Climate change risk policy

December 2022

Our approach to managing climate change across Nest's investments

nestpensions.org.uk

Contents

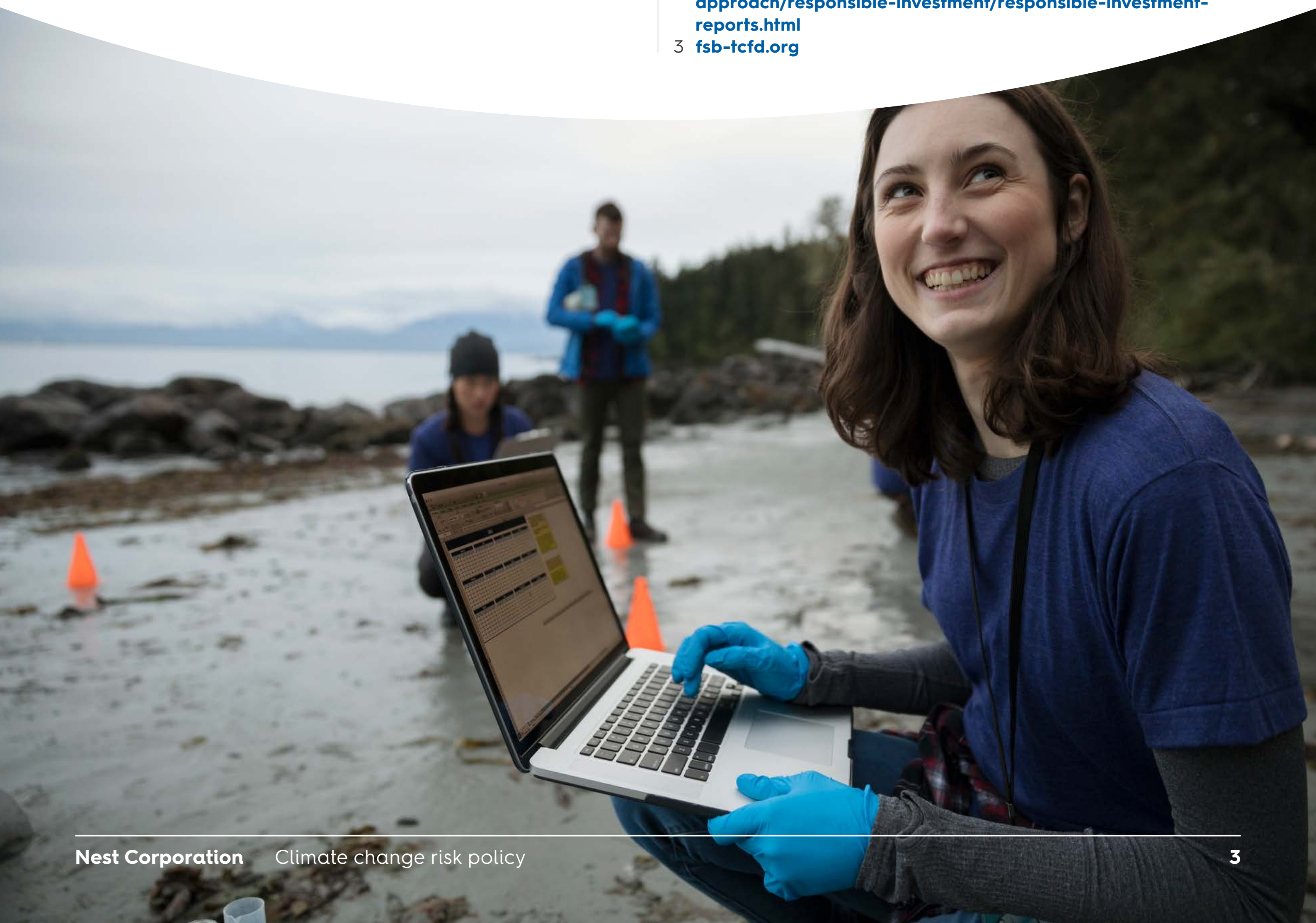
About this document

This document sets out Nest Corporation's policy for considering and integrating climate change-related risks and opportunities in the way we manage assets on behalf of scheme members.

Nest's climate change policy was approved by the Trustee's investment committee in June 2020 and last reviewed in July 2022. It will be reviewed and updated at least every three years.

Nest has also developed a climate change roadmap setting out the targets that we intend to meet by 2025. These short-term targets support the long-term commitments we've outlined in this policy[1]. We will report on our progress against this policy and the climate change roadmap in our annual responsible investment reports[2] and our annual reporting against the Task Force on Climate-related Financial Disclosures (TCFD)[3]. Our TCFD report for 2021/22 has been published on our website.

1 **nestpensions.org.uk/schemeweb/dam/nestlibrary/climate-change-roadmap.pdf**
2 **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/responsible-investment/responsible-investment-reports.html**
3 **fsb-tcfd.org**



Policy overview

Climate change is one of the world's biggest challenges, posing a significant threat not just to the environment but to social and economic stability.

Scientists agree that the world faces an existential threat if global warming continues on its current trajectory. If we do not change course now, humanity risks missing the point where we can avoid runaway climate change, with disastrous consequences for the world's people and economies as well as all the natural systems that sustain us.

Nest Corporation supports this view of the risks and threat of climate change and believes that limiting global warming to 1.5C could help curb the catastrophic consequences of climate change. Our ambition is to align our whole investment portfolio with limiting global warming to 1.5C above pre-industrial levels[4] by reaching net zero carbon emissions by 2050 or earlier. We expect that emissions in our portfolio will have to halve by 2030 from a 2019 baseline in order to be on course to meet this ambition. We also set further short-term targets as part of our climate change roadmap[5].

Our strategy and commitments

We have put in place a strategy to reach this ambition based on four core commitments:

- **Asset allocation**
  We will continue to decarbonise our portfolio. This will include divesting by set dates from companies involved in thermal coal, oil sands and arctic drilling, reducing other carbon-intensive holdings and investing more money in companies that are developing solutions such as renewable energy infrastructure and low-carbon technologies.

- **Fund manager selection and monitoring**
  We expect all our fund managers to work towards aligning the portfolio they manage for Nest with the 1.5C global warming limit. This is a requirement for all new mandates from July 2020. Incumbent managers at this date have until 2023 to demonstrate meaningful progress against defined benchmarks.

- **Stewardship**
  We will continue to make climate change a focus of our stewardship strategy. We believe that stewardship is one of the most powerful tools investors can use to influence companies to change to low-carbon approaches. It also provides a means for protecting our members' pension pots. Where engagement fails, we may divest.

- **Public policy**
  We will continue to contribute actively to the public discourse on climate change risks and opportunities as one of the UK's largest pension schemes by membership. This includes addressing how climate change will affect the pensions industry and the global economy.

By taking a forward-looking and dynamic approach to managing climate-related risks and opportunities, we can better protect and enhance the saving outcomes for our millions of members at retirement.

Our view on climate change on pages **5** to **6** explains in more detail why we consider climate change to be a central consideration when making investment decisions.

How we are taking action on pages **7** to **9** explains in more detail how we intend to implement the strategy to achieve our ambition.

We conclude with how we will report and monitor our progress on page **10**.

4 See chapter 1 in Intergovernmental Panel on Climate Change, Special report: global warming of 1.5C (October 2018), **ipcc.ch/sr15/chapter/chapter-1**

5 **nestpensions.org.uk/schemeweb/dam/nestlibrary/climate-change-roadmap.pdf**

Our view on climate change

At Nest we accept the scientific evidence that climate change presents one of the biggest financial, environmental and societal challenges of our time.

The evidence of climate change

The scientific evidence clearly shows that human activities have contributed to around 1C of global warming since the modern industrial era, based on comparison with the average temperature for the period 1850 to 1900. If warming continues to increase at the current rate, we may reach an average increase in global temperatures of 1.5C before 2040[6].

The impact of this amount of warming is already being felt through extreme weather events. Further increases in emissions from human activities will cause long-term changes to the climatic system. This in turn will irreversibly affect the planet and all life on it, including human society.

Research on the consequences of climate change continues to develop. However, there is a growing body of evidence of the physical and transition risks resulting from climate change on the environment, economic activity, human health and the productivity and functioning of financial markets[7]. Research has also identified several key opportunities.

In response to this evidence, during the United Nations Climate Change Conference 2015 (COP21), held in Paris, governments from around the world reached an agreement to combat climate change and accelerate and intensify the actions and investments needed for a sustainable, low-carbon future. The aim of the Paris Agreement, as it is now known, is to keep 'global temperature rises in this century to well below 2C above pre-industrial levels and to pursue efforts to limit the temperature increase further to 1.5C'[8]. To date 193 Parties (192 countries plus the European Union) have ratified it.

Research by the Intergovernmental Panel on Climate Change (IPCC) suggests that there would be significant differences in the impact of global warming of 2C versus 1.5C. Keeping global warming below 1.5C would limit damage to ecosystems and human health and wellbeing. It is still possible to limit warming to 1.5C, but this will require deep emissions reductions over the next decades. To limit warming to 1.5C, the IPCC projects that global carbon emissions need to halve by 2030 and reach net zero by around 2050[9] .

This is why we are aiming to align our whole portfolio by 2050 with the Paris Agreement's more ambitious 1.5C limit on warming.

6 IPCC, Sixth Assessment Report: The Physical Science Basis, **ipcc.ch/report/ar6/wg1**
7 Bank of England, Financial stability report and record (July 2019), **bankofengland.co.uk/financial-stability-report/2019/july-2019**
8 **unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement**
9 IPCC, Special report: global warming of 1.5C, **ipcc.ch/sr15**

Why climate change matters to Nest

With over 11.5 million members as at October 2022, Nest is one of the UK's biggest workplace pension schemes by membership.

Nest Corporation has developed a set of investment beliefs that guide our approach to investing our members' money. These are published in our Statement of investment principles[10].

Two of these beliefs relate to our responsible investment activities:

- As long-term investors, we believe that integrating environmental, social and governance (ESG) considerations into the investment management process improves risk-adjusted returns.
- We believe that long-term returns to investors are likely to be more sustainable if companies consider the interests of wider stakeholders – customers, employees and the wider public as well as shareholders and lenders.

Millions of Nest's members will be invested with us for decades. Over this time horizon, we believe that climate change will present significant investment risks for them.

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

We are also mindful of the broader impacts of climate change on our members, beyond the effect on their retirement savings. The physical impact of changes to the climatic system and the economic cost of adapting to a warmer planet will impact their lives in the coming years.

The transition to a low-carbon economy may also have disruptive effects on workers and communities in the UK and around the world. We must consider these too.

We believe that Nest has a social responsibility to contribute to the transition to a low-carbon economy in ways that will not only allow our members to sustainably grow their retirement pots but also positively impact the world they live and retire in.

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

How we are taking action

We have developed a strategy for realising our climate change ambition by 2050.

Asset allocation

We will decarbonise our portfolio. This will include divesting by set dates from companies involved in thermal coal, oil sands and arctic drilling, reducing other carbon-intensive holdings and investing more money in companies that are developing solutions such as renewable energy infrastructure and low-carbon technologies.

We are mindful that methodologies are still being developed to assess portfolio alignment with a particular temperature goal across all asset classes. We are committed to actively contributing to research in this area.

We are taking the following actions:

- We will transition our portfolios to become climate-aware. We have already started with equities and fixed income. 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.
- We will continue to explore practices for identifying net zero emissions options 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 transition.
- There are some business activities that we do not believe can be aligned with the goals of the Paris Agreement and therefore pose an investment risk. These include thermal coal, oil sands and arctic drilling. We divested from all companies with more than 20% of revenues from these activities at the end of 2020.
- We will continue to exclude from our investment portfolios:
  - all companies making new developments in these activities
  - all companies with more than 10% of revenues from these activities by 2023
  - then all companies still involved in these activities by 2025 if they have not committed to a full, accountable phase-out by 2030 at the latest
- We believe that all companies have a role to play in the low-carbon transition. They can do this through:
  - managing direct emissions generated by their operations
  - managing indirect emissions, for example, the emissions generated through their supply chains, financing decisions and public policy and lobbying activities

We will continue to assess how the companies we invest in contribute to climate change and monitor their alignment with the goals of the Paris Agreement. Companies that we do not consider to be making progress in the transition, or in recognising how climate change will impact their businesses, may be excluded from our portfolios.

- We believe that investment in private markets continues to present opportunities to deliver returns for our members whilst supporting companies and projects which are contributing to the low-carbon transition. We will seek to allocate more money to investing in climate solutions, starting with an allocation to renewable energy in private equity infrastructure.
- We will continue to research the impact of climate change on asset-class risks and returns. This includes assessing the impact of different climate change scenarios on our asset allocation and disclosing the results through our TCFD report. In the future we may invest more or less in certain asset classes or regions depending on how we believe they will perform in a low-carbon economy.

Fund manager selection and monitoring

We will expect all our fund managers to work towards aligning the portfolio they manage for Nest with the 1.5C global warming limit. This will be a requirement for all new mandates. Incumbent managers will have three years to demonstrate meaningful progress against defined benchmarks.

In order for the scheme to be aligned with the goals of the Paris Agreement, we need to work towards alignment of all the building blocks of our portfolios.

We have started and will continue to work closely with our fund managers on how each of our portfolios is aligned with the Paris Agreement. We have set different objectives and benchmarks for each manager. These will be dependent on how far they have already progressed in evolving their investment approach towards a low-carbon economy.

We have also formulated three key expectations for **all** fund managers to meet by 2023:

- We expect our managers to develop a strategy to align the portfolio they manage for Nest's members with the 1.5C global warming limit. This will include analysis of how they could halve emissions by 2030 and working with us to translate this into shorter-term targets.
- We expect our managers to report on the climate change risks and opportunities in their portfolio using the TCFD framework. This includes reporting on their portfolio's carbon intensity as well as climate change scenario analyses.
- We expect our 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 have become a requirement of our standard tender process for new mandates, and managers that cannot demonstrate their commitment to meeting these expectations will not be selected.

We expect all incumbent managers to deliver on our expectations by the end of 2023.

We plan to review our managers' progress annually. If limited progress has been made in any individual portfolio by the end of 2023, we may withdraw our members' assets.

Stewardship

We will make climate change a focus of our stewardship strategy. We believe that stewardship is one of the most powerful tools investors can use to influence companies to change to low-carbon approaches. It also provides a means for protecting our members' pension pots. Where engagement fails, we may divest.

To help speed up the low-carbon transition, we will use our shareholder voting rights and, through collaborations with other institutional asset owners, increase pressure on the largest carbon emitters and those who finance them. In particular, we are taking the following actions:

- We will continue to engage with companies on how they are transitioning to meet the goals of the Paris Agreement and how they will manage the impact the transition will have on their stakeholders, employees and the wider community. We will do this through direct engagement as an investor and a partner, and through our participation in coalitions such as Climate Action 100+[11].
- We will support all shareholder resolutions, where reasonable, that call on companies to disclose more information on how they manage climate change risks.
- We have and will continue to vote against companies' management resolutions if they do not make adequate disclosures on climate change risks and opportunities, or if they fail to appropriately link their executive pay policies to climate change-related key performance indicators. Nest's voting and engagement standards provide more information on this[12].
- We have reviewed our voting and engagement standards on climate change and will continue to do this annually.

For every stewardship activity we will set time-bound milestones on which we expect the company to deliver over the short or medium term.

Where our 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, voting against management, speaking at the annual general meeting (AGM) or co-filing shareholder resolutions.

Public policy

11 **climateaction100.org**
12 **nestpensions.org.uk/schemeweb/nest/nestcorporation/investment-approach/investment-principles.html**

We will contribute actively to the public discourse on climate change risks and opportunities as one of the UK's largest pension schemes by membership. This includes addressing how climate change will affect the pensions industry and the global economy.

Specifically, we are taking the following actions:

- We will continue to exchange views and work with our peers on climate change issues, both directly and through industry groups such as the Institutional Investors Group on Climate Change (IIGCC)[13].
- We will use our influence to improve disclosures on climate change risks and opportunities in the UK pensions sector in line with the recommendations of the TCFD. We will use our voice to encourage policymakers to implement their net zero emissions targets and credible strategies to reach them, such as carbon pricing.

13 **iigcc.org**

How we will report and monitor success

Nest's climate change policy is overseen by the Trustee's investment committee and implemented by Nest Corporation's internal investment team. We will publicly report on the implementation and progress of our ambition and commitments on an annual basis.

Each year the investment team will review how we are implementing this climate change policy and will report these findings to the Trustee's investment committee.

We will hold our fund managers to account on how they implement their own climate policies and annually assess their progress towards our expectations as well as the objectives we set with them for the management of Nest's portfolios. We may share information across our fund managers in order to promote consistency and alignment of approaches across our whole investment portfolio.

This policy is intended to set out a pathway for change. It does not propose radical actions be taken simultaneously or straight away. We expect approaches to implementation will be adjusted and developed over time, with different actions taken at the right time. Our short-term targets and commitments are set out in our 2025 climate change roadmap.

Glossary

carbon pricing

Attempts to capture the external and often indirect cost of CO_2 emissions, which is borne by society, and shift this cost to emitters. It forms the basis for regulatory instruments such as carbon taxes.

Climate Action 100+

CA100+

Global investor initiative of more than 450 signatories with US$40 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

Committee on Climate Change

CCC

Independent statutory body that advises the UK and devolved governments on emissions targets, monitoring progress in reducing emissions and meeting carbon budgets.

theccc.org.uk

Conference of Parties

COP

Decision-making body for the UNFCCC that has met every year since 1995.

COP26 was originally scheduled to be held in November 2020 but has been postponed to 2021 due to the novel coronavirus pandemic. It is the first global stocktake of the 2015 Paris Agreement and an opportunity for countries to present and adopt more ambitious commitments. It will be co-hosted by the UK and Italy.

ukcop26.org

green finance strategy (UK)

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 purchased electricity, steam energy, heating and cooling that have been consumed by the reporting company. Scope 3 includes all other indirect emissions that occur in the reporting company’s value chain.

ghgprotocol.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

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+.

iigcc.org

Paris Agreement

The Paris Agreement was reached at COP21 in 2015. Its aim is to ensure global warming in the 21st century remains well below 2C above the average level recorded for the period 1850 to 1900 and to support efforts to limit global warming to 1.5C.

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

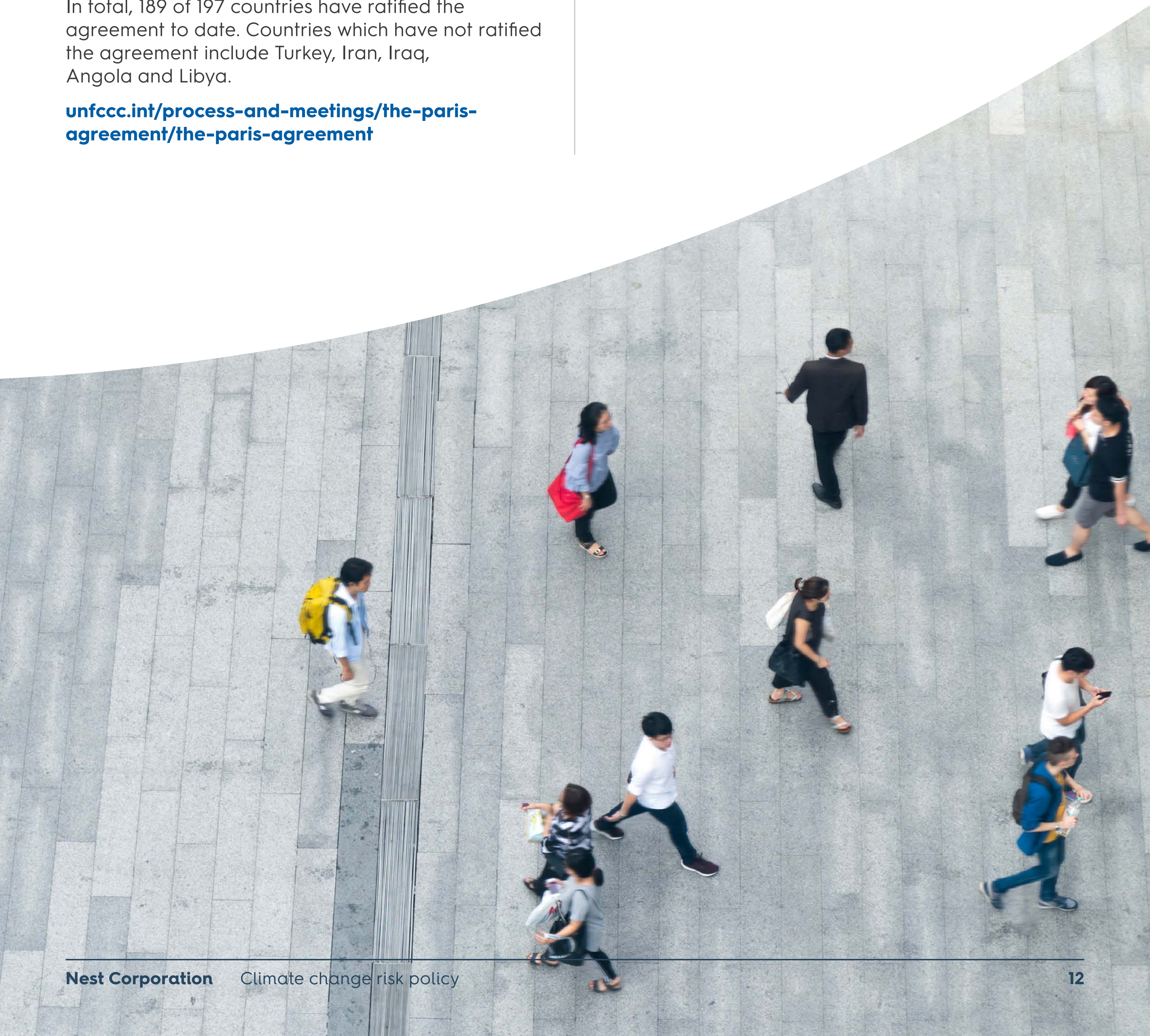
fsb-tcfd.org

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



Document history

Climate change risk policy		
Version	**Change**	**Date**
1	Document created	07/2020
2	Update to reflect key developments in first year of the policy	11/2021
3	Updated following internal review	12/2022

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