRock Inc and company disclosure data as at 31 March 2021

Global commercial real estate debt made up 0.9% of our total portfolio as at 31 March 2021. This allocation is managed by Amundi Asset Management. Scope 3 emissions are not currently provided in reporting for this allocation, as there is no commonly agreed methodology for calculating them.

[19] This number is a best estimate of annual production of the assets.

[20] Relative to the country's current electricity mix, calculated with IEA 2017 emission factors for electricity generation in the countries where the assets were located.

[21] These figures apply at project level and are not pro-rated.

[22] These figures apply to the entire company's emissions and have not been attributed to the portfolio's share.

Table 20: Emissions

Total scopes 1 and 2 fund emissions ($tCO_2e/metre^2/yr$)	Fund scopes 1 and 2 emissions intensity (tCO_2e /£m)
18,781	947.9

Source: Amundi Asset Management as at 31 March 2021

Other fund choices

Around 99% of Scheme members are invested in our default strategy, the Nest Retirement Date Funds. For members who wish to make active investment choices, we offer a range of clearly labelled other fund choices. Two of these alternative funds are values-based.

Nest Ethical Fund

The Nest Ethical Fund is for Scheme members who are particularly concerned about the impact that their investments can have on the environment and society, for example in areas such as human rights, fair labour practices and fair trade. It excludes fossil fuel-related assets. Unlike many other ethical funds, the Nest Ethical Fund consists of multiple asset classes.

Ethical global equities made up 0.6% and ethical sterling corporate bonds made up 0.2% of our total fund as at 31 March 2021. These allocations are managed by BMO Global Asset Management. The benchmark for the sterling bond fund is the iBoxx Sterling Non-Gilt All Maturities Index. For the global equity fund it is the MSCI World Index.

Table 21: Emissions

	Total portfolio emissions (tCO_2e)		Portfolio carbon intensity ($tCO_2e/\$m$)		Weighted average carbon intensity ($tCO_2e/\$m$ sales)	
	Scopes 1 and 2	Scope 3	Scopes 1 and 2	Scope 3	Scopes 1 and 2	Scope 3
Responsible sterling bonds	2,798 (coverage 55.6%[23])	8,432 (coverage 55.6%)	56.3 (coverage 59.9%)	169.7 (coverage 57.8%)	118.3 (coverage 85.6%)	565.8 (coverage 64.3%)
Benchmark	3,638 (coverage 49.8%)	17,164 (coverage 49.6%)	73.2 (coverage 54.6%)	385.7 (coverage 51.4%)	131.7 (coverage 87.6%)	728.3 (coverage 56.7%)
Relative	–23.1%	–50.87%	–23.1%	–56%	–10.2%	–22.31%
Responsible global equities	2,840 (coverage 98.9%)	17,275 (coverage 98.9%)	21.1 (coverage 98.9%)	128.6 (coverage 99.6%)	87.6 (coverage 98.9%)	391 (coverage 98.9%)
Benchmark	10,511 (coverage 99.7%)	52,637 (coverage 99.6%)	78.3 (coverage 99.7%)	391.9 (coverage 99.6%)	140.5 (coverage 99.7%)	625 (coverage 99.6%)
Relative	–73.0%	–67.2%	–73.0%	–67.2%	–37.7%	–37.4%

Source: BMO Global Asset Management and MSCI data as at 31 March 2021

[23] Green bonds have been removed for the purposes of this calculation, as these are for ringfenced projects and so the inclusion of issuer-level data would be misleading. Bond holdings in Wessex Water are also excluded, as MSCI ESG maps these to the parent company, YTL Corporation.

Table 22: Engagement on climate change

	Number of companies engaged	Engagement milestones met
Responsible global equities	12	5
Responsible sterling bonds	35	13

Source: HSBC Global Asset Management as at 31 March 2021

Table 23: Green bonds

	Percentage of bonds in fund that are green bonds
Responsible sterling bonds	11.3%

Source: HSBC Global Asset Management as at 31 March 2021

Nest Sharia Fund

The Nest Sharia Fund is for Scheme members who want an investment approach based on Islamic law. It is invested entirely in global equities judged to meet Sharia financial principles.

The fund is invested in the HSBC Islamic Global Equity Index Fund managed by HSBC Global Asset Management and the benchmark is the Dow Jones Islamic Titans 100 Index. The allocation made up 0.4% of our total fund as at 31 March 2021.

Table 24: Emissions

	Total scopes 1 and 2 emissions (tCO_2e)	Scopes 1 and2 WACI (CO_2e/$m sales)	Carbon footprint (tCO_2e/$m invested)
Fund	5,123,214	72.88	23.31
Benchmark	5,149,385	73.30	23.43
Relative	–0.5%	–0.6%	–0.5%

Source: HSBC Global Asset Management and S&P/Trucost data as at 31 March 2021

Table 25: Engagement on climate change

Number of companies engaged	Percentage of fund value engaged
12	11.7%

Source: HSBC Global Asset Management as at 31 March 2021

Table 26: Other metrics

	Percentage of fund value with any revenue from high-intensity carbon activities	Percentage of benchmark value with any revenue from high-intensity carbon activities
Fossil fuels	4.7%	4.8%
Coal	0.7%	0.7%
Fossil fuel power generation	0.4%	0.4%

Source: HSBC Global Asset Management as at 31 March 2021

Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets

We aim to align our whole investment fund with limiting global warming to 1.5°C above pre-industrial levels by reaching net zero carbon emissions by 2050 at the latest. We expect that emissions in our fund will need to be halved by 2030 from reported and estimated levels as at 31 March 2020 in order for us to be on course to meet our ambition. We are currently working with other peers in the pensions industry on developing frameworks for setting a series of interim targets between now, 2030 and 2050.

Due to the challenges of aggregating data across all of our investment mandates, we are working with our external investment managers to develop fund-level targets for the assets and asset classes that they manage for the Scheme. Our funds of developed market equities and global investment-grade bonds already have specific emissions reduction targets attached to them:

- **Developed market equities:** This fund managed by UBS Asset Management has targets to reduce carbon intensity by 50% for scope 1, 20% for scope 2 and 10% for scope 3 GHG emissions relative to the benchmark index, the FTSE All World Developed (ex Tobacco) Index, by 2050 at the latest. It also has a target to increase exposure to renewable energy by 30% and decrease exposure to fossil fuel reserves and coal energy by 30% relative to the benchmark.
- **Global investment-grade bonds:** This fund managed by Wells Fargo Asset Management currently has a target to maintain carbon intensity at least 30% below the carbon intensity of the benchmark, Barclays Global Aggregate Corporate. It also has a target to decrease fund carbon intensity by 7% per year starting from its 2020 baseline level.
- **Property:** Our property fund manager Legal & General Investment Management has set a target to achieve net zero carbon for its real estate platform by 2050 or sooner. This includes reducing the operational carbon and energy intensity (scopes 1 and 2 emissions) of landlord-controlled areas by 6% per annum and by 60% overall by 2030. LGIM will establish science-based targets for scope 3 emissions during 2021.

Five of our external investment managers are signatories to the Net Zero Asset Managers Initiative. As part of this initiative they have committed to work in partnership with asset-owner clients such as the Nest Scheme on setting goals for decarbonisation consistent with an ambition to reach net zero emissions across all assets under management by 2050 at the latest. They have also committed to set at least one interim target for achieving net zero emissions by 2050.

Conclusion

Pension schemes have the ability to influence the entities in which they invest, including to improve those entities' own climate-related financial disclosures. We welcome the introduction of mandatory reporting against the TCFD framework for large pension schemes as set out in the Pension Schemes Act 2021. This requirement aims to raise standards of reporting across the industry. We hope that in time the TCFD will become the global standard for climate-related disclosures.

Otto Thoresen
Chair, Nest Corporation

20 October 2021

Glossary

asset

Something of economic value that an individual, an organisation, a corporation or a government owns, for example, a piece of property, a share in a company or a building or machinery.

asset class

A group of assets that have the same characteristics, for example, real estate, equities or bonds.

benchmark

A standard used to judge the investment performance of an asset or asset class. Stock and bond indices which track the average performance of a broad selection of assets are often used as benchmarks.

bonds

Loans, issued as tradeable securities, made between an investor and a borrower. Bonds are usually issued in the investment markets by corporations or governments.

carbon pricing

Attempts to capture the external and often indirect cost of CO_2 emissions to society and shift this cost to the actual emitters based on their emissions. Carbon pricing forms the basis for regulatory instruments such as carbon taxes.

Climate Action 100+

Global investor initiative of more than 570 signatories with US $54 trillion assets under management. It engages with the 100 biggest emitters globally and more than 60 companies considered instrumental to the low-carbon transition.

climateaction100.org

climate-aware fund

A fund invested in equities and based on a market index, but with overweighting and underweighting of company shares in certain sectors based on the companies' exposure to climate-related opportunities (when overweighted) or risks (when underweighted).

The methodology for 'tilting' our developed market equities CAF was developed by us in partnership with UBS Asset Management, our investment manager for developed market equities.

In line with our climate change policy we completed moving all of the Scheme's developed market equity holdings into the developed market equities CAF in 2020/21 and began the process of moving our emerging market equities into a CAF managed by Northern Trust Global Investments.

commodities

Raw materials, such as coffee, wheat, cotton, gold and oil, which can be bought and sold.

default fund

A pension fund set up for members into which they are automatically enrolled.

Our default funds, the Nest Retirement Date Funds are target-date funds, where the investment objectives follow a glide path based on how far away the member is from their expected retirement date, year by year.

divestment

When an investor sells assets. This can be based on poor performance, ethical or governance concerns or social or political goals.

environmental, social and governance factors

These are investment risks that investors consider when evaluating investments.

We believe that well-run organisations with sound ESG practices have a better chance of long-term success and profitability. This is set out among our investment beliefs.

equities

Shares in a company or other entity which can be bought or sold.

green finance strategy

Strategy put forward by the UK government in 2019 to support financing of companies developing sustainable, low-carbon technologies and increasing consideration of climate change and other environmental issues in the financial sector.

gov.uk/government/publications/green-finance-strategy

greenhouse gases (GHGs)

There are four GHGs that are linked to global warming: carbon dioxide (CO_2), methane, nitrous oxide and fluorinated gases. Over three quarters of global GHGs are CO_2.

The Greenhouse Gas Protocol, an international accounting tool, categorises GHG emissions into three groups or 'scopes':

- **Scope 1** covers direct emissions from the reporting company's owned or controlled sources.
- **Scope 2** covers indirect emissions from the generation of purchased electricity, steam, heating and cooling that has been consumed by the reporting company.
- **Scope 3** includes all other indirect emissions that occur in the reporting company's value chain.

ghgprotocol.org

Institutional Investors Group on Climate Change (IIGCC)

European membership body for institutional investor action on climate change. Its work focuses on corporate governance, investor practices and public policy. IIGCC runs the European secretariat for CA100+.

www.iigcc.org

Intergovernmental Panel on Climate Change (IPCC)

United Nations intergovernmental body for assessing the science of climate change. The IPCC's assessment reports supported the creation of the UNFCCC and the Paris Agreement.

ipcc.ch

International Energy Agency (IEA)

Autonomous intergovernmental organisation established in the framework of the OECD (Organisation for Economic Co-operation and Development). It provides analysis, data and energy policy advice to member states.

investment beliefs

A set of values used to guide day-to-day investment decisions and strategy. Our investment beliefs are set out in our 'Statement of investment principles'.

nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/statement-of-investment-principles.html

investment committee

A group that oversees the overall investment strategy and approach of an organisation as well as the investment team. The Board delegates these powers to our investment committee, whose membership includes members of the Board and independent investment specialists.

investment manager

A third party that is responsible for implementing an investment strategy in an asset class or classes and for managing the portfolio of assets in which members' money is invested on their behalf.

investment return

The amount gained or lost on money invested in assets, usually expressed as a percentage. Annualised investment returns over several years help to demonstrate the longer-term performance of an investment.

investment risk

The probability, or likelihood of occurrence, of losses on an investment in assets, relative to the expected return on them.

investment strategy

The guidelines that lay out future investment goals and the rules and procedures to be used when making investment decisions. Investment strategy evolves in response to changes in the economy and investors' needs. We also prioritise members' needs when evolving our investment strategy.

market index

A hypothetical portfolio of investments used to judge the performance of types of assets or asset classes. An example is the FTSE 100 Index which calculates the value of shares in the 100 most highly capitalised companies on the London Stock Exchange. Some indices focus on particular sectors or geographic regions.

Net Zero Asset Managers Initiative

A global association of investment managers who are committed to achieving net zero greenhouse gas emissions by 2050 at the latest. As at May 2021, 87 investment managers with US $37 trillion in assets under management had signed on to the initiative.

netzeroassetmanagers.org

overweighting

When an investor purposefully increases holdings of a certain stock or group of stocks above the investor's normal target or above a designated benchmark.

In the case of our developed market equities climate-aware fund with UBS, we are overweighting companies who are having a positive impact on climate change relative to their peers – for example, investing more in renewable energy companies compared to pure fossil fuel companies.

Paris Agreement

The Paris Agreement was reached at COP21 in 2015, the 21st meeting of the decision-making body of the UNFCCC. Its central aim is to ensure global warming in the twenty-first century remains well below 2°C above the average level recorded for the period 1850 to 1900 and to pursue efforts to limit global warming to 1.5°C.

In total, 189 of 197 countries have ratified the agreement to date. Countries which have not ratified the agreement include Turkey, Iran, Iraq, Angola and Libya.

unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

Task Force on Climate-related Financial Disclosures (TCFD)

Provides a framework for consistent climate-related financial risk disclosures for use by companies in communicating information to investors, lenders, insurers and other stakeholders.

fsb-tcfd.org

UK Sustainable Investment and Finance Association (UKSIF)

Industry membership group committed to increasing sustainable and responsible finance.

uksif.org

underweighting

When an investor purposefully reduces holdings of a certain asset or asset class in relation to the investor’s normal target or a designated benchmark.

United Nations Framework Convention on Climate Change (UNFCC)

United Nations entity to address the threats of climate change. Adopted in 1992, it is the parent treaty to the 2015 Paris Agreement and the 1997 Kyoto Protocol.

unfccc.int

Voting versus engagement

Most shares in publicly traded companies give their owners a right to vote on some of company decisions, including things such as whether to take over another company or approve the amount senior executives are paid. Voting usually takes place at each company’s annual general meeting (AGM).

Engagement can be done by voting at AGMs or separately by engaging with companies directly or through investor groups. An individual or organisation with shareholder ownership has more opportunities for engagement.

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