



**A4S**

**ASSET OWNERS  
NETWORK**

# SETTING A NET ZERO INVESTMENT STRATEGY

**Case study: Scottish Widows Master Trust**



THE PRINCE OF WALES'S  
CHARITABLE FUND

**SCOTTISH WIDOWS**



# WHAT?

Scottish Widows Master Trust is a part of the Scottish Widows Group. The scheme is a defined contribution scheme, with £620 million assets under management and 45,000 members.

We have committed to a net zero greenhouse gas (GHG) emissions target by 2050 or earlier, across all our investments, with significant progress to have taken place by 2030. We have been transparent about our climate change targets, publicly presenting our position in our climate change guide, **Scottish Widows Climate Change Approach: Achieving Net Zero in Our Investments by 2050**.

We have participated in developing and implementing the **Institutional Investors Group on Climate Change's (IIGCC's) Net Zero Investment Framework**, which has helped us to define our net zero investment strategy.

The scheme is just starting out on its net zero journey and we do not anticipate that we will have finalized our internal discussions and decision making until the end of 2022.

## OUR CLIMATE CHANGE TARGETS

Our ambition is to align all our investments with limiting global warming to 1.5°C above pre-industrial levels by targeting net zero carbon emissions by 2050 or earlier. To do this we're introducing:

- ✓ A 2025 target of increasing investment in companies adapting their businesses to be less carbon-intensive and developing climate solutions
- ✓ A 2030 target of halving the carbon footprint of our investment portfolios
- ✓ A 2050 target of net zero across the entirety of Scottish Widows' investments

By committing to gradually reduce the overall emissions contained in our investment portfolios to net zero, we'll be assisting and incentivising companies we invest in to embark on decarbonisation pathways of a scale and pace needed to meet the 1.5°C global warming objective of the Paris Climate Agreement.

The extent to which we can meet our targets will depend on the pace towards net zero of the wider economy. However, our future investment decisions on asset allocation, company exclusions and shareholder engagement will be driving the transition to carbon neutral in the real economy.

Figure 1: Scottish Widows climate change targets (Source: 'Scottish Widows Climate Change Approach – Achieving Net Zero in Our Investments by 2050')



## WHY?

We are taking net zero action to align with the global efforts to achieve the goals of the Paris Agreement. We anticipate that, especially given COP26 and other international activity relating to climate change, the Paris Agreement targets may become more ambitious in the near term, and we will stay close to these developments in case we need to adjust our target dates and strategy.

Climate change is a high rated risk on our scheme's risk register, which we are mitigating by creating a coherent and well-planned net zero strategy. As an accepted core risk, climate

change discussions and decisions are smoother, and we have largely avoided the need to spend a long period of time debating the need to act among the trustees or with wider stakeholders.

Regulation and international policy have had a clear climate focus over recent years, which signalled to us that this was something we had to address substantively from within our scheme, before regulation and mandatory requirements were set down. We wanted to be an industry leader taking action on transitioning to a net zero-aligned investment strategy.

In addition, we believe that actively managing climate risk is consistent with our fiduciary duty as trustees and will provide better risk-adjusted returns to members over the long term. It also mitigates our members' exposure to the wide variety of risks to their pension which could materialize due to climate change.



## HOW?

Having logged climate risk as a financially material strategic risk on our risk register, we had to respond with a mitigation plan. We see mitigation as an opportunity to diversify our investments to attractive emerging sectors as well as tilting away from carbon-intensive industries. This was our trigger to take action.

We have already started to implement the **Task Force on Climate-related Financial Disclosures (TCFD) recommendations**, including preparing for annual reporting commencing next year. We believe that TCFD will be an important tool in developing our net zero investment strategy further over the coming years.

The next step, which we will achieve over the coming months, is for the board of trustees to document a roadmap covering the activities we intend to undertake to reduce and to measure the reduction in our GHG emissions.

Using the TCFD framework has not only benefited our internal planning but has also helped us to influence reporting from our fund managers. Selection of our third-party fund managers includes assessing them against the following three criteria:

1. Disclosure in line with TCFD
2. The fund manager's own net zero alignment
3. The fund manager's UK Stewardship Code signatory status and relevant experience

The main benefit of working with TCFD-reporting fund managers is ensuring a certain amount of consistency of reporting across all our third-party managers, which means we do not have to find the time or resources to translate disparate data into one format.

Being a signatory of the UK Stewardship Code is an initial indication that the fund manager has a baseline understanding of active-investment stewardship. We expect appointed fund

managers to demonstrate how they will fully utilize the opportunities stewardship presents for aligning with net zero outcomes.

We have recently commissioned a review by our investment adviser of our Statement of Investment Principles (SIP), with a plan to create a new version including both net zero and wider environmental, social, governance (ESG) details by October this year. This work will take in a review of our ESG Policy, Voting Policy and the drafting of a new Climate Governance Policy. It will also drive expansion of the content of our Investment Governance Reporting Framework to ensure we can demonstrate adherence with our policies and measure progress towards ESG objectives.



## OUR STRATEGIC OBJECTIVE FRAMEWORK

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We developed our Strategic Objective Framework (**Figure 2**) to guide all key activities of the scheme. As far as possible we have used plain English, to help members understand how we invest their money. Taking investment as an example, we started this by defining a hierarchy of statements.

1. The first level is the trustees' strategic objective: "To be trusted by members to help them to achieve good retirement outcomes and value for money."
2. We then developed the second level, which is the trustees' investment strategy: "To maximise risk adjusted investment returns for our members in a way which aims to achieve equity between different cohorts of members," ie our investment strategy is based upon lifestyle flightpaths.

3. Our third step was to define our investment objective: "To invest members' savings in a way which will make them grow faster than inflation."
4. The fourth level of our hierarchy is a set of investment beliefs, including an explicit net zero belief: "We believe that our immediate priority is to address man-made climate change which poses a huge risk to everyone. Therefore, our objective is to implement an investment strategy which will move towards a net zero investment portfolio by 2050." We believe that embedding an explicit investment belief that prioritizes tackling climate change demonstrates our formal commitment to achieve net zero.

This exercise has allowed us to redesign our Investment Governance Reporting Framework to report on metrics aligned to our investment strategy, objective and beliefs. However, this has also presented the biggest challenge to implementing our net zero approach. The lesson we have learned has been the need to design our reporting metrics parallel to our investment beliefs, ensuring we do not have to rework the latter if appropriate monitoring data is unavailable.

Finally, we will review both our stewardship and voting policies alongside our new SIP to ensure they support our Strategic Objective Framework.

## SCOTTISH WIDOWS MASTER TRUST STRATEGIC OBJECTIVE FRAMEWORK

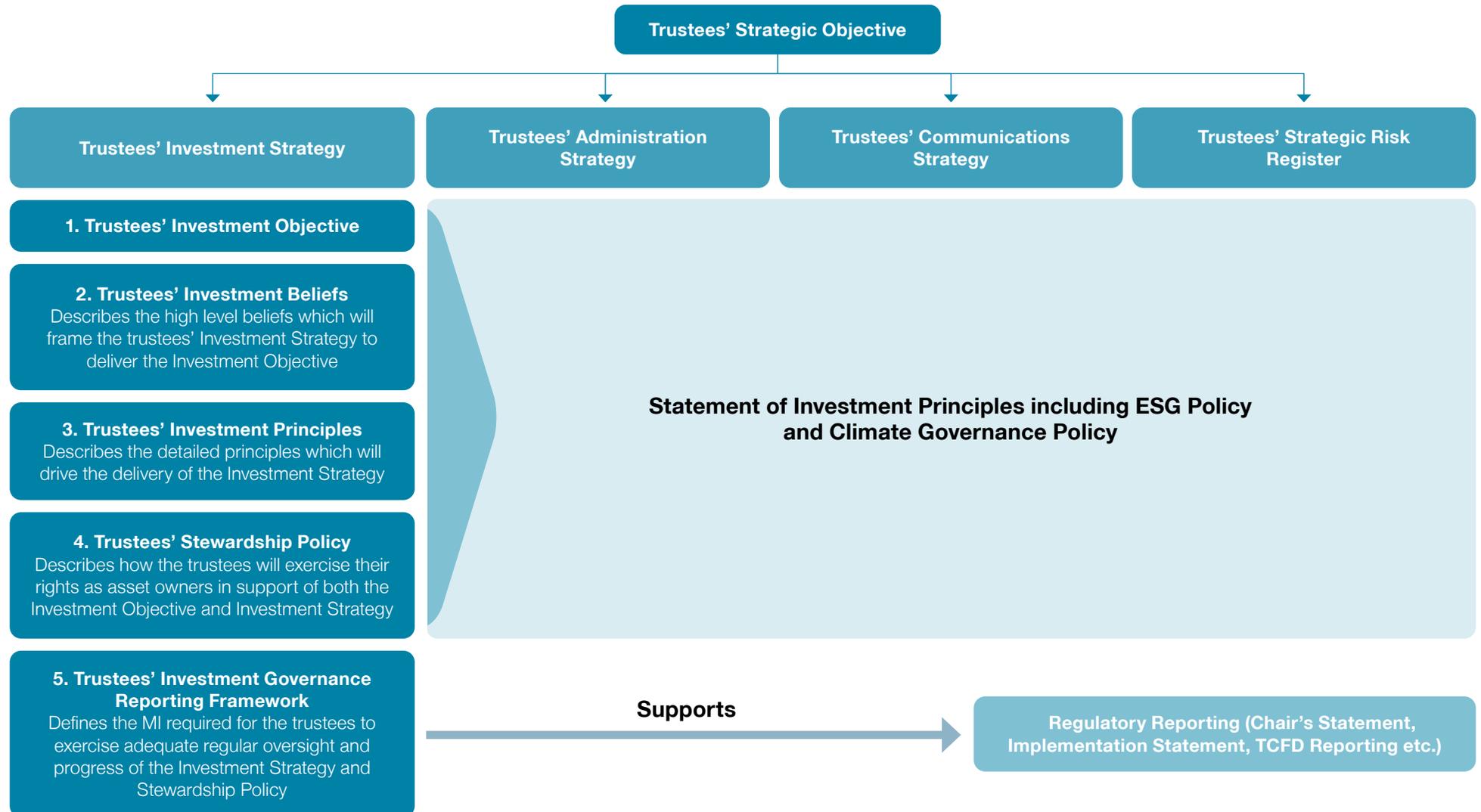


Figure 2: Strategic Objective Framework (Source: Scottish Widows Master Trust)

## STAKEHOLDER ENGAGEMENT

### Engaging our members

To respond to growing member interest on climate change, we are working closely with Scottish Widows Group on a range of digital communication approaches for our members. We are keen to gather member views to help us understand what they would like us to do, supporting our fiduciary responsibility. We will develop a range of digital tools to engage our scheme's members and to seek their views and preferences. This will provide us with a new level of granularity and coverage in respect of their views across several topics, including ESG. We hope these member views will support trustee decision making in the future, as we gain insight into what our members really want.

It is important to us that our members understand our investment objective and beliefs. To help achieve this, we have produced a member-facing climate change guide, to support their knowledge on the issue, including what the current international response is, as well as our pension scheme's investment response. An example extract from our guide is shown in Figure 3.

### Engaging our clients (sponsoring employers)

There is a growing realization that many businesses' own climate approaches and net zero commitments do not align with that of their pension schemes. Our clients and potential clients want to know about our scheme's position on these issues and we are increasingly looking to communicate this. We anticipate a growing market for ESG-integrated and net zero-aligned master trusts. We think master trusts with strong investment governance and a clear net zero investment strategy will become the preferred suppliers for employers and as preferred destinations for existing defined contribution scheme trustees.

To engage our sponsoring employers, we have hosted a series of webinars on net zero and ESG. Through this channel we have created an opportunity for our trustees to speak directly to the sponsoring employers, have an interactive discussion and provide answers to their questions, including questions regarding our alignment with Scottish Widows as a financial services institution. We have plans to produce video blogs and release thought leadership pieces to elevate the engagement with employers and their employees (our underlying members).

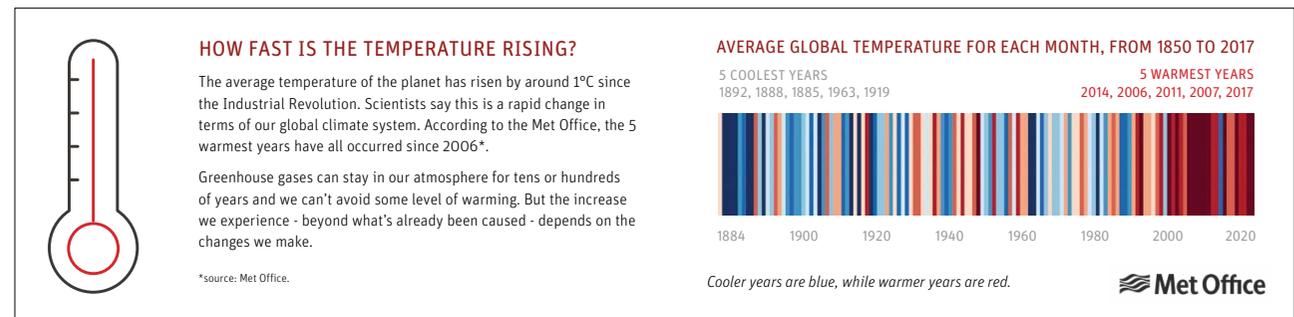


Figure 3: Example content from climate change guide (Source: 'Scottish Widows Climate Change Approach – Achieving Net Zero in Our Investments by 2050')



## NEXT STEPS

Over the next six months, we will create a roadmap presenting the key milestones we intend to deliver to meet our net zero target. This will involve discussing and agreeing more detailed approaches to our net zero investment strategy, such as our approach to carbon offsetting and completing the review of our SIP.

We plan to perform continuous engagement activities with our members and sponsoring employers (our clients). We will host further webinars, create a video blog series and also roll out new digital tools to our members.

We will continue to be an active member of the IIGCC and engage on recommendations to deepen net zero practice within our scheme and across the industry.

# TOP TIPS

## **DEVELOP A CLEAR STRATEGIC OBJECTIVE, INVESTMENT STRATEGY, INVESTMENT OBJECTIVE AND SET OF INVESTMENT BELIEFS FOR YOUR SCHEME**

Being clear what you are trying to achieve can focus your investment deliberations and avoid misleading interpretations.

Formalizing your net zero approach within your ESG investment beliefs demonstrates a deep level of commitment to net zero and keeps ESG at the front of trustees' minds.

## **DO NOT UNDERESTIMATE THE TIME IT TAKES TO PLAN**

The creation of a new strategy requires additional time and energy from the trustees, over and above running the everyday business of the scheme.

Plan this extra time in and set expectations around deliverables and outputs.

## **COLLABORATE WITH PEERS**

Speak to other organizations who have already defined their net zero investment strategy.

It is valuable to use the experience of others and benefit from their lessons learned. Industry initiatives such as IIGCC are also there for that purpose.

## **DEVELOP THE DIFFERENT ELEMENTS OF YOUR APPROACH IN PARALLEL**

We have benefited from designing our reporting methodology in parallel to developing our ESG and net zero investment strategy and beliefs. By not leaving the design of your metrics to the end of the process will help you to avoid possible rework due to data gaps.

## **DEVELOP A METHODOLOGY FOR IDENTIFYING AND AVOIDING “GREEN WASH” RESPONSES FROM YOUR SERVICE PROVIDERS**

We have done this by building compliance with the IIGCC net zero framework and the UK Stewardship Code into our fund manager procurement and monitoring process. There are plenty of other international ESG metrics you could consider in addition to these two.

## GET IN TOUCH OR FIND OUT MORE



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The Prince's Accounting for Sustainability Project (A4S)



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[www.accountingforsustainability.org](http://www.accountingforsustainability.org)



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