



Smart Pension Master Trust Climate and Nature Policy

June 2023

A message to our members

Climate change and nature related issues can affect the risk and value of your investments. This document sets out why that is the case and how we approach managing the risks and taking advantage of the opportunities to improve your long-term outcomes, and positively contribute to progress in the real world.

We believe that to provide the best outcomes for our members we need to take into consideration the long term impact of their investments from a climate and nature perspective. Economies rely on goods and services generated by natural capital, such as food, raw materials and water. These economies are often regulated by climate legislation. Climate and nature are under unprecedented threat which in turn can adversely affect our members' money when not considered from an investment perspective.

Our Climate and Nature policy is embedded in our investment strategy and informs all the investment funds we provide for members, both within the default funds and the self-select investments. The policy is written and executed by the Trustee's Investment Sub-Committee which constantly monitors the application of the principles and investment guidelines. The policy is summarised and referred to in the Trustee's Statement of Investment Principles.

Guiding Principles

Climate change

Climate change is one of the most important challenges facing the world today and cannot be solved overnight. Being proactive in addressing the causes of climate change, and targeting a lower temperature outcome than is currently forecast, is a key sustainability goal of our investment strategy. Decisions today will have an impact many years from now and the Trustee believes that the pensions industry has a responsibility to be part of the solution. We recognise that addressing climate change requires a global response and changes beyond our investments. The Trustee supports effective stewardship and collaboration with industry groups as a strong tool to promote wider progress and solutions to the climate challenge.

Transitioning from a fossil fuel economy to a low-carbon economy requires huge long-term investment and can only be achieved if new sources of capital are identified and directed towards those investments. Pension schemes can therefore play a meaningful role in facilitating the transition to a Net Zero economy in the coming decades. It is also essential for the value of our members' pension pots that we are proactive in identifying the climate-related risks and opportunities. We aim to manage the risks and take advantage of new opportunities where appropriate.

Nature (including biodiversity)

The Trustee recognises that we cannot deliver on net-zero commitments and keep global temperature rise to 1.5°C without considering nature and biodiversity issues, including ending commodity-driven deforestation. Forests provide food and shelter for life on earth, influence rainfall patterns, water and soil quality and flood prevention. Trees also absorb and store carbon dioxide. If forests are cleared, or even disturbed, they release carbon dioxide and other greenhouse gases.

When we refer to nature, we mean the natural world and all its living and non-living things, with an emphasis on the diversity of living organisms (including people) and their interactions among themselves and with their environment. Biodiversity is a part of nature, as is the variability among living organisms from all sources including the diversity within species, between species and of ecosystems. Specific issues such as deforestation are related to climate change and nature and biodiversity loss, as well as human right violations.

Therefore our commitments to be net-zero by 2040 and to eliminate commodity-driven deforestation are interlinked with our overall aim to mitigate climate change and nature and biodiversity loss to reduce the risk in our members' investments as well as having a positive impact on our planet and people. It is also essential for the value of our members' pension pots that we are proactive in identifying the nature-related risks and opportunities. We aim to manage the risks and take advantage of new opportunities where appropriate.

The risks

Climate change and nature and biodiversity loss brings both physical and transition risks to the value of investments. Physical risks refer to the direct impacts: rising sea levels, coastal damage, flood risks, extreme weather events and droughts are all linked to climate change and nature, which pose risks to physical assets and higher insurance costs. Transition risk refers to the costs and disruptions from changing behaviour and policy actions to address climate change and nature and biodiversity loss. As an example, fossil fuel companies may see lower commodity prices and the risk of “stranded assets” where assets are no longer economically viable due to policy changes or climate effects and need to be written off. Heavy polluters are also likely to face rising costs from taxation and regulation. Another example is palm oil, which is an ingredient used widely in many products, and is a major driver of deforestation in tropical regions. The deforestation, land-use change and human rights violations linked to the production of palm oil poses reputational and financial risks to companies exposed.

The opportunities

The transition to a low-carbon and nature-aware economy will also create many new opportunities. The scale of investment required in the coming years is huge. New technologies and new industries in climate and nature-related investments are certain to be created in the need to make meaningful progress towards longer-term net zero goals and many of these will generate attractive long-term investment returns appropriate for pension funds. And financing large scale new infrastructure developments which address climate change opens up further

opportunities, such as the green bond market. A key goal of our investment strategy is to look for new opportunities which not only limit harmful emissions and the impact on our biodiversity but are also part of the climate and nature solution.

As a master trust there are significant price constraints on the “investment budget” which means we need to balance the allocation to higher cost impact / climate / active strategies with the overall costs to members. There will almost certainly be more room for a greater allocation in the coming years as 1) the increase in the provision of such strategies together with increased allocations from investors will serve to lower the cost of these funds for pension schemes; 2) the advances in, and growth of, green technologies will reach levels where there are greater economies of scale leading again to lower costs; 3) as the Smart Pension Master Trust itself grows in size the ability to allocate to higher cost (impactful) strategies will increase as investment cost is spread over the total investment budget of the default fund.

Investment Beliefs

The Trustee of the Smart Pension Master Trust believes that climate change and nature and biodiversity loss, including the policies to address the negative impacts of these and how we transition to a lower carbon and nature-aware future, will have a material impact on the value of investments over the time horizon of its members’ pension savings. Additionally, the interests of members are best served if the investment strategy takes full account of the risks and opportunities related to climate change and nature.

The Trustee seeks to:

- ensure that the investment strategy considers the physical and transition risks to its members investments associated with climate change and nature including biodiversity loss and current and future policy action and is positioned accordingly;
- identify opportunities which are sustainable and offer climate and nature solutions;
- position the members’ investments, in a manner consistent with providing strong returns on members’ assets and limiting global warming to 1.5°C above pre-industrial levels in line with the best efforts target of the Paris Agreement on Climate Action and recommendations by the Intergovernmental Panel on Climate Change (IPCC);
- use external managers who have in place policies and/or commitments to cease fossil fuel expansion; and
- align members’ investments with our commitments to eliminate commodity-driven deforestation and biodiversity loss from investments.

We aim to limit the global warming indication of our default investment portfolio by reaching net zero carbon emissions by 2040, halving emissions before 2025 from our baseline year of 2019. We also aim to limit the effects on nature and biodiversity by eliminating commodity-driven deforestation and biodiversity loss. We expect fund managers to consider these targets in the funds they manage for us, and will aim to pick new managers who align, or will align, to this. In addition, as set out in our Responsible Investment Policy (available [here](#)),

we expect fund managers to be, or are working towards being, signatories of the UN Principles for Responsible Investment and the UK Stewardship Code.

While the Trustee commits to this Climate and Nature Policy, there may be exceptional short-term circumstances where the Trustee is unable to meet the requirements of this Policy. The Trustee expects that these exceptional circumstances would be minimal, of short duration and would reverse as soon as possible. As such, it is also expected that these circumstances would not materially hinder the ability of the Smart Pension Master Trust to operate in line with the Climate and Nature Policy for any significant period of time.

Smart Pensions' Climate and Nature Policy is based on the broader investment principles set out in the Trustee's Statement of Investment Principles which can be found [here](#). This policy covers all the investments we make on behalf of our members, across different asset classes, and determines our overarching approach to the selection of external asset managers and individual funds.

Investment Strategy

Our approach to addressing climate change and nature and biodiversity loss can be summarised as follows:

1. We analyse the climate and nature related risks in the investments we make on behalf of our members and set our investment strategy to take into account those risks. Limiting climate and nature risks is a key consideration in the selection of the investment funds we select for our members pension portfolios;
2. We seek appropriate investment opportunities which contribute to addressing climate change and nature and biodiversity loss and are consistent with the best interests of our members;
3. We publicly advocate and support initiatives which promote the transition to a low carbon economy, nature positive and deforestation-free investments with industry, policymakers and stakeholders;
4. We monitor the carbon footprint of our members portfolios and set targets to reduce the harmful emissions of the portfolios in line with our commitment to the goal of net zero emissions;
5. When we select a new fund for the default investment funds or self-select options we research each fund to ensure their practices align with our responsible investment and climate and nature policies. This includes detailed questions of their approach to managing these risks, their journey to net zero, their advocacy for climate action and limiting nature and biodiversity loss through policies in relation to fossil fuel, biodiversity and deforestation. As we move towards monitoring and reporting the climate and nature performance of our funds, we ensure that external managers measure and disclose the carbon footprint of their funds, using consistent methodology and are looking to develop measurements beyond emissions;

6. We look to direct or influence voting and engagement activities, with particular consideration to companies which are most material to climate and nature risks, such as deforestation as outlined by Global Canopy's Forest 500 companies, deployed in line with our Voting and Engagement Policy;
7. We will fully inform our members and other stakeholders of our actions, commitments and targets for addressing climate change and nature and biodiversity loss, and the performance of portfolios against those targets, in line with the best practices recommended by the Taskforce for Climate-Related Financial Disclosures (TCFD); and
8. We will endeavour to continue to seek member feedback on the scheme's effectiveness of communicating our pathway to net zero.

We recognise the need for a balance between the risk and return of our investments. Therefore, we will continue to decarbonise our default investment portfolio through a carbon-reduction transition and look to allocate towards climate and nature solutions which have a positive impact. As stated in our Responsible Investment Policy, we want to encourage this action to be taken through focused engagements, which aims to benefit from investment opportunities over time. More information on our approach on engagement and stewardship can be found in our Voting and Engagement Policy [here](#).

The Trustee also seeks to minimise and manage the greatest financially material risks to protect long-term returns by excluding companies which are considered the "worst offenders" this includes those that are involved in the manufacturing of controversial weapons as defined by the United Nations, derive the majority of their revenues from coal mining and violate the United Nations Global Compact standards on human rights, labour, the environment and corruption.

We have signed up to the Institutional Investors Group on Climate Change (IIGCC), which feeds into the Paris Aligned Investment Initiative's (PAII) net zero framework, and we have committed to the Impact Investing Institute's Impact Investing Principles, to support and progress our investment solutions in light of climate change and nature and biodiversity loss.

Find out more about our road to net zero [here](#).

Glossary

Climate

Climate refers to the composite or general prevailing weather conditions of a region, as temperature, air pressure, humidity, precipitation, sunshine, cloudiness, and winds, throughout the year, averaged over a series of years.

Global warming

The long-term heating of Earth's climate since the pre-industrial period (between 1850 and 1900) due to human activities, primarily fossil fuel burning.

Greenhouse gases

There are four greenhouse gases linked to global warming: carbon dioxide (the majority), methane, nitrous oxide and fluorinated gases. "Carbon dioxide equivalent" or "CO₂e" is a term for describing different greenhouse gases in a common unit. For any quantity and type of greenhouse gas, CO₂e signifies the amount of CO₂ which would have the equivalent global warming impact.

Net Zero

The balance between the amount of greenhouse gases produced and the amount removed from the atmosphere. We reach net zero when the amount we add is no more than the amount taken away. It will help limit global warming.

Climate solutions

Investments which look to help the conservation, restoration and improved land, water and waste management actions that increase carbon storage or avoid greenhouse gas emissions.

Nature

Nature refers to the natural world, with an emphasis on the diversity of living organisms (including people) and their interactions among themselves and with their environment.

Natural Capital

The stock of renewable and non-renewable natural resources (e.g., plants, animals, air, water, soils, minerals) that combine to yield a flow of benefits to people.

Biodiversity

Biodiversity refers to the variety of living species on Earth, including plants, animals, bacteria, and fungi, and their interactions with each other.

Biodiversity solutions

Projects or companies which support the sustainable use of natural resources and ecosystem services, as well as technologies, products and services to help reduce biodiversity loss, threats or restore natural habitats.

Deforestation

Deforestation is the intentional clearing of forested land, usually for commodity-driven reasons to make space for agriculture and animal grazing or to obtain wood for fuel, manufacturing, and construction. It can greatly change our physical land, our climate and our economies.

Economy (economies)

The state of a country or region in terms of the production and consumption of goods and services and the supply of money.

Principles for Responsible Investment (PRI)

A United Nations-supported international network of investors working together to use responsible investment to enhance returns and better manage risks.

UK Stewardship Code

High stewardship standards for those investing money with the aim for responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Paris Agreement

A legally binding international treaty on climate change to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels. Countries communicate actions they will take to reduce their Greenhouse Gas emissions and they will take to build resilience to adapt to the impacts of rising temperatures.

Intergovernmental Panel on Climate Change (IPCC)

The United Nations body for assessing the science of climate change and to report on its implications and potential future risks, as well as to put forward adaptation and mitigation options.

Institutional Investors Group on Climate Change (IIGCC)

The European membership body for institutional investor collaboration on climate change. Its work supports and helps to define the public policies, investment practices and corporate behaviours that address the long-term risks and opportunities associated with climate change.

Paris Aligned Investment Initiative (PAII)

Established in May 2019 by the Institutional Investors Group on Climate Change (IIGCC), it has grown into a global collaboration supported by four regional investor networks – AIGCC (Asia), Ceres (North America), IIGCC (Europe) and IGCC (Australasia).

Impact Investing Institute

Launched in 2019 with a simple mission: to accelerate the growth and improve the effectiveness of the impact investing market in the UK and internationally – as set out in the United Nations' Sustainable Development Goals.

Task Force on Climate-related Financial Disclosures (TCFD)

A Task Force which has developed consistent climate-related financial risk disclosures for use by companies, banks, and investors in providing information.



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