Investment

HM Treasury Consultation on the value case for a green taxonomy

Response from Nest Corporation

6th February 2025

1 About us

Nest was established in 2010 as part of the auto enrolment programme to help people save for retirement. Unlike any other pension scheme in the UK, Nest has a legal obligation to accept any employer that wishes to use us to discharge their auto enrolment obligations. Over 1.2 million employers have signed up to use Nest.

Over the last decade, Nest has grown to be one of the largest pension schemes in the UK. We are operating at scale as a high quality, low cost pension scheme helping over 13.7 million members save for their retirement. Many are low to moderate earners who may be saving into a pension for the first time.

Nest is built around the needs and behaviours of our members, from our approach to responsible investment to our focus on customer service. We now occupy a place in the market as a major Master Trust, helping to drive up standards and best practice across the industry. Nest has great potential for delivering pensions to mass market consumers for many years to come, leveraging our scale to deliver value through the combination of low costs, our market leading investment strategy and modernised services all overseen by strong trustee governance.

2 Response

We welcome the opportunity to respond to HM Treasury's (HMT) consultation on the value case for a UK green taxonomy. We believe that the taxonomy plays an important role in the UK's ambition to be a leader in sustainable finance and an area where further regulatory clarity is urgently needed.

We are supportive of a sequenced approach starting with criteria for climate change mitigation and adaptation followed by further environmental objectives and transition finance. The latter is an area which we feel is underdeveloped in existing taxonomies and therefore presents an opportunity for the UK to demonstrate leadership.

Given the development of taxonomies in other jurisdictions and increasing evidence of the benefits and drawbacks of these approaches, we believe that the UK should proceed with developing a robust, science-based taxonomy drawing on the most useful and relevant elements of the existing frameworks such as the EU taxonomy rather than developing an entirely new approach. We would also urge HMT to consider the reporting burden on companies facing disclosure requirements across multiple taxonomies and how to achieve a high level of interoperability. In light of this and further upcoming regulation, in particular the introduction of ISSB standards and transition planning, we are in favour of a voluntary approach to taxonomy-related disclosures initially, with a view to potentially introduce mandatory disclosures over time.

Question 1: To what extent, within the wider context of government policy, including sustainability disclosures, transition planning, transition finance and market practices, is a UK

Taxonomy distinctly valuable in supporting the goals of channelling capital and preventing greenwashing?

a) Are there other existing or alternative government policies which would better meet these objectives or the needs of stakeholders?

b) How can activity-level standards or data support decision making and complement other government sustainable finance policies and the use of entity-level data (e.g. as provided by ISSB disclosures or transition plans)?

We agree that one of the primary objectives of the taxonomy should be to tackle greenwashing and protect consumers. To that end, we believe that a UK taxonomy is an important complement to existing and prospective regulation. For example, the taxonomy could be used as a credible standard to demonstrate compliance with the criteria to obtain a sustainability fund label under the FCA's Sustainability Disclosure Requirements (SDR) and investment labels regime.

The taxonomy can also be used by preparers of transition plans to disclose targets for green and transition activities. A key challenge for investors like Nest is the lack of consistency in voluntary transition plans published by investee companies. A consistent classification system will help us to better assess the robustness of corporate transition plans as well as the impact that investee companies have on the environment and society, and support our stewardship and engagement activities.

In addition to tackling greenwashing, we believe that the taxonomy can also be helpful in supporting capital allocation towards net zero. This is not just limited to the creation of new products, but is also important in making it easier for investors to increase the allocation to taxonomy-aligned investments in mainstream products. As members of the Paris Aligned Asset Owners initiative (PAAO), Nest is expected to set a climate solutions target. To date we've taken a very conservative approach to this by only considering renewable energy infrastructure in our target. A key reason for this is the lack of a credible, science-based and widely accepted classification system (we did not consider the EU taxonomy appropriate due to the inclusion of natural gas) and a lack of resource to develop our own classification system. There is a risk, in the absence of such a framework, that companies do not disclose their activities due to concerns about reputational risk ("greenhushing").

We believe that the taxonomy will also be helpful in creating consistency in public and private sector investments and help government assess progress towards its net zero commitment.

While there are existing taxonomies in other jurisdictions, we see some benefits of a UK-specific taxonomy in particular for transition activities. We believe that transition activities need to be context-specific. For example, in emerging economies that are currently heavily reliant on coal-based electricity generation we see a bigger role for natural gas as a transition fuel than in the UK. We therefore believe that a UK taxonomy for transition activities would be beneficial in highlighting the areas where transition finance is most needed, and allow for capital to be channelled more effectively from both private and public sources. However, we also urge HMT to consider that financial market participants and listed companies will have exposure to jurisdictions with other taxonomies, and that interoperability could be a key barrier to the effectiveness of a UK-specific taxonomy.

Question 2: What are the specific use cases for a UK Taxonomy which would contribute to the stated goals? This could include through voluntary use cases or through links to government policy and regulation.

a) What are respondents' views on the benefits of the proposed use case (paragraph 2.2)?

We agree with the use cases set out by the Green Taxonomy Advisory Group in its report from June 2024.[1] and have outlined what we believe to be the key benefits in our response to question 1.

b) Are there any other use cases respondents have identified?

[1] **https://www.greenfinanceinstitute.com/wp-content/uploads/2024/06/GTAG-Final-Report-on-Policy-Links.pdf**

As highlighted in our response to question 1, we would add the role of the taxonomy in meeting other existing or prospective disclosure requirements as another key use case. We do not expect this list to be exhaustive and other use cases may be identified over time.

c) How does each use case identified link to the stated goals?

We've outlined what we believe to be the key benefits in our response to question 1.

d) Under these or other use cases, which types of organisations could benefit from a UK Taxonomy?

We believe that a UK taxonomy would benefit a wide range of stakeholders:

- Corporates: by providing greater transparency on the key economic activities supporting climate and environmental objectives, the taxonomy can help corporates make more informed capital allocation decisions. It may also reduce reporting burden for corporates, particularly alongside further regulation on transition plans and ISSB-aligned sustainability disclosures, by reducing the number of ad-hoc requests from investors and other stakeholders.
- Financial markets participants: Information on taxonomy-aligned activities can help investors better assess transition risks in their portfolios and serve as a framework to support their stewardship activities. It can also support investors in identifying investment opportunities with the greatest potential contribution to the UK's net zero goals, and support the development of new products.
- Government: The taxonomy can equally be used to assess the role of public spending in meeting the UK's climate targets. It will also help government assess progress towards its goal of being a leader in sustainable finance and support an economy wide transition.

e) For each use case identified, do respondents have any concerns or views on the practical challenges?

Our biggest concern, as highlighted in previous responses, is around interoperability and the additional resource and cost implications of having to report against multiple taxonomies. This is why we are supportive of a voluntary standard initially.

f) What is the role for government within each use case identified, if any (i.e. to provide oversight, responsible for ongoing maintenance, implement legislation, including disclosure requirements)?

We believe that in order for the taxonomy to be considered science-based and robust, there is a need for an independent oversight body to advise government on the technical criteria. It should work closely with government on regularly reviewing the criteria. Government also needs to consider how the taxonomy interacts with other regulatory measures and ensure that there is good communication between different departments and regulators around implementation.

Question 3: Is a UK Taxonomy a useful tool in supporting the allocation of transition finance alongside transition planning? If so, explain how, with reference to any specific design features which can facilitate this.

Yes, we believe the taxonomy can be a useful tool in the allocation of transition finance. The Transition Finance Market Review (TFMR) proposed a Transition Finance Classification System, which could be incorporated into the taxonomy. As highlighted in our response to question 1, we believe that this is an area that needs to be quite context-specific. In our view this is currently insufficiently captured in the EU taxonomy, which only considers "enabling" activities. We believe it's important to make a distinction between "green" and "transition" finance to ensure the integrity of the taxonomy, but there should be no hierarchy of green vs transitioning activities as both are important in helping the UK achieve its environmental objectives.

Question 4: How could the success of a UK Taxonomy be evaluated? What measurable key performance indicators could show that a UK Taxonomy is achieving its goals?

One of the key use cases of the taxonomy would be to allow the tracking of capital flows towards net zero goals (for example, looking at the percentage of capex aligned with the taxonomy for corporates, and the AUM allocated to taxonomy-aligned activities for investors). Other KPIs could include the number of financial products in the marketplace that draw on the taxonomy.

Question 5: There are already several sustainable taxonomies in operation in other jurisdictions that UK based companies may interact with. How do respondents currently use different taxonomies (both jurisdictional and internal/market-led) to inform decision making?

For investors like Nest, the most commonly used framework is the EU taxonomy. The primary use case for this is to assess allocation to climate solutions and report progress through initiatives such as the Paris Aligned Asset Owners initiative. We also review our investee companies' disclosure on revenues and capex alignment with the EU taxonomy. This can be helpful in assessing which companies are well placed to take advantage of transition opportunities, and which companies may be exposed to higher transition risk. This can inform asset allocation decisions as well as help us to identify stewardship priorities.

Question 6: In which areas of the design of a UK Taxonomy would interoperability with these existing taxonomies be most helpful? These could include format, structure and naming, or thresholds and metrics.

We believe that interoperability on format, structure and naming, and metrics would be helpful. There are good reasons why the UK may wish to diverge from the EU taxonomy on thresholds.

Question 7: Are there any lessons learned, or best practice from other jurisdictional taxonomies that a potential UK Taxonomy could be informed by?

The most important learning from the EU taxonomy is that the taxonomy must be subject to robust scientific criteria and immune to political lobbying. We believe that the inclusion of natural gas in the EU taxonomy has significantly undermined its usefulness and is one of the reasons why we don't currently feel comfortable using it.

The EU taxonomy also does not currently define "transition activities". While there is a provision for "enabling activities", in practice we have seen companies struggling with this definition. The development of a "transition activities" category could also avoid the pushback the EU faced around including natural gas activities in its taxonomy.

Given these concerns, we are also in favour of a more principles-based approach rather than a very narrow set of defining criteria which leads to a significant resource burden for corporates and investors. In the EU, average taxonomy-aligned levels of capital expenditure have remained mostly flat in the last two years.[2] This may suggest that the scope is overly narrow. We believe that extending the taxonomy to transition activities will be crucial in meeting the UK's objectives but will require some flexibility and will likely vary across different sectors.

Question 8: What is the preferred scope of a UK Taxonomy in terms of sectors?

Our preferred approach is base this on the EU taxonomy register of activities and mapping with the addition of sectors relevant to the UK economy, such as agriculture, forestry and fisheries.

[2] **https://www.sustainalytics.com/esg-research/resource/investors-esg-blog/current-state-of-eu-taxonomy-alignment-2024**

Question 9: What environmental objectives should a UK taxonomy focus on (examples listed in paragraph 3.3)? How should these be prioritised?

Again, we would welcome the UK building on the EU taxonomy. We agree with starting with climate mitigation and adaptation and extending to other environmental objectives over time.

Question 10: When developing these objectives, what are the key metrics which could be used for companies to demonstrate alignment with a UK Taxonomy?

The key metrics for corporates would be percentage of revenues and capex aligned with the UK taxonomy. For financial services, this should be financing activity.

Question 11. What are the key design features and characteristics which would maximise the potential of a UK Taxonomy to contribute to the stated goals? Please consider usability both for investors and those seeking investment. This may include but not be limited to the level of detail in the criteria and the type of threshold (e.g. quantitative, qualitative, legislative)

Some of the key elements necessary to make the UK taxonomy a success in our view include:

- Robust, scientific and independent determination of screening criteria
- Embedded into policymaking with support across departments and regulators
- A voluntary standard initially, with mandatory disclosures sequenced appropriately by starting with real economy companies before extending disclosure requirements to financial institutions

Question 12. What are respondents' views on how to incorporate a Do No Significant Harm principle, and how this could work?

We believe that a Do No Significant Harm principle is important to protect against unintended consequences. We are aware of challenges in the EU taxonomy given that all economic activities may have some negative consequences, and the inherent subjectivity in determining what constitutes "significant harm". It's important to strike the right balance here. An overly strict interpretation will lead to a low-level of taxonomy alignment, but it needs to be robust enough to ensure the taxonomy remains credible.

We believe that the EU taxonomy's DNSH criteria would be an appropriate starting point but that the UK should consider whether potential deviations would be appropriate.

Question 13. It is likely a UK Taxonomy would need regular updates, potentially as often as every three years.

a) Do you agree with this regularity?
b) Would this pose any practical challenges to users of a UK Taxonomy?
c) Would this timeframe be appropriate for transition plans?

We agree with this regularity and believe that a similar approach is appropriate for transition plans, at least in the first instance. We don't believe that "green" activities will change substantially but in our view, what is considered "transition finance" will vary over time. This timeframe also aligns with the European Commission's reviewing of the EU taxonomy's TSC every three years and therefore supports interoperability.

Question 14. What governance and oversight arrangements should be put in place for ongoing maintenance and updates to accompany a UK Taxonomy?

We would be supportive of an independent advisory body building on the work of the GTAG to advise HMT on the technical criteria for the taxonomy to ensure it remains science-based. This is particularly important it transition activities are brought into scope. We expect that over time, disclosure requirements based on the taxonomy may be implemented by a range of government departments as well as regulators but believe it is appropriate for Treasury to maintain overall oversight, with close coordination with other departments.