Task Force on Climate-Related Financial Disclosures (TCFD) Report for Nest's investments 2023/24

September 2024

nestpensions.org.uk

The data reported in this report has been obtained from the investment managers of each portfolio. The draft report was shared with the investment managers for verification prior to publication. Nest Corporation assume no responsibility for the accuracy of the data.

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Foreword from the Chair

Nest Corporation as Trustee of the Nest Scheme believes that 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. Both the physical impacts of a sustained rise in global temperatures such as more frequent extreme weather events, and the economic impacts of transitioning to a low-carbon economy will affect the investments we make on behalf of our members. Climate change risks could impact our members through lower returns on their retirement savings and a lower quality of life in retirement. If we do not take these risks into account in our investment strategy, they could threaten our goal to build financial peace of mind for all.

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 our progress in the 2023/24 financial year, which ran from 1 April 2023 to 31 March 2024. This report supplements the summary in our Scheme annual report and accounts for 2023/24 and details how climate change is considered by the Board and implemented in investment decision-making, and the metrics and targets we use to track progress.

Our commitments

In 2020 we set an ambition to align our investment portfolio with limiting global warming to 1.5C by reaching net zero emissions across our portfolio by 2050 at the latest. This is aligned with the commitment made by governments across the world through the Paris Agreement, and consistent with the UK's legislated target of net zero emissions by 2050. Analysis carried out by Aon on our portfolio, shown on pages 17-20 of this report, also showed that over a 30-year horizon, our investments will perform best in a scenario where warming is limited to1.5C.

We manage climate-related risks and opportunities through four distinct areas of the investment process:

Asset allocation

Manager selection and monitoring

Stewardship

Public policy

Our progress

We are pleased with the progress we've made over the year across all four of these areas. This includes the following milestones:

- We have achieved a 33% reduction in the Scope 1+2 carbon footprint for our listed equity and fixed income funds since 2019. This is ahead of our target to achieve a 30% reduction in Scope 1 and Scope 2 carbon footprint in our listed equity and corporate bond mandates by 2025 from a 2019 baseline. This means that around 70% of our portfolio has a decarbonisation target.
- Over the past year, the carbon footprint of our equity allocation, which makes up around half of our default fund, has reduced by almost 10%. These reductions have been mostly driven by changes in the make-up of the portfolio, as well as improvements in the carbon performance of some of the assets we hold. We, alongside our fund managers have also been engaging with companies over many years on emissions reductions and this may have started to help reduce the overall carbon footprint too.
- Alongside emissions reductions, we also report on portfolio alignment by measuring the percentage of holdings that have **Science Based Targets Initiative** (SBTi)[1] approved decarbonisation targets. 21% of assets in our default fund now have an SBTi-approved target, up from 18.8% last year.
- Almost all of the climate-related objectives we set for our fund managers when we first published our climate change policy were achieved in full by the end of 2023. We continue to work with our managers on the few outstanding objectives.
- We have now invested almost £1.3bn in renewable infrastructure equity and debt and are well on track to meet our target of £1.4 billion by 2030.
- We appointed Lombard Odier Investment Management to manage a new thematic equity fund for us, which will help us gain access to more investable opportunities in climate mitigation and adaptation.
- In the past year, we have also continued engaging with several of the energy companies on their plans to transition to net zero generally, and on their plans to reduce fossil fuel production specifically. In early 2024, we updated our voting guidelines on climate change to set clearer expectations of companies publishing say-on-climate resolutions. You can read more about our stewardship activities in our **responsible investment report.**
- We continued our work with the UK Treasury's Transition Plan Taskforce (TPT), which was set up to establish best practice for firm-level transition plans and develop a set of templates setting out both baseline and sector-specific disclosures and metrics. This year, we contributed to the development of the sector-specific guidance for asset owners and were part of the Just Transition Working Group, which provided guidance on how to anticipate, assess and address social risks and opportunities of the transition to net zero, and ensure meaningful dialogue with impacted groups such as workers, communities, supply chains and consumers.

[1] The SBTi is a partnership between CDP, the United Nations Global Compact, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF). Companies submit their decarbonisation targets to SBTi for validation based on sector-specific science-based criteria.

Looking ahead

As ever the political, regulatory and industry landscape is constantly evolving, and we need to remain at the forefront of developments. Earlier this year, we started a review of our climate change policy to ensure it remains relevant and continues to focus on the most pertinent issues for members. The updates to the policy will include a greater focus on the physical risks of climate change, the connection between climate and nature risks and the social aspects of climate change. We expect to publish an updated policy in the second half of 2024. We will also be running our triennial scenario analysis to assess the potential outcomes of different degrees of warming on our asset allocation and members' pension pots.

The transition to net zero will be challenging, but we are committed to managing the risks and opportunities that it brings to achieve the best outcomes for our members. We look forward to continuing to report on our progress in next year's report.

Brendan McCafferty
Chair, Nest Corporation

26 September 2024

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. Over this time horizon, climate-related risks and opportunities are likely to increase and have an impact on Scheme members' pension pots. As the Trustee of the Scheme, Nest Corporation sees consideration of climate change as a key part of our fiduciary duty to members. For this reason, we have embedded the consideration of climate-related risks and opportunities into our investment strategy.

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

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. As of October 2023, the TCFD has fulfilled its remit and has been disbanded. The Financial Stability Board has tasked the International Financial Reporting Standards (IFRS) Foundation to take over the monitoring of companies' climate-related disclosures and has incorporated the TCFD recommendations in its IFRS S2 Standard on *Climate-related disclosures*.

In line with these recommendations, this accompanying document to the **Scheme annual report and accounts** is structured into four sections corresponding to the four thematic areas of the TCFD framework:

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.

This report covers our activities to address and manage climate-related risks and opportunities in our investment strategy during the 2023/24 financial year, which ran from 1 April 2023 to 31 March 2024. Further information on our broader responsible investment activities can be found in our **2023/24 responsible investment report** 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 2023/24.

Section 1

Governance

The Board’s oversight of relevant 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.

The Scheme has one Trustee: Nest Corporation. The Trustee is a public corporation. The Board has responsibility for the overall direction of the Trustee. The Board can have between 9 and 15 members, including the Chair. They are the directors of the Trustee.

The Board maintains oversight of climate-related risks and opportunities as part of its remit of having responsibility and oversight for the Scheme’s investment policy and strategy. Our duty to serve every employer with auto enrolment duties, and their workers, is written into the **Nest Order and Rules** as a public service obligation, like the one the BBC or NHS has. The Nest Order gives the Board the sole power to invest the Scheme’s assets. In addition, the Nest Rules confirm that the composition of the underlying investments attributed to each investment fund shall be determined by the Board. The Board cannot delegate the setting of the investment strategy.

The Board delegates some investment decisions to the investment committee, which currently has five members. Two members of the investment committee members are members of the Board. There are three subject matter experts on the committee who are not Board members. The Board retains the powers relating to, and responsibility for approval of:

- Our investment objectives, beliefs and related investment strategy, and any proposed changes.
- The approval of the **Statement of investment principles** (SIP).
- Any additions, changes to objectives, or deletions to fund choices.
- Any required changes to the body of the investment management agreement with Nest Invest Ltd (see page 10).
- Our statutory reporting on responsible investment, including the annual **Statement of investment principles implementation statement** and this report on our climate change progress.

These continued responsibilities and approvals give the Board confidence that its statutory obligations and fiduciary duties are being met.

The Board has delegated responsibility for review of the above matters to the investment committee, and, where relevant, the committee gives its recommendation to the Board.

In addition, the investment committee has responsibility for:

- Approval of our **climate change risk policy**.
- Approval of our annual **responsible investment report**.
- Oversight and approval of our **responsible investment objectives and policies**, including our voting and engagement policy and our stewardship conflicts of interest policy.
- Annual approval of our investment risk appetite statement.
- Approval of strategic asset allocation and changes to the investable universe.
- Review and oversight of the implementation of our agreed investment strategy, activity, costs and performance.

Time and resources

The investment committee assesses and manages climate-related risks and opportunities supported by quarterly updates and information provided by the Chief Executive Officer (CEO) and Chief Investment Officer (CIO) of Nest Invest. The committee is also provided with detailed papers on all the above

matters as required throughout the year. Key performance indicators on climate-related risks and opportunities are provided to the investment committee biannually.

During 2023/24 the investment committee met eight times. In addition to the responsibilities set out above, the committee's work during the year included but was not limited to:

- A workshop to discuss updates to our **climate change risk policy**.
- Maintaining oversight of the investment performance and risk management of the Scheme's default investment strategy and the other fund choices available to members, including approving changes in asset allocations as required.

The Board also receives a regular report from the chair of the investment committee. This includes key updates on the management of climate-related risks and opportunities, where relevant. The Board undertakes periodic training in relation to Scheme governance and Board members' knowledge and understanding. The Board last received training on climate-related risks and opportunities in early 2022.

The allocation of time and resources is in line with the Board's delegations and approvals. It also reflects the Board's broader remit and the investment committee's specific role to consider, make decisions on and provide oversight and challenge of all investment issues. These allocations are kept under review in light of our improving understanding of the types, likelihood and impact of climate-related risks and opportunities, including the understanding we have developed through the activities documented in this report.

Oversight of those undertaking or assisting with governance of relevant climate-related risks and opportunities

Nest Invest Ltd, a wholly owned subsidiary of Nest Corporation, was authorised by the Financial Conduct Authority (FCA) as an occupational pension scheme firm in January 2020.

Nest Invest's relationship with Nest Corporation is governed by an investment management agreement (IMA) under which Nest Invest undertakes to provide investment management and other investment services.

Under the schedules to the IMA, Nest Invest undertakes to:

- Provide advice, recommendations, and assistance to the investment committee in relation to environmental, social, and governance (ESG) issues, responsible investment, and active ownership. This includes advice, recommendations, and assistance around the management of climate-related risks and opportunities.
- Comply with and seek to give effect to our policies on responsible investment and other similar policies including our climate change risk policy.
- Focus on the objective of maintaining the Trustee's reputation with stakeholders and the media as a high-quality responsible investor.

The investment committee, through its terms of reference, is responsible for reviewing whether Nest Invest is taking adequate steps to identify, assess, and manage climate-related risks and opportunities and is given clear direction about how and when it reports to the Board on Nest Invest's work.

Reporting and communications

As noted above, the CEO and CIO provide updates at least quarterly to the investment committee on the responsible investment activities carried out on the committee's behalf, including in relation to climate change.

In 2023/24 the CEO and CIO 's updates included information about:

- Our progress in developing and monitoring the effectiveness of existing investment fund strategies that take account of climate-related risks and align these strategies with the Paris Agreement's target of limiting global warming to 1.5C above the average temperatures recorded before modern industrialisation.

- Our proxy voting activities and company engagement, including how we have engaged with certain sectors on climate change.
- Our engagement with standard setters and regulators, including responses to public consultations on climate change such as the Transition Plan Taskforce disclosure framework.
- New investor initiatives and key activities undertaken with initiatives that we have previously joined, such as Climate Action 100+.

Informing the investment committee about responsible investment-related activity undertaken during the quarter is a standing agenda item for the committee's meetings. The committee members are given opportunities to check their understanding of this information and, where appropriate, critically challenge the information. Investment committee members have in the past year questioned:

- The engagement record of some investment managers.
- Increasing the allocation to climate solutions.
- The quality of climate metrics data received from investment managers.
- The increasing occurrence of extreme weather events and how these risks would be managed.

In response to the investment committee's feedback, management information provided biannually includes:

- Scope 1, 2, and 3 emissions intensities and decarbonisation trajectory for key mandates, compared to our targets for them. For information on these Scopes, see Section 4.
- Progress on our chosen portfolio alignment metric and investment in climate solutions.
- Progress of investment managers against the climate objectives we have set with them.
- Recent company engagement.
- Updates on consultation responses and other policy engagement.

Together, the processes described above enable the investment committee – and ultimately the Board – to check that the Scheme's investment strategy adequately prioritises climate-related risks and opportunities.

In line with our internal investment governance framework, information about the Scheme's assets relevant to the identification, assessment and management of climate-related risks and opportunities is shared between persons tasked with these responsibilities. There are clear lines of communication between our responsible investment team and the manager monitoring team as well as with Nest Invest's investment risk and asset allocation committees, all of which meet quarterly.

Training

FCA-certified staff of Nest Invest must complete a minimum of 30 hours of continuing professional development annually. All Nest Invest staff are encouraged to aim for this level of professional development to ensure continued competency in their role. Where appropriate this includes training on climate change issues. The members of our responsible investment team also provide scheduled and on-demand updates on climate-related risks and opportunities to the various internal committees on which they sit, including the asset allocation, risk management and manager monitoring committees. They also do this quarterly for all staff of Nest Invest as well as annually during Nest's Responsible Investment month during which responsible investment team members and expert guest speakers present responsible investment and climate change related updates.

Section 2

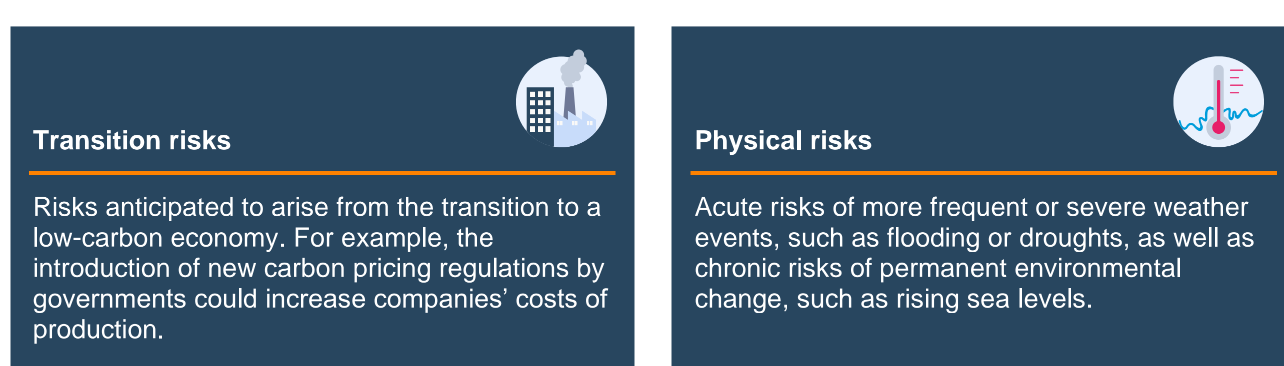
Strategy

Climate-related risks will affect the financial stability of companies and other assets in our portfolio, thereby potentially limiting risk-adjusted returns on the Scheme's investments and the pension pot value available to Scheme members at retirement. If we do not take these risks into account in the investment strategy, our goal to build financial peace of mind for our members 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 mindful of the broader impact, beyond the effect on their retirement saving, that climate change will 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 could also have disruptive effects on workers and communities. We also consider these in developing our strategy.

Identifying climate-related risks and opportunities

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



Transition risks occur as the economy decarbonises towards net zero. They can arise from government policies such as carbon taxes, which raise costs for carbon-intensive companies and could negatively impact their financial value. Transition risks may also arise from new technologies, such as electric vehicles, and changing consumer preferences.

Physical risks could directly impact some of the Scheme's assets, for example, by reducing the ability of some 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.

Climate change and nature and biodiversity loss are closely interlinked. Natural ecosystems including vegetation, soils and oceans absorb around half of the carbon emissions generated by human activities. Preserving these natural carbon sinks will be crucial to limit warming.[2] Nature can also act as a buffer for physical climate risks, and preserving biodiversity will help maintain the stability of ecosystems and their ability to adapt to changing temperatures.

The financial risks of climate change do not stem solely from environmental considerations.

Climate change will also have socioeconomic impacts which are themselves financially material risks for the Scheme. For example, the transition to a low-carbon economy will lead to the decline of highly carbon-intensive industries, affecting jobs and local communities. Failure to address these impacts could also undermine public support and delay climate action.

[2] IPCC, **AR6: Working Group I Chapter 5** (2021)

At the same time we see potential investment opportunities from the transition, which include low-carbon technologies such as renewable energy and electric vehicles. Increasingly, we are also seeing opportunities to invest in adaptation finance, which supports communities to reduce the risks from climate change and the damages from the physical impacts of climate change.

Short-, medium-, and long-term risks and opportunities

For the purposes of identifying the climate-related risks and opportunities which we believe will have an effect on the Scheme's investment strategy, we consider three time horizons:

- **Short term:** 1 to 5 years
- **Medium term:** 6 to 10 years
- **Long term:** 10 years or more

We have defined these time horizons based on how we expect climate-related risks will vary in type and intensity over time.

We expect transition risks to be greatest over the short and medium term and highly dependent on the timing of the transition to a low-carbon economy. In the short term, some sectors of the global economy could see changes in their valuation because of climate-related risks. For example, highly carbon-intensive companies already face withdrawal of financing for projects. We have identified short- to medium-term 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.

In the medium term, if the 1.5C target is to be met, the Intergovernmental Panel on Climate Change (IPCC) has highlighted in its **special report on global warming** that carbon emissions will need to be reduced, by around 45% from 2010 levels, by 2030 or sooner. We believe opportunities will be greater in decarbonising initiatives than in negative emissions technologies. We are also engaging in stewardship to encourage the companies in which the Scheme is invested to decarbonise their operations and explore climate-related opportunities.

As we progress through this decade with a persisting gap between policies currently in place and those needed to limit warming to well below 2C, we believe abrupt changes in response to climate-related events are now more likely than a gradual transition to 1.5C. If, however, the low-carbon transition is delayed further, there is a prospect that transition risks will become more significant into the long term.

We are already seeing the impacts of physical climate change risks in many regions with extreme weather events increasing in frequency and severity globally and wider disruption to economic activity taking place. We expect these to increase in the medium term, and over the long term, we expect physical risks to predominate as average global temperatures rise. In the long term we also believe negative emissions technologies such as carbon capture and storage will need to be developed to counteract residual emissions and ensure a net zero global economy. These could present investment opportunities in the future, but are not something we are focussing on at the moment. 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. We have also started engaging with companies to better understand their resilience to the physical impacts of climate change and how they are adapting to a changing climate.

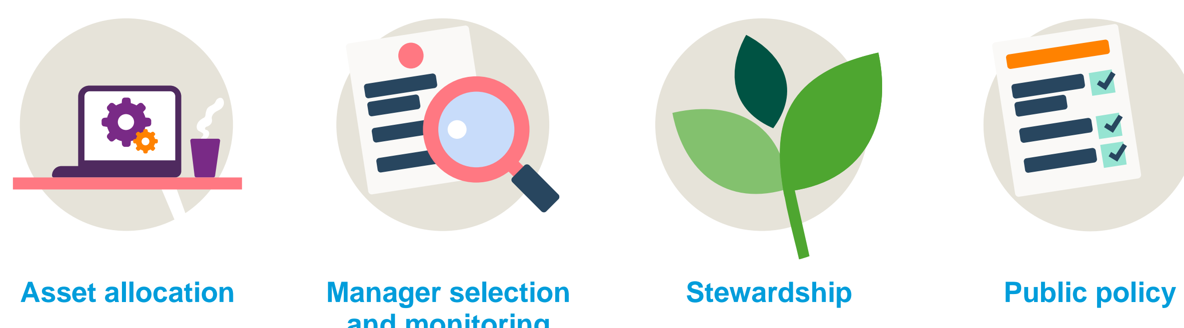
How we have managed climate-related risks and opportunities

In managing climate-related risks and opportunities, we consider:

- **Financed emissions:** Monitoring and reducing the greenhouse gas emissions associated with the Scheme's overall portfolio.
- **Alignment:** We track the proportion of companies or assets in a portfolio that have committed to net zero, are aligned with net zero, aligning with net zero or not aligned.
- **Exposure to climate solutions:** Direct investments in critical green infrastructure such as renewable energy, as well as the proportion of revenues that our investee companies derive from 'green' products.

› **Supporting a low-carbon economy through advocacy and policy engagement:** The role we can play in contributing to a smooth transition to a low-carbon economy, which will minimise both transition and physical risks as well as broader societal outcomes such as the impact on workers and communities.

We manage climate-related risks and opportunities through four distinct areas of the investment process:



We review our asset allocation and manager selection and monitoring below. Stewardship and public policy are covered on pages 24 to 26.

Asset allocation

We have publicly stated our aim to align with the goals of the Paris Agreement of limiting the increase in global temperatures to 1.5C above pre-industrial levels, and accordingly reaching net zero financed carbon emissions across the Scheme's portfolio by 2050 or earlier. We have also set an interim goal of reducing the Scope 1+2 carbon footprint in our public equity and fixed income portfolios by 30% by 2025, from a 2019 baseline.

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**.

This work includes the following activities:

› We look for opportunities to invest in the transition. To date, we have invested almost £1.3bn in renewable infrastructure equity and debt. This year, we also invested in a thematic equity mandate with Lombard Odier Investment Management that will help us gain access to more investable opportunities in climate mitigation and adaptation.

› There are some business activities that we do not believe can be aligned with the goals of the Paris Agreement. These include thermal coal, oil sands and arctic drilling and exploration. Companies that are heavily involved in these activities may face significant losses as a result of the transition to net zero. Across our asset allocation, we've divested from all companies with more than 20% of revenues from these activities at the end of 2020. That revenue threshold for those activities was reduced to just 10% at the end of 2023 and we will continue to exclude from our investment portfolios:
  - All companies that make new developments in these activities, as we become aware of it.
  - All companies still involved in these activities in 2025 if they have not committed to a full, accountable phase-out by 2030 or sooner.

› We will continue to assess how sector and business activities 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 towards the low-carbon transition, or in recognising how climate change will impact their businesses, may be excluded from our portfolios.

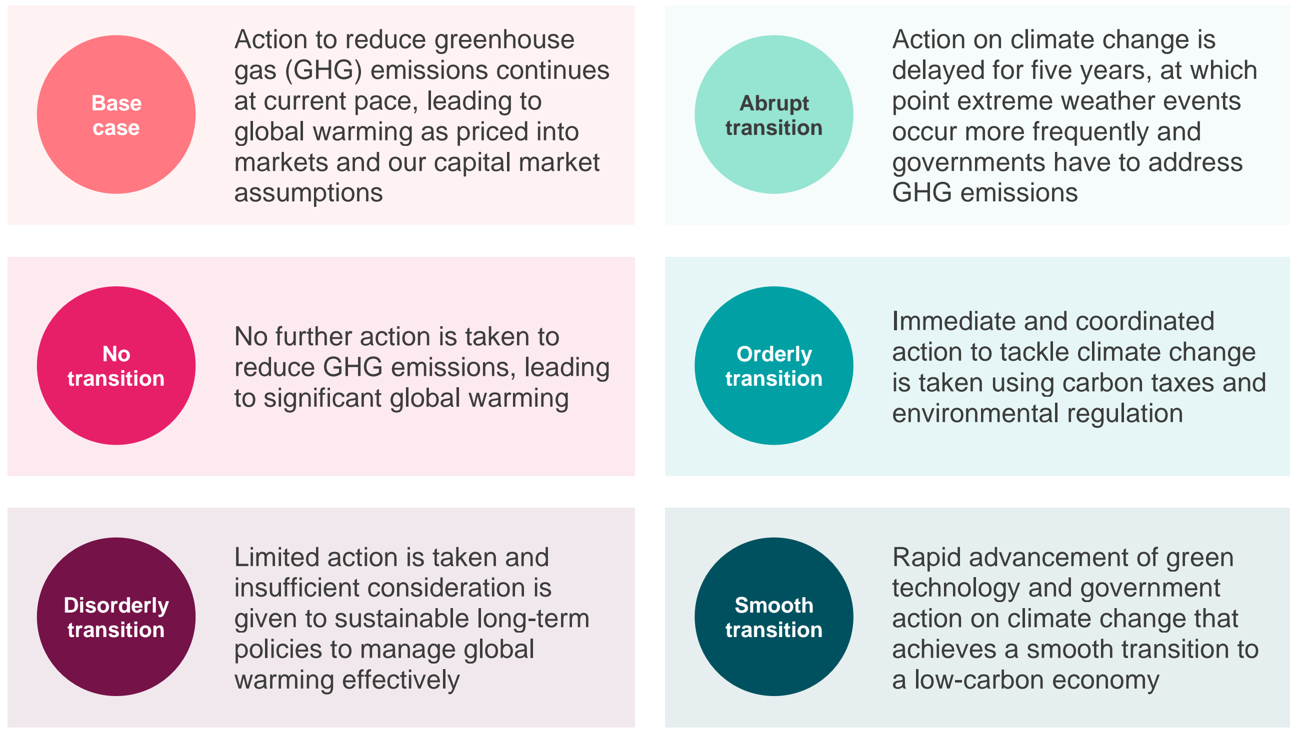
› We will continue to research the impact of climate change on asset-class risks and returns. In the future we may increase or decrease investments in certain asset classes or regions depending on how we believe they will perform in a low-carbon economy. You can read more about how we might determine this in the section on 'Identifying and addressing risks across our asset allocation' in our **responsible investment report**.

Resilience of the Scheme's investment strategy under different climate scenarios

In line with statutory guidance, we test the resilience of the Scheme's investment strategy under different climate scenarios every three years. In 2022 we commissioned Aon plc to help us test the performance of the Scheme's portfolio under different climate scenarios.[3] There have been no material changes to the Scheme's investment strategy or the climate scenarios since. We therefore believe that the analysis carried out by Aon continues to be up-to-date and relevant. We will update the scenario analysis for the 2024/25 financial year.

In addition to a base case, which projects that actions to reduce greenhouse gas emissions continue at the current pace, Aon, working in partnership with the **Cambridge Institute for Sustainability Leadership**, has developed five transition scenarios. Each scenario makes a number of assumptions about variables including policy, technology, socio-demographic developments and transition timeframes. These assumptions are translated into impact 'shocks' on macroeconomic variables such as gross domestic product (GDP), interest rates and inflation, using a mixture of economic and econometric models, historical analysis and expert judgement. Finally, Aon calculates the valuation impact of changes in macroeconomic variables on key asset classes. While these scenarios capture the physical climate and transition effects, the scenario analysis doesn't currently capture extreme 'tipping points' in the climate system when critical thresholds are exceeded, as this goes beyond the current limitations of modelling capabilities.

Figure 1: Aon's climate scenarios



[3] We appointed one new manager in the year under review, however we did not start investing until after the financial year end and therefore have not included it in the analysis for this year's report.

	Base case	No transition	Disorderly transition	Abrupt transition	Orderly transition	Smooth transition
Temperature rise by 2100	1.5C to 2.4C	4C or more	Less than 3C	1.5C to 2C	1.3C to 2C	Less than 1.5C
Reach net zero by	2050	After 2050	After 2050	2050	2050	2045
Carbon price 2030	$80	$40	$65	$135	$100	$80
Carbon price 2050	$140	$50	$340	$280	$215H	$165
Introduction of environmental regulations	Fragmented	None	Late and aggressive	Aggressive	Coordinated	Highly coordinated

Source: Aon, 2022

Impact of these risks on our assets

Aon tested these scenarios over the three time horizons outlined above. The Scheme's relatively high allocation to equity makes the portfolio as a whole fairly sensitive to the timing and pace of the transition to a low-carbon economy.

Aon's analysis shows that in the short term (5 years or less), the largest risks to the Scheme's investment funds will likely come from an orderly transition to a low-carbon economy. In an orderly transition, governments take action with regulation to tackle climate change coming into force soon. As carbon taxes and environmental regulations take hold, companies that conduct highly carbon-intensive activities may need to make costly changes to their operations or even write off assets. For this reason, in the first years of an orderly transition equity performance is expected to be poor, and this is likely to have a pronounced negative impact on asset returns. Equity owners also rank behind all other investors in the case of bankruptcy. This means that equity holders are most exposed to the risks of longer-term earnings impairment of the firms in which they invest and are more likely to lose out if those firms fail.

However, the aggregate decline in equity performance in the orderly scenario is mitigated by the climate tilts we have applied to the Scheme's equity funds. So, while an orderly transition has higher risk, we have mitigated against some of this risk. Indeed, the only scenario in Aon's analysis that outperforms the base case in the short term is the smooth transition scenario. This scenario assumes rapid technological advancement and adoption of green technology, which significantly reduces the cost of transitioning.

In the medium term (6 to 10 years), the Scheme's assets are anticipated to grow from close to £30 billion to approximately £100 billion, based on current estimates. We expect to continue to have a high proportion of equity to debt in the Scheme's portfolio. This approach reflects the age skew towards younger workers across the Scheme's membership. At the same time, we anticipate increasing the proportion of private market assets, including infrastructure, in the Scheme's portfolio. Already we are starting to see the impact of an abrupt transition, which assumes that aggressive policies are introduced in the second half of this decade. According to Aon's analysis the Scheme's portfolio performs best over the medium term in the orderly transition scenario, where the early costs of transitioning are outweighed by later benefits, including lower physical risks, than in the base case.

In the long term (more than 10 years), Aon's analysis finds that the Scheme's portfolio performs worst in a disorderly transition. This is driven primarily by increasing physical impacts of climate change over time. However, the disorderly scenario assumes that actions to make the transition to a low-carbon economy are not only taken very late, but also that they must be very aggressive, because a number of physical impacts of climate change will already be locked in due to the delay. This makes for a very costly scenario. In contrast the orderly transition scenario continues to outperform the base case over the long term, as we see increasing investment opportunities from the transition.

The table below shows the investment return and cumulative change in value of the Scheme's total portfolio under each of Aon's climate change scenarios at varying time horizons.

Table 1: Impact on expected investment returns

	Base case	No transition	Disorderly transition	Abrupt transition	Orderly transition	Smooth transition
Short term (3 years)						
Absolute return (% pa)[4]	4.6%	4.6%	4.6%	4.4%	0.2%	6.7%
Change in value (£bn)[5]	£ 21.1	£ 21.1	£ 21.1	£20.9	£ 17.6	£ 23.5
Change in value relative to base case (£bn)[5]	£ 0	£ 0	£ 0	£ –0.2	£ –3.5	£ 2.4
Medium term (10 years)						
Absolute return (% pa)[4]	4.6%	4.5%	4.5%	3.6%	5.6%	5.6%
Change in value (£bn)[5]	£ 91.0	£ 90.0	£ 90.0	£ 85.2	£ 105.6	£ 97.2
Change in value relative to base case (£bn)[5]	£ 0	£ –1.0	£ –1.0	£ –5.8	£ 14.6	£ 6.2
Long term (30 years)						
Absolute return (% pa)[4]	4.6%	4.1%	3.5%	4.4%	5.3%	5.4%
Change in value (£bn)[5]	£ 538.8	£ 488.7	£ 467.5	£ 542.4	£ 628.2	£ 621.0
Change in value relative to base case (£bn)[5]	£ 0	£ –50.1	£ –71.2	£ 3.7	£ 89.5	£ 82.3

Source: Aon and Nest Corporation, 2022. Asset allocation as at 31 December 2021

This analysis suggests that climate change will impact different cohorts of members differently. Nest members tend to be younger than the broader market. Around 65% of our members are under the age of 45, and 20% are 30 and under. This means that most of our members will be saving into their pension for the next few decades, and the long-term timeframe will be the most material.

To assess these impacts on members' pension pots in more detail, Aon also modelled the impact on a representative member of the Scheme. The Scheme's default strategy, the Nest Retirement Date Funds, is comprised of a series of life styled target-date funds, which are invested based on how far

[4] Median cumulative annualised real return over 3, 10 and 30 years.

[5] Projections assume no withdrawals from the asset pool over the modelling period and contributions into the fund are assumed to be paid halfway through the year.

away the members in the fund are from their expected retirement date. A 22-year-old member enrolled in the Scheme in 2021 would have their pension pot invested for about the first five years in the foundation phase, which aims to keep pace with inflation. For most of their time in the Scheme, their pot would be in the growth phase, where the maximum growth in assets is targeted with a goal of outperforming inflation. Then, 10 years before their expected retirement date, their pot is moved to the consolidation phase, where investments are progressively switched out of higher risk into lower risk investments. Aon's analysis shows that this younger member will be more exposed to climate-related risks due to their increased exposure to equities during the Nest Retirement Date Funds' growth phase. The findings are quite stark – over the long term, this member's pension pot could be worth £11,000 to £12,000 less if the transition to a low-carbon economy is disorderly, or no transition is made. On the upside, in an orderly or smooth transition, the member could be £6,000 better off compared to the base case scenario.

The Nest Post Retirement Date Fund, Nest Guided Retirement Fund and Nest Lower Growth Fund all have lower exposure to the physical and transition risks associated with climate change. This is a result of their high allocation to fixed-income assets. However, these fund choices still have some climate-related risks, and their overall risk profile means that we expect them to deliver lower long-term returns.

Manager selection and monitoring

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

To keep the Scheme's whole portfolio in line 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 the portfolio.

We have taken action on our analysis of climate-related risks and opportunities by working with our investment managers to set specific climate change objectives, whether the assets they manage for the Scheme are in a segregated mandate (where the Scheme's assets are managed separately from other investors') or a pooled fund (where several investors' assets are pooled together).

We formulated three key expectations for all investment managers to have met by 2023:

- **Reducing emissions:** We expect our investment managers to develop a strategy to align the portfolio they manage for Scheme members with the Paris Agreement's 1.5C global warming limit target. We have asked them to include analysis of how they could halve emissions by 2030. We are working with investment managers to set decarbonisation targets for each portfolio based on scientific pathways to reach net zero. You can read more about this target-setting work in Section 4, Metrics and targets.
- **Reporting:** We expect our investment managers to report on climate-related risks and opportunities in the portion of the Scheme's portfolio that they are managing, using the TCFD framework. This includes reporting on the portfolio's carbon footprint as well as climate change scenario analysis. We have asked for reporting on Scope 1 and 2 carbon emissions, and Scope 3 emissions where available.
- **Stewardship** 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 both directly and by participating in the Climate Action 100+ initiative.

Our climate change policy and the manager expectations set out within it 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.

Additional asset manager-specific objectives include, but are not limited to:

- Extending their coal exclusion policy to be in line with the targets to fully phase out thermal coal generation in OECD countries[6] by 2030 and developing countries by 2040.

[6] The Organisation for Economic Co-operation and Development (OECD) is an intergovernmental economic organisation with 38 member countries.

- Integrating the physical risks resulting from climate change into their country-level risk assessments.
- Providing regular updates on the share of green assets such as green bonds in their portfolio, as well as corporate issuers who have a verified science-based target.
- Working with companies and issuers to improve reporting of climate change metrics such as emissions data particularly Scope 3 emissions.
- Exploring how to set targets for reducing emissions in line with a trajectory to reach net zero.
- Exploring how to set targets for investing in green solutions.
- Further exploring scenario analysis and temperature stress-testing assets and portfolios.

We expected all incumbent investment managers to deliver on our expectations by the end of 2023. Almost all objectives were achieved by this deadline. For some objectives, progress was slower than we had hoped because of particular difficulties for the relevant asset classes.

For example, reporting on ESG metrics, in particular carbon data, remains very challenging in private debt. While data availability has improved, many of the companies that we provide private equity to are smaller companies that do not have the structures and/or processes in place to gather Scope 1, 2, and 3 carbon emissions. Our private equity managers often have controlling positions in these companies which provides a good opportunity for them to encourage and help these companies build these reporting processes.

However, companies are often working on multiple priorities post-acquisition and this can take time to achieve. In addition, when we are purely lending to these companies through private debt, we are not owners of the business and thus have more limited ability to demand this reporting from these smaller companies. In all cases, we encourage our managers to work on getting this data from the companies they invest in on our behalf. Several of our private markets fund managers are members of the ESG Data Convergence Initiative which aims to improve consistent reporting across the industry.

We will be working on a new set of manager objectives as part of our climate change policy review during the 2024/25 financial year.

Section 3

Risk management

Our responsible investment objectives explain that we seek to identify and manage ESG-related risks and opportunities across the Scheme's portfolio where we believe doing so leads to lower risk or enhanced returns.

We consider both climate-related transition risks and physical risks. Our immediate focus is on transition risks, as these have the greatest potential to affect returns in the short to medium term. They are also where we have the greatest ability to effect change – primarily through our stewardship activities, which we describe in more detail on pages 24-25. However we are now increasingly turning our attention to managing physical risks.

We view our risk management processes primarily through the lens of alignment with net zero. This means that we assess the risk to our investments in part by monitoring our progress in reducing our carbon footprint and, in the longer term, our total emissions.

Processes for identifying, assessing, and managing climate-related risks

Governance of climate-related risk management

Nest Invest has established an investment risk committee which meets quarterly and sits alongside the asset allocation committee, and manager monitoring committee as part of the investment team's internal investment governance framework.

The investment risk committee oversees investment risk management activities across the investment process – asset allocation, manager selection, implementation, and monitoring – and makes decisions on:

- The risk management process.
- Risk mitigation measures and resolutions.
- Proposals for changes to existing risk limits or targets, including the inclusion of new risk limits or controls.

The investment risk committee monitors risk management activities across the different teams within our investment risk governance structure to help ensure adequate checks and balances are embedded consistently.

Included in the investment risk committee's terms of reference are specific responsibility for reviewing and assessing relevant climate-related risks and ensuring that these risks are integrated across the investment management process.

Identification of climate-related risks

We identify climate-related risks through a range of tools and approaches. These include:

- Internal thematic horizon scanning – during the 2023/24 financial year this included projects on physical climate change risks and on the link between climate change and nature degradation.
- Regular reporting from external investment managers on key climate metrics including total portfolio emissions, fossil fuel reserves, top carbon emitters, the proportion of assets that have set net zero targets and the proportion of assets under engagement.
- Climate change scenario analysis carried out at the Scheme-level, as well as at the portfolio-level by our external investment managers.
- 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.
- Crowdsourcing across our investment team through a regular 'risks and opportunities radar' survey.

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- Meetings convened with respect to our internal investment governance framework, including for example through the oversight of the investment risk committee.

Assessment and management of climate-related risks

We take a proportionate approach to the assessment and management of climate-related risks. We have used a traditional impact and severity approach consistent with our assessments of other risks, the materiality of the Scheme's exposure and the implications for investment strategies.

We have identified financial and strategic climate-related risks, over the short, medium, and long term. These include that:

- Policy announcements on regulations to curb global warming happen faster than expected. Examples of this might include the sudden introduction of a carbon tax or a sales ban on vehicles with petrol or diesel engines. Investors and businesses may be unprepared, or customers might shun unsustainable businesses and products. Either of these would mean our portfolio becoming increasingly misaligned with net zero.
- We identify the decarbonisation trajectory in our policies, but our investment team or our external investment managers fail to appropriately implement them in our investment process.
- The physical risks of climate change affect assets and companies in the Scheme's portfolio impairing their profitability.

Our assessment is that, without appropriate controls and mitigations, climate-related risks have the potential to be a critical risk to the Scheme. For this reason, we have established a number of processes to control and mitigate them. Our controls and mitigations include:

Ongoing

- Investing the Scheme's equity and public fixed-income allocations in climate-aware funds, allowing us to decrease exposure to those companies most likely to be financially impacted by policy changes and the transition to the low-carbon economy.
- Increasing the Scheme's exposure to investments in line with the low-carbon economy.
- Increasing the Scheme's investment in alternative asset classes, particularly in renewable energy, to take advantage of investment opportunities in the low-carbon transition.
- Excluding the most environmentally damaging business activities, particularly those like thermal coal, oil sands, and arctic drilling and exploration, which are likely to be phased out first in the low-carbon transition.
- Voting and engaging with companies on climate change including participation in industry climate initiatives such as the Institutional Investors' Group on Climate Change and Climate Action 100+.
- Engaging with the highest risk companies in the economy to encourage them to transition towards the low-carbon economy and net zero emissions. This engagement is covered in more detail in our **responsible investment report**.
- Setting short- and medium-term targets to help us measure and assess our progress towards our net zero goals for the Scheme's portfolio. These are covered in Section 4.

Quarterly

- Having the investment committee review climate-related risks and the controls and mitigations in our investment risk register.
- Reviewing all investment exclusions against current company revenues where we screen out investments based on a percentage of revenues coming from thermal coal, oil sands and arctic drilling and exploration.

Semi-annually

- Having the investment committee review our progress on climate change risk metrics and targets.
- Reviewing investment managers' performance against their specific climate change objectives and benchmarks to progress the mandates they manage for the Scheme in line with reaching net zero

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targets in the medium and long term. Where progress is poor, monitoring is stepped up and they are placed on a watchlist, with next steps discussed at manager monitoring committee meetings.

Annually

- Having the investment committee review our climate change policy and whether it remains fit for purpose. This sets out our approach to manage climate change risk across the Scheme's portfolio through asset allocation, exclusions and, where necessary and after voting and engagement, divestment from companies ill-prepared for the transition to a low-carbon economy. All changes are clearly communicated to our external investment managers. We started a large-scale review of our climate change policy in 2023 which we expect to complete in 2024.

Our assessment of climate-related risks

We believe that climate change is a systemic risk that will impact the entire economy and our ability to influence the likelihood of these risks manifesting is limited, though we can take steps to reduce our exposure to these risks. Collectively, these controls have been assessed using our internal risk management framework to lower the likelihood of climate-related risks causing the Scheme's investments to fail to meet our performance objectives from 'very likely' to 'possible'. The mitigating actions lower the impact of climate-related risks to the Scheme's investments from 'severe' to 'moderate'.

Integrating processes into overall risk management

We have incorporated climate-related risks into our existing risk management framework and enterprise risk register utilising the same process for identifying, assessing, and managing climate-related risks as for other financial and strategic risks.

Climate-related risks could have both a financial and strategic impact on the Scheme. This is captured under one of the principal risks in our risk management framework – the risk that our investments fail to perform to targets or that stakeholders, in particular members, could lose confidence in our investment approach. In other words, we do not view climate change as a new risk category within our risk management framework. Instead, climate-related risks are mapped into our existing risk categories.

The principal risks are discussed and monitored by Nest Corporation's executive committee.

By integrating climate-related risks into our overall risk management framework, we seek to ensure that all relevant functions, departments, and experts are involved in the integration and ongoing management of these risks. Our risk framework is designed to ensure that a robust and consistent approach to risk management is applied to drive improvements in our risk management in line with our risk appetite – the level of risk that we are prepared to accept while pursuing our strategic priorities.

The framework also ensures there is both individual and collective accountability for risk management, risk oversight and risk assurance. We use the industry best-practice three lines of defence model:

1. The people doing the job – those who own day-to-day controls and processes to manage risks.
2. The control function – those providing assurance to senior management that processes and controls are operating properly.
3. Internal and external audit teams – independent, specialist auditors who provide in-depth analysis to the board.

Stewardship

We actively employ stewardship as a mechanism to manage climate-related risks, both to reduce the impact on the Scheme of abrupt policy responses leading to a disorderly transition, or the likelihood of a shock to the financial system from catastrophic climate change. We believe that all companies have a role to play in the low-carbon transition and building resilience against the physical impacts of climate change. They can do this through:

- **Managing direct emissions** generated by their operations.

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- **Managing indirect emissions**, for example, the emissions generated through their supply chains and financing decisions.
- **Directing capital expenditure** towards developing low carbon technologies and investing in adaptation and resilience.
- **Aligning their public policy and lobbying activities** with their net zero commitments.

Stewardship is one of the four core pillars in our climate change risk policy:

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 will divest.

We have committed to the following:

- **Engagement:** We engage with companies on how they are transitioning to meet the goals of the Paris Agreement. We do this through direct engagement as an investor, and through coalitions such as Climate Action 100+. We also expect our investment managers to engage with companies on our behalf and report quarterly on progress.
- **Disclosures and reporting:** We support all reasonable shareholder resolutions 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. This year we added clearer expectations of oil and gas companies transition plans to our voting and engagement policy, given the critical role that the sector plays in the transition. Where companies' transition plans do not meet our expectations, we will vote against the Chair of the sustainability committee, Chair of the audit committee or the Chair of the board.
- **Milestones:** We review our voting and engagement guidelines on climate change annually, and we set time-bound milestones in our stewardship activity on which we expect the company to deliver.
- **Escalation:** Where engagement over a period is unsuccessful and we consider a company to be progressing insufficiently or too slowly towards alignment with the goals of the Paris Agreement, we will consider a range of other options including co-filing a shareholder resolution, reducing exposure to an investment or divestment.

Our stewardship activities are described in more detail in our annual responsible investment report.

Public policy

A second core commitment in our climate change risk policy is the related tool of public policy engagement:

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.

We aim to use our influence as one of the UK's largest defined contribution (DC) workplace pension schemes to improve disclosures on climate-related risks and opportunities in line with the TCFD's recommendations.

We continue 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 and the UK Sustainable Investment and Finance Association. Our public policy and advocacy work focuses on the following areas:

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- **Greening the financial system:** We advocate for effective financial sector regulation that promotes climate risk management in the financial sector and mobilises mainstream finance to support the transition towards a net zero economy. This includes disclosure requirements for financial institutions and regulation on marketing of sustainable investment products that protects the interests of pensions savers and retail customers.
- **Financing the transition:** For Nest to be able to meet its net zero ambition, it is crucial that there are sufficient opportunities to invest in businesses that are delivering solutions to address climate change, and regulatory frameworks that encourage corporates to transition their business models in line with net zero. We advocate for consistent disclosure standards across all companies and support policies that make it easier for Nest to invest in climate solutions, such as subsidies for renewable energy generation.

For the last two years, one of the key industry developments that we have been involved in has been the Transition Plan Taskforce (TPT). The TPT was announced at COP26, the global climate change conference, which was held in Glasgow in November 2021 by the Chancellor as part of a set of proposals to make the UK the world's first net zero aligned financial centre.

It was launched in April 2022 with a two-year mandate to establish best practice for firm-level transition plans and develop a set of templates setting out both generic and sector-specific disclosures and metrics. Nest has been involved in the TPT from the start. Mark Fawcett, the CEO of Nest Invest, sat on the Steering Group and Nest has also been represented on the delivery group. This year, we contributed to the development of the sector-specific guidance for asset owners. We were also part of the Just Transition Working Group, which provided guidance on how to anticipate, assess and address social risks and opportunities of the transition to net zero. It also ensured meaningful dialogue with impacted groups such as workers, communities, supply chains and consumers.

Section 4

Metrics and targets

The data reported in the metrics and targets section has been obtained from the investment managers of each portfolio. The draft report was shared with the investment managers for verification prior to publication. Nest Corporation assume no responsibility for the accuracy of the data.

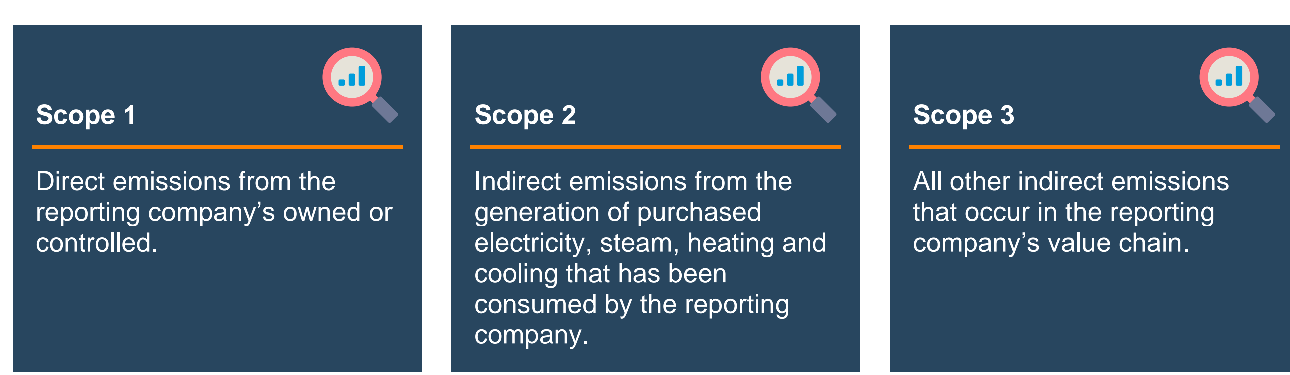
Our chosen metrics

Absolute financed emissions and emissions intensity metrics

Our key reported metrics are financed carbon emissions, which are the emissions associated with our investments. Measuring financed emissions is a key metric for understanding our contribution to climate change, as well as understanding our exposure to climate-related risks across the Scheme's portfolios. We also use this data as a starting point for setting mandate-level decarbonisation targets that are in line with our long-term goal of net zero emissions by 2050 or sooner. These will be regularly reviewed and ramped up over time as net zero pathways for different asset classes become clearer.

We report on financed Scope 1, 2, and 3 greenhouse gas (GHG) emissions in tonnes of carbon dioxide equivalent (tCO_2e) emissions – that is, absolute emissions – across our building block funds. Absolute financed emissions are a function of the total emissions of the assets in our portfolio, adjusted for the share that Nest holds in each asset. This means that as the Scheme's total assets under management continue to grow and we put more money into each asset, total financed emissions will go up in the short term.

We also measure an emissions intensity metric by calculating the emissions per million pounds (tCO_2e /£m) invested or financed – the carbon footprint. Assessing emissions per million pounds invested helps us to better understand whether the Scheme's exposure to climate-related risks has changed by identifying whether the assets we are investing in are reducing their emissions.



Source: Greenhouse Gas Protocol

Our methodology and its limitations

Wherever possible we have followed the GHG emissions accounting and reporting standard developed by the Partnership for Carbon Accounting Financials (PCAF) when calculating the emissions attributed to the Scheme's investments.[7] This means calculating our share of the emissions of the financed asset using a ratio between the amount we have invested in the asset (such as the market value for equity investments and the book value for debt investments) and the value of the financed asset (for listed assets this is enterprise value including cash, or EVIC).

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

This attribution factor is not suitable for all asset classes. Governments, for example, do not have an enterprise value. Our emerging market debt manager uses consumption-based emissions to attribute emissions from sovereign debt holdings, which takes into account emissions resulting from the final use of goods and services in a national economy, including imported emissions. Another approach is to only measure emissions from goods and services produced within the country. This approach is used by some of our other fixed income fund managers. Measuring consumption emissions gives a more holistic assessment of a government's role as a regulator than production emissions, but it can lead to double counting. This is because emissions are attributed both to the sovereign as well as the companies operating in the economy, in which we may have investments in other parts of the portfolio. It is also difficult to categorise sovereign emissions as Scopes 1, 2, or 3. We have therefore chosen not to include the sovereign debt emissions in the table.

In private markets (private credit, private equity, and private infrastructure equity), there are few data providers that are able to estimate emissions, so where data is not reported directly there can be significant gaps in reporting. It can also be challenging to obtain EVIC data for private issuers. As a result, some of our managers instead report on Weighted Average Carbon Intensity (WACI), which uses revenues as an attribution factor, as this data point is more readily available. This methodology gives slightly different emissions figures to the metrics using EVIC. As a result, we have not included portfolios in the data tables where we were only able to obtain WACI data. We are working with our investment managers to improve the quality and comprehensiveness of data in this area.

Portfolio alignment metric

Portfolio alignment metrics are forward-looking metrics that can provide an indication of the exposure of a scheme to climate-related transition risks and opportunities. Methodologies and approaches are still evolving. The percentage of portfolio with net zero targets is the simplest and most transparent approach and allows for a basic assessment of the extent to which a portfolio is committed to net zero. We are only including targets that have received third-party validation through the **Science Based Targets Initiative (SBTi)**[8] to ensure that targets are scientifically robust. The SBTi methodology only applies to companies, so we are not currently able to measure alignment for other asset classes such as sovereign debt and commodity futures. A key drawback of the binary target approach is that only the alignment of investments with validated targets is known, which is currently a relatively small proportion of the total portfolio. The speed at which coverage increases is dependent on the resources of SBTi. The approach also does not differentiate between companies that have identical targets, but a different distance to achieving them.

Neither financed emissions nor portfolio alignment metrics are perfect, but combining these metrics gives a more holistic picture of Nest's progress in meeting its net zero ambition.

Data quality metric

We are also reporting on data quality as an optional metric. Our investment managers receive carbon emissions information from a range of sources including directly from companies or assets, from external data providers such as MSCI or Trucost, or estimate them internally using proprietary modelling. We have asked our managers to disclose the proportion of assets for which data was reported, estimated or unavailable and have reported this as a data quality metric in the data tables below. Where data is unavailable, this is because the companies or projects in which the Scheme is invested are not reporting it, and estimates have not been produced by our investment managers or their contracted data providers to fill those gaps.

Where data has been estimated, these estimates have been made by our investment managers or contracted data providers using company energy consumption, output and revenue, combined with relevant emissions' factors for that energy source, product or sector, as well as other assumptions.

We have found that the proportion of reported emissions data from companies varies significantly across asset classes, but no portfolio has achieved 100% reported emissions even for Scope 1. Gaps

[8] The SBTi is a partnership between CDP, the United Nations Global Compact, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF). Companies submit their decarbonisation targets to SBTi for validation based on sector-specific science-based criteria.

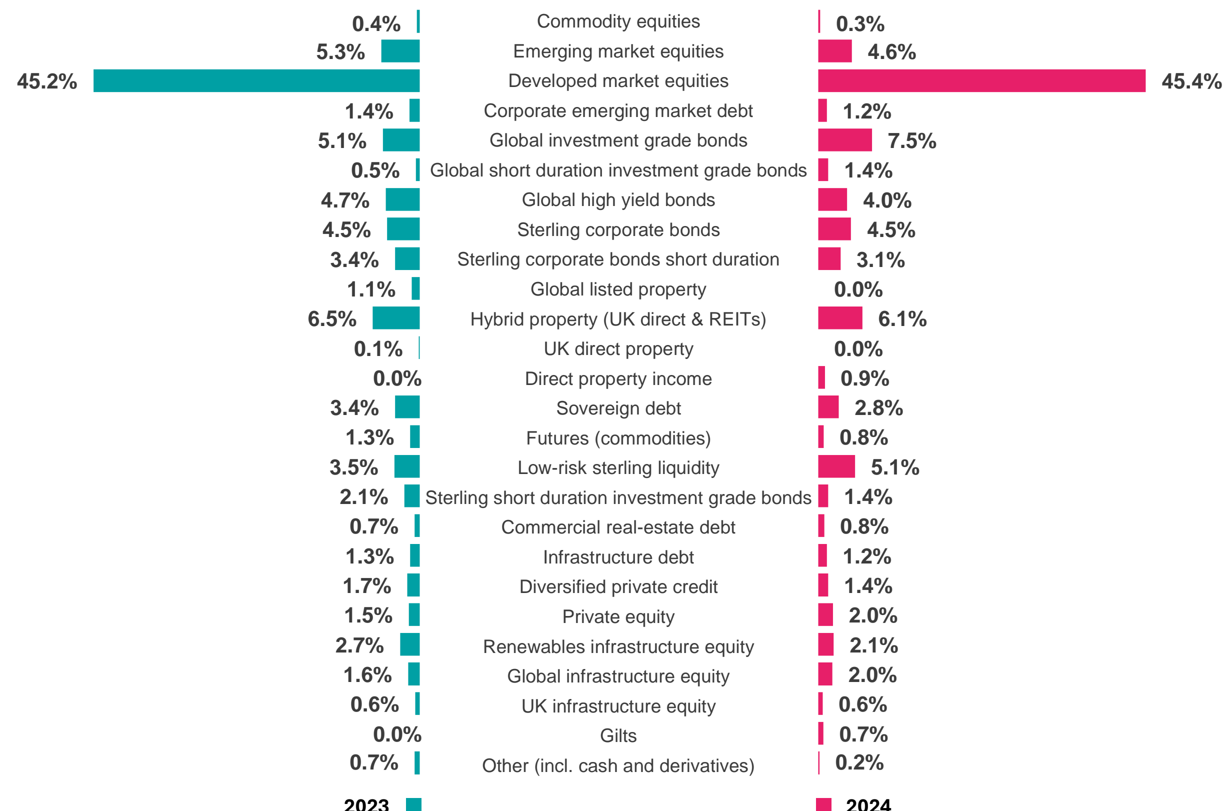
in reporting are generally filled by estimates carried out by data providers using proprietary methodologies. This means that the emissions figures for the same company could be different depending on which data provider was used, which can be challenging when aggregating data across portfolios. This is a particular issue for Scope 3 where the majority of available data has been estimated by third-party data providers, **so this data should be treated with caution.**

Nest works closely with its managers and other industry groups to improve disclosure of high-quality data. For example, we participated in a working group with the Pensions and Lifetime Savings Association (PLSA), Association of British Insurers (ABI), the Investment Association and other asset owners and managers to develop a template to help pension schemes and investment managers to meet their reporting obligations and standardise disclosures across the industry. We also engage directly with investee companies on their own TCFD disclosures through the Climate Action100+ collaborative investor initiative.

Default strategy

The below tables shows the selected metrics for the Scheme's default strategy by asset class. The majority of members (currently over 98%) will be invested in Nest's default strategy, made up of around 50 tailored retirement date funds. Nest's flagship default strategy provides a fund for each year in which we expect a member to retire. The actual asset allocation will vary depending on the year of retirement. As at 31 March 2024, total assets under management were £40.1 bn, of which 94.8% was in the default strategy. Figure 1 shows the asset allocation of the default strategy as at 31 March 2024, compared with 31 March 2023. Table 2 below aggregates the relevant metrics for each underlying portfolio within an asset class to give an overall metric. It does not include sovereign debt, liquid assets, or private equity and credit, cash or derivatives, due to the challenges of collecting robust and comparable data. These omitted asset classes make up c. 16% of the portfolio.

Figure 1: Asset allocation in the default strategy



Default strategy metrics by asset class

Table 2A: Default strategy carbon emissions metrics by asset class

Asset type	% of total portfolio	Absolute emissions (tCO_2e)		Carbon footprint (tCO_2e/£m)		Year-on-year change in carbon footprint (%)	
		Scope 1+2	Scope 3	Scope 1+2	Scope 3	Scope 1+2	Scope 3
Equities	50.3%	1,086,560	2,551,336	40.8	103.1	-9.8%	-15.1%
Corporate Bonds	21.7%	560,512	1,549,339	85.6	272.4	-33.4%	-19.6%
Property	6.8%	6,087	53,715	2.6	24.2	-15.6%	-53%
Infrastruc-ture Equity	4.7%	55,077	90,246	31.0	56.5	-19.8%	+196.6%
Total	**83.4%**	**1,708,236**	**4,244,637**	**40.7**	**115.1**	**-18%**	**-10.3%**

Table 2B: Default strategy data quality and portfolio alignment metrics by asset class

Asset type	Data quality – % of holdings for which						Portfolio alignment (% of assets with SBTi target)
	Scope 1+2 data			Scope 3 data			
	Reported	Estimated	Unavail-able	Reported	Estimated	Unavail-able	
Equities	53%	44%	3%	45%	52%	3%	32%
Corporate Bonds[9]	69%		31%	69%		31%	15%
Property	97%	3%	0%	10%	3%	87%	13%
Infrastruct-ure Equity	95%	4%	1%	95%	4%	1%	0%
Total	**48%**	**27%**	**25%**	**38%**	**31%**	**31%**	**20%**

n/d: denotes no data

n/a: denotes not applicable

What the data shows

There are several reasons why the carbon footprint may vary from year to year, including:

- Changes in the carbon emissions reported by the underlying assets
- Changes in asset allocation, for example by allocating more money to less carbon-intensive holdings
- Changes in the methodology used to estimate emissions that are not directly reported by the assets
- Changes in data providers, which may lead to changes in estimated emissions where emissions are not reported
- Changes in the attribution factor. The carbon footprint metric based on EVIC is quite sensitive to market volatility and can lead to fluctuations in the metric that are not driven by changes in the actual emissions of the underlying asset. For example, if a company's market capitalisation falls while total debt remains the same, a bigger proportion of the company's emissions will be attributed to bondholders.

[9] We were unable to obtain a breakdown of reported versus estimated emissions for all portfolios in this asset class. The figures are therefore aggregated to show the proportion of assets for which data was available.

We expect that in the next few years, the carbon footprint may still fluctuate as more companies report data directly and we become less reliant on data estimation. Our fund managers also engage with companies throughout the year on emissions reductions and better reporting. For example, our high-yield fund manager engaged with a US mid-stream energy company during the year. While the manager acknowledged the company's ESG efforts, including targets of reducing flaring and methane intensity, they pointed out that the company does not have a TCFD report. This was considered a poor response from a large company that operates in a sector which is significantly exposed to climate risks and over the course of 2023 the manager reduced the portfolio's exposure to the company. In the longer term, we therefore expect that asset allocation and decarbonisation of the underlying assets will become the main drivers of the carbon footprint.

Below we give more detail on the changes in the carbon footprint from last year for each asset class:

- **Equities:** Almost 90% of our total equities allocation in the default strategy is in our climate-aware developed market equities fund. This fund has a lower carbon footprint than the other two equity funds in emerging market equities and commodity equities. Compared with March 2023, the Scope 1+2 carbon footprint of our equities allocation decreased by nearly 10%. This was primarily due to the reduction in the carbon footprint of the developed market and emerging market equities funds. It was driven by a tightening of the threshold for excluding companies with more than 10% of revenues from thermal coal-based power generation, oil sands and arctic exploration (from 20% previously). In the developed market equities fund, a lower allocation to high-emitting sectors in the developed market equity index also contributed to the reduced carbon footprint.
- **Corporate bonds:** Our corporate bonds allocation includes investment grade (global and sterling), high yield and emerging market bonds. The reduction in the carbon footprint in the bonds portfolio is primarily driven by the reduction in the carbon footprint in the high-yield, sterling, and emerging market corporate bond funds. Over the year, our high-yield fund manager reduced its exposure to high carbon emitters in the oil and energy midstream, utility and travel and leisure sectors. In the sterling bond funds, the reduction in carbon footprint was also driven by position changes within the funds, with the manager reducing its holding of three of the top five contributors to carbon footprint in March 2023. In our emerging market corporate bonds portfolio, the carbon footprint fell as a result of reduced exposure to selective higher carbon emitters, as well as reductions in the reported carbon footprint from some issuers.
- **Property:** The property section of the default fund is invested in a mix of listed Real Estate Investments Trusts (REITs), direct investment in UK properties and a property income fund. We were not invested in the property income fund in 2023, so there is no comparison to the previous year. The overall Scope 1+2 carbon footprint decreased slightly due to a lower allocation to REITs, which are more carbon-intensive. The Scope 1+2 carbon footprint for the direct investments increased slightly from last year, driven by an increase in energy consumption. Energy consumption is affected by a number of factors including tenant occupancy levels and use, accuracy of data collection and changing seasons, and therefore fluctuations in consumption figures are expected. On this fund, there has also been a slight increase in landlord purchased electricity and therefore Scope 2 emissions for the fund, owing to the continued phase out of gas across its assets. Energy purchased by occupiers represents Scope 3 emissions for our direct property assets. Last year, we only had information on the Scope 3 carbon footprint for REITs. This has reduced by 53%. Scope 3 data for the direct property fund is being reported for the first time this year. The manager is working to improve the quality and volume of Scope 3 data and has established an occupier engagement programme and new data collection and engagement tools to support this process.
- **Infrastructure:** The infrastructure allocation is mostly invested in global core infrastructure and renewable infrastructure, with a smaller allocation to UK infrastructure. The Scope 1+2 infrastructure carbon footprint reduced by nearly 20% compared to last year. In the global infrastructure portfolio, Scope 1+2 carbon emissions decreased by nearly 50%. This was due to a combination of factors including the sale of assets and some methodology changes. Some holdings also improved their emissions performance during the year. For example, a ferry operator increased the share of low and zero emissions vessels and increased its charging capacity leading to a decrease in its Scope 2 emissions. The Scope 3 carbon footprint increased from last year. This was primarily due to an increase in Scope 3 emissions in our renewable infrastructure portfolio. The manager engaged heavily with the fund's investments to improve data capture and quality over the reporting period,

which may have impacted this number. During the period, the fund also completed construction of several new wind farms and a solar rooftop portfolio, and therefore had increased emissions from construction activities and purchased goods. Now that these assets are operational, Scope 3 emissions are expected to fall over the next reporting period.

- **Total default fund strategy:** In the total default strategy the Scope 1+2 carbon footprint fell by around 18% compared to last year. In addition to the movements within each asset class highlighted above, the carbon footprint fell due to small changes in asset allocation, including increasing our exposure to developed market equities, whilst reducing our exposure to emerging market equities, which has a higher carbon footprint. The default strategy's Scope 3 carbon footprint fell by 10.3%, similarly driven by decreases in the carbon footprint of equities and bonds.
- **Alignment metric:** The proportion of assets with a validated SBTi target increased slightly from 18.8% last year to 20% this year. This was due to a higher proportion of issuers with accredited targets in the global and sterling investment grade bond portfolios.

Fund choices

In addition to the default fund, we offer a number of other fund choices for our members and report on the relevant metrics in table 3:

- **Ethical Fund**: The Nest Ethical Fund is for people who want to invest in line with specific ethical or moral concerns, for example in areas such as human rights and fair trade. It doesn't just exclude companies that harm the world, its people, or the environment, it also proactively invests in organisations that make a positive contribution to society. The fund invests in a range of asset classes to manage risk appropriately at different stages of members' lives. It follows a dynamically managed, three-stage glide path which is similar to our flagship Nest Retirement Date Funds. We have chosen to display the ethical growth stage fund as most of our members will be in the growth phase fund for a long time. 60% of this fund is invested in equities, with the remainder in corporate bonds, property, renewable equity infrastructure and liquid assets.
- **Sharia Fund**: The investments in this fund are screened by Islamic scholars to meet Sharia standards. Lifestyling and diversification at the asset allocation level are not currently possible for this fund as it invests entirely in a single asset class – equities.
- **Higher Risk Fund**: The Higher Risk Fund is for members who are more confident about taking investment risk in the expectation that their pot will grow faster. 70% of this fund is invested in equities, with a higher proportion in emerging market and commodity equities than the default fund. We have not included emissions from sovereign debt in the aggregate for this fund due to the issues around aggregation outlined above. This asset class makes up c. 3.4% of the fund.
- **Lower Growth Fund**: This fund is provided for members who are very cautious about investing and are prepared to accept their pot will not grow very much. The aim of the fund is to maintain the value of members' savings after all scheme charges over the long term. It may not keep up with the rising cost of living. All of this fund is invested in investment grade bonds.

You can read more about the asset allocation of our retirement date funds in our **quarterly investment report**. We are not reporting separately on Nest's post-retirement option, the Nest Guided Retirement Fund.

Metrics by fund choice

Table 3A: Carbon emissions metrics by fund choice

	Absolute emissions (tCO2e)		Carbon footprint (tCO2e/£m)		Year-on-year change in carbon footprint (%)	
Fund choice	Scope1+2	Scope 3	Scope 1+2	Scope 3	Scope 1+2	Scope 3
Ethical Fund	7,451	139,903	25	334	-44%	+43%
Sharia Fund	9,839	n/d	18.8	n/d	-25%	n/d
Higher Risk Fund	327,588	213,256	313.4	187.5	-5%	-8%
Lower Growth Fund	230	1,678	18	113	-44%	+14%

Table 3B: Data quality and portfolio alignment metrics by fund choice

	Data quality – % of holdings for which						Portfolio alignment (% of assets with SBTi target)
	Scope 1+2 data			Scope 3 data			
Fund choice	Reported	Estimated	Unavail-able	Reported	Estimated	Unavail-able	
Ethical Fund	87%	4%	9%	21%	67%	10%	34%
Sharia Fund	62%	34%	4%	0%	0%	100%	50%
Higher Risk Fund[9]	90%		9%	77%		23%	28%
Lower Growth Fund	26%	3%	71%	26%	3%	72%	7%

n/d: denotes no data

n/a: denotes not applicable for the asset class

What the data shows

- **Ethical fund:** The majority of the ethical fund is invested in ethical equities and corporate bond funds, with a small proportion in property and renewable infrastructure assets. There's been a decrease in the Scope 1+2 carbon footprint since 2023 in line with the equity and corporate bond funds targets to reduce financed emissions by 50% by 2050 from a 2019 baseline. The decrease in the Scope 1+2 carbon footprint was largely driven by a 60% fall in the carbon footprint of the ethical sterling corporate bonds portfolio. Whilst the Scope 1+2 carbon footprint fell, the Scope 3 carbon footprint increased by 43%, primarily driven by a 45% and 127% increase Scope 3 carbon footprints in the ethical equities and ethical corporate bond funds, respectively. This increase occurred for a few reasons, including portfolio weight changes which can impact the contribution of large emitters disproportionately, especially in a concentrated portfolio. Additionally, new holdings have pushed up the ethical equities carbon footprint, for example in waste collection provider Waste Connections, now the second-largest contributor to the ethical equity strategy's carbon footprint.
- **Sharia fund:** As a result of being invested only in equities with a high proportion of technology companies, this fund has a low Scope 1+2 carbon footprint at 19 tonnes of CO2e per £million invested. The Scope 1+2 carbon footprint decreased from last year mainly due to a reduction in the fund's allocation to oil & gas companies. The investment manager does not provide Scope 3 carbon data, which relies primarily on estimated and can vary significantly between sources. The manager is looking for improved coverage and quality of the data before providing it in reporting to clients
- **Higher risk fund:** The higher risk fund has a higher allocation to emerging market equities and high-yield corporate bonds than the default fund. Both of these sub-asset classes are relatively carbon-intensive. The fund's has decreased by 5% since last year. This was driven primarily by the

reduction in the carbon footprints of the high-yield corporate bonds, emerging market corporate bonds and REITs. The rationale for these changes is set out above.

- **Lower growth fund:** The lower growth fund only invests in investment grade corporate bonds. There's been a decrease in the Scope 1+2 carbon footprint driven primarily by the reduction in carbon footprint in the sterling short duration portfolio, which makes up c. 45% of the fund. This was driven primarily by position changes within the fund. For example, the fund has reduced positions in Fonterra Co-operative Group, Enel, and Go-Ahead Group, which were all in the top 5 contributors to carbon footprint in the fund in March 2023.

Targets

We aim to align the Scheme's whole investment portfolio with limiting global warming to 1.5C above pre-industrial levels by reaching net zero carbon emissions – across Scopes 1 to 3 – by 2050 or sooner.

To set a course for this ambition, we have set a 2025 target of a 30% reduction in Scope 1 and Scope 2 carbon footprint in our listed equity and corporate bonds portfolios from a December 2019 baseline. We have set a 2030 emissions reduction target of 50% on the same basis, which is in line with the need for global emissions to roughly halve by 2030 from a 2019 baseline to be on track for net zero emissions by 2050. This target translated into a decarbonisation rate of around 7% per year.

We have communicated these targets to our investment managers and reflected them in our governance, strategy and risk management processes. Twelve of the Scheme's current external investment managers[10], collectively managing almost 87% of the Scheme's assets, 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 like Nest 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.

As a result of the challenges around data availability we have not yet set targets for alternative asset classes, although we are tracking emissions performance where possible and have set specific objectives for managers for all asset classes. We take account of our performance, as well as improving data quality and progress in the wider economy, including updates to decarbonisation pathways, when reviewing these targets. We will consider extending these targets to include Scope 3 emissions and a wider range of asset classes in due course. Just under 70% of total assets in the default fund have specific portfolio-level decarbonisation targets for 2025. These are shown in table 4 below.

We are also mindful of the strategies available to us to reduce financed emissions, and the real-world impacts of doing this. For example, it is possible to reduce financed emissions through large-scale exclusions of carbon-intensive assets. However, such an approach is unlikely to have a significant impact on real-world emissions. In turn, it is unlikely to significantly contribute to meeting the goals of the Paris Agreement. By engaging with investee companies and encouraging them to decarbonise, we have a better chance of achieving real-world emissions reductions. We have therefore set a target to engage with companies responsible for at least 70% of the Scheme's financed Scope 1 and Scope 2 carbon emissions by 2025.

Progress to date

Table 4 sets out the decarbonisation targets for each relevant mandate and the progress to date. We work closely with our investment managers to translate our high-level targets into fund objectives. We develop these targets on a fair share basis, reflecting the different starting point for different regions and asset classes. As a result, our 2025 target for developed market equities is more ambitious than our

[10] As at 31 March 2024 these were Amundi (UK) Ltd, BlackRock Inc., BNP Paribas Asset Management, CBRE Investment Management, Columbia Threadneedle Investments, HSBC Global Asset Management, J.P. Morgan Asset Management (UK) Ltd, Legal & General Investment Management Ltd, Northern Trust Asset Management, Royal London Asset Management Ltd, Schroders plc and UBS Asset Management (UK) Ltd.

overall portfolio target. In aggregate, we have achieved a 33% reduction since 2019 in the carbon footprint for the scheme.

These changes have been driven primarily through asset allocation decisions, tilts, and exclusions in specific portfolios.

Most portfolios are ahead of their targets. The exception is the ethical sterling corporate bonds fund, which is slightly off its trajectory. The fund's carbon footprint has fallen slightly from end-2022 and must continue to fall further to stay in line with the reference trajectory. The materials sector is the largest contributor to the fund's carbon footprint. Cement producer CRH the largest contributor at the issuer level, followed by utility company Engie. Both have SBTi-approved near-term emissions reduction targets in place.

Table 4: Targets and progress across portfolios

Portfolio	Decarbonisation rate and baseline year	2024 target implied by decarbonisation rate[11]	2024 actual performance
Developed market equities	-7% per annum, 2019 baseline	-25.2%	-58.3%
Investment grade bonds[12]	-7% per annum, 2019 baseline	-25.2%	-70.9%
Investment grade bonds short duration[12]	-7% per annum, 2019 baseline	-25.2%	-68.6%
Ethical equities[13]	50% by end-2029, 2019 baseline	-25%	-50.1%
Ethical sterling corporate bonds[13]	50% by end-2029, 2019 baseline	-25%	-22.9%
High-yield bonds[12]	-7% per annum, 2020 baseline	-19.6%	-28.1%

[11] The implied target is as at March 2023 assuming a 7% decrease per annum relative to the previous year's residual emissions figure.

[12] Target is based on WACI rather than EVIC. WACI normalises by revenues and is therefore often preferred by investment managers for comparing potential holdings and making investment decisions, while the EVIC is generally the preferred approach for assessing the emissions financed by investors.

[13] Only held in the Ethical fund choice

Glossary

absolute emissions
The total GHG emissions of an asset class or portfolio

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 footprint
A measure of the emissions per million pounds (tCO2e /£m) invested or financed.

carbon offset
Compensating for emissions by funding an equivalent unit of carbon dioxide saving elsewhere.

carbon pricing
Attempts to capture the external and often indirect cost of CO2 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 and emerging markets equities climate-aware fund was developed by us in partnership with UBS Asset Management and Northern Trust Asset Management, our investment managers for developed and emerging markets equities respectively.

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.
The Scheme's default investment strategy, 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.

EVIC

Enterprise value including cash. The sum of the market capitalization of ordinary shares at fiscal year end, the market capitalization of preferred shares at fiscal year-end, and the book values of total debt and minorities' interests. No deductions of cash or cash equivalents are made to avoid the possibility of negative enterprise values.

financed emissions

Emissions that investors finance through their loans and investments.

green bond

A fixed-income instrument issued by companies or governments to raise money for environmental and renewable energy projects.

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 (CO2), methane, nitrous oxide and fluorinated gases. Over three quarters of global GHGs are CO2.

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 Climate Action 100+.

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' (SIP).

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 2C above the average level recorded for the period 1850 to 1900 and to pursue efforts to limit global warming to 1.5C.

In total, 193 of 197 countries have ratified the agreement to date. Countries which have signed but not yet ratified the agreement as at 31 March 2022 are Eritrea, Iran, Libya and Yemen.

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

Partnership for Carbon Accounting Financials (PCAF)

A global partnership of financial institutions that work together to develop and implement a harmonized approach to assess and disclose the greenhouse gas (GHG) emissions associated with their loans and investments.

carbonaccountingfinancials.com/

purchasing power parity

The rate at which the currency of one country would have to be converted into that of another country to buy the same amount of goods and services in that country.

science-based targets

Targets adopted by companies to reduce GHG emissions are considered science-based if they are in line with what the latest climate science says is necessary to meet the goals of the Paris Agreement—to limit global warming to well-below 2°C above preindustrial levels and pursue efforts to limit warming to 1.5°C.

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

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.

WACI

Weighted Average Carbon Intensity. Measures a portfolio's emissions intensity by calculating the weighted average emissions of the portfolio normalised by revenues.

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nestpensions.org.uk

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