ASSET OWNERS NETWORK

DELIVERING A NET ZERO INVESTMENT STRATEGY

Practical example: National Employment Savings Trust (NEST)

THE PRINCE OF WALES'S CHARITABLE FUND

nest

WHAT

Nest Corporation is the trustee for the UK's biggest pension fund by members, National Employment Savings Trust (Nest). This pension scheme was created as part of the UK government's automatic enrolment reforms for workplace pensions.

In July 2020, we announced a new climate change policy, which sets out our ambition to align our entire investment strategy with limiting global warming to 1.5°C. To achieve this, we expect to halve our greenhouse gas emissions by 2030 and reach net zero greenhouse gas emissions by 2050 at the latest.

We have made specific commitments for how we will achieve this in the following areas of our work:

- Asset allocation
- Fund manager selection and monitoring
- Stewardship
- Public policy

An immediate step was to reallocate all of our developed market equity allocation in the default fund to climate aware strategies – representing £5.5 billion of members' money. Our climate aware fund positively tilts towards companies mitigating and adapting to climate change such as those producing renewable energy and green technology and those with strong carbon reduction plans in place. This move represented 45 per cent of our entire portfolio and had an immediate effect on the default funds in which more than 9 million of our members remain.

WHY

Pension funds have long-term investment horizons, so it's important for us to manage the long-term impacts of climate change on our portfolio. It's not only about the future, though: climate change is affecting asset prices today and we need to stay ahead of evolving regulation.

We have been concerned about our exposure to climate change risk for many years. With our ambitious new commitments in our climate change policy, we can build on our previous work and manage climate risk and opportunity consistently across all of the assets we manage. There's also a lot of evidence that taking into account environmental, social and governance (ESG) factors improves risk-adjusted returns.

Our climate change work also helps us to show our members that investing is not just about what happens to their money when they retire. They can see how their capital can be used now to have a positive impact on the environment and their communities. We are finding that this helps to engage members, the majority of whom expect us to be investing responsibly.

HOW

We started by building up our evidence so that we could develop a business case for our scheme's trustees. Tracking news stories helped to demonstrate that companies thinking about long-term climate risk are more likely to be successful and to manage these risks well. Big insurance companies told us that they have been pricing in climate change risk for several years now. Our own data also supported our decision to invest significantly into our climate aware fund, with a strong three-year track record on a range of risk and return metrics.

From our research, we developed the new climate change policy, which includes specific bold commitments to act on immediately. For example, under our strategy for asset allocation we have committed to divest from companies engaging in the most environmentally damaging and financially risky fossil fuels and business activities, such as thermal coal, oil sands and Arctic drilling. To do this, we plan to divest from any companies with more than 20% of their revenues coming from these activities by the end of 2020, and divest completely from all relevant companies by 2030 at the latest. We will annually review the policy and our progress.

To integrate climate change across all of our portfolios we need to collaborate with fund managers, who deliver our investment strategy. We have now set expectations for how our fund managers work towards our goal of 1.5°C, and they must demonstrate to us how they will go about halving the emissions of our portfolio by 2030. We anticipate that this can provide a multiplier effect by encouraging big fund managers to make further changes, potentially shifting the investment industry even more.

A climate-focused approach to stewardship, too, helps us to build more sustainable portfolios. By engaging in dialogue with companies and voting on relevant resolutions, we can make a tangible difference to whether and how those companies transition towards a low-carbon economy.

ENGAGING WITH STEWARDSHIP

Stewardship and engagement were big parts of our earlier strategy. We have strengthened our approach and brought it through into our new policy. This is how we will keep the pressure up on companies to align with a 1.5°C future.

Previously, we focused on creating incentives for companies to make positive changes. In the new policy, where our engagement is unsuccessful, or where 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 take place after several escalation options have been explored, such as engaging collectively with other investors, voting against management or speaking at the annual general meeting (AGM).

Our view is that companies that are part of the problem now could well be part of the solution in the future. Wherever possible, we want to support that change by sharing best practices and encouraging companies to take steps in the right direction. So we're not operating a blanket exclusion for companies in most industries, but instead trying to bring companies with us as we work towards a net zero carbon future.

As well as engaging directly with companies, we will promote sustainability by exercising our voting rights. In general, we will support shareholder resolutions that ask companies to improve their climate-related disclosures. We will vote against management resolutions that fall short of our expected standards on sustainability. To help us manage these activities, we have put in place voting and engagement standards that explain our approach to several areas of concern, including sustainability.

WORKING WITH FUND MANAGERS

Our internal investment team focuses on procuring and monitoring our fund managers. Keeping this function in-house shortens the investment chain, giving us a more direct relationship with our fund managers.

There are three key things that we want fund managers to do when managing all of our portfolios:

1. Report on climate change risk and opportunities in line with the recommendations of the Task Force on Climate-related Financial Disclosures.

2. Plan how to align the portfolios with the goal of 1.5°C global warming, including how they plan to halve emissions by 2030.

3. Vote and engage with companies in their portfolio to encourage them to transition to low-carbon approaches.

Introducing this aspect of the climate change policy will be easier when appointing new fund managers, because we can detail our expectations at the procurement stage. For existing fund managers, we are asking them to tell us how they plan to address our requirements: how they will adapt their portfolios, how they will measure their progress and how they will report to us. Fund managers will have three years to put those plans in place, and we will monitor their progress.

Our direct relationship with fund managers opens the way for other possibilities, too. Asking fund managers to vote in line with our policy on our portfolios creates impact – but that impact is amplified if fund managers choose to adopt a similar policy themselves. Even the biggest pension funds are small compared to the biggest fund managers. By keeping an open dialogue and encouraging our fund managers to embed ESG into their own activities, we can drive greater change than we could achieve alone.

NEXT STEPS

One challenge for us is tracking our progress towards net zero carbon emissions. The methodology should align with our 1.5°C pathway and measure our progress across all asset classes. It's an area that we're still working on.

Building on our work in developed equity, we would like to take a similar approach with emerging market equity. We want to make sure that underlying investments for this asset class are also on the right path for creating a 1.5°C world. The data here is not as strong, though. After examining the quality of the data, we will decide whether and how to adapt our approach.

We would like to create space for a two-way dialogue with our members and are exploring fintech solutions. At the moment, we are mostly informing members what we're doing. Member feedback could help us to prioritize where we commit our resources. It could even improve our engagement with companies, by showing that our vote represents the views of a large number of members who cared enough to express a preference.

"It's clear climate change poses serious risks to both our members and their investments. If we fail to act, we'll leave our portfolio more exposed and less able to achieve the right long term risk-adjusted returns.

Every scheme should carefully consider the risk climate change poses to their funds and what their options are. Different portfolios will face different challenges, so it's important we share information to help schemes make the right decisions.

Taking the first step is important. You don't need to have every detail mapped out - setting your commitments and intentions in relation to tackling climate change can get you on the right path."

CHRIS HITCHEN,
CHAIR OF NEST'S INVESTMENT COMMITTEE

TOP TIPS

SET OUT YOUR INTENT

Be clear about your goals and what you want to achieve. You don't have to know how you're going to deliver on every aspect. We found it helpful to set out our intentions publicly so that we had something to start working towards.

CHOOSE THE RIGHT FUND MANAGERS

Having the right team of fund managers makes a huge difference. Help them to understand why thinking about climate change risk and other ESG factors is important. We've found that our fund managers have been very open to these ideas, but they needed the right push from their clients.

BE AN ACTIVE SHAREHOLDER

By engaging with the companies that you're invested in, you can use your influence to bring about real change. It also makes a difference to talk about being an active shareholder. Talking openly about your experience and collaborating can encourage others in the industry to take a similar approach.

CHECK THE NUMBERS

It's vital to be evidence-based when you are making decisions about sustainable investing and pension funds. Make sure that you have good numbers and strong evidence. This will help you to demonstrate the rationale for what you're doing and to follow through in a meaningful way.

SPEAK TO YOUR SAVERS

Communicating with members about sustainability will become increasingly crucial for pension funds. Input from savers is also a way to develop a stronger licence to operate.

GET IN TOUCH OR FIND OUT MORE

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A4S ASSET OWNERS NETWORK

The A4S Asset Owners Network is a grouping of pension fund chairs and trustees to discuss integrating sustainability into investment decision making. Click here to find out more.