Smart Pension

Smart Pension Master Trust Climate policy

July 2021

Guiding principles

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, are key sustainability goals of our investment strategy. Decisions made today will have an impact many years from now and the Trustee believes that the pension industry has a responsibility to be part of the solution.

Climate change brings both physical and transition risks to the value of investments. Physical risks refer to the direct impacts of climate change – rising sea levels, coastal damage, flood risks, extreme weather events and droughts are all linked to climate change, and all pose risks to physical assets and higher insurance costs. Transition risks are the costs and disruptions from changing behaviour and policy actions to address climate change. As examples, 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) which need to be written off. Heavy polluters are likely to face rising costs from taxation and regulation. Products based on energy-intensive technologies may become obsolete, an example of which is the phasing-out of diesel car engines in many European countries in the coming years.

Yet the transition to a low-carbon economy will also create many new opportunities. The scale of investment required in the coming years is huge. New technologies and industries are certain to be created, and many of these will generate attractive long-term investment returns appropriate for pension funds. And financing new large-scale 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 but also form part of the climate solution.

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. With the introduction of Auto Enrolment (AE) in the UK, pension savings are growing strongly. DC workplace assets will be pushing £1trn by 2028 (Broadridge UK Defined Contribution and Retirement Income, 2019). Pension schemes can 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. This includes setting an appropriate investment strategy to both manage the risks and identify and take advantage of new opportunities where appropriate.

As a master trust, there are significant price constraints on our "investment budget". (What that means is that 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, and (3) as the Smart

Pension Master Trust (SPMT) 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 SPMT believes that climate change, and policies to address the negative impacts of climate change and the transition to a lower carbon future, will have a material impact on the value of investments over the time horizon of its members' pension savings. Additionally, the interests of its members are best served if its investment strategy takes full account of the risks and opportunities relating to climate change.

The Trustee seeks to:

- ensure that the investment strategy considers the physical and transition risks to its members' investments associated with climate change, and that current and future policy action and is positioned accordingly, and
- position the members' investments in a manner consistent with maximising the value of the members' assets, to contribute to the goals of the Paris Agreement.

Smart Pension Limited is aligning its business, which includes the SPMT, with a pathway to net zero harmful emissions by 2050, in line with the policy commitment of the UK government. The term 'net zero emissions' implies that global warming is limited to +1.5°C above pre-industrial levels in line with the best efforts target of the Paris Agreement on Climate Action.

While the Trustee commits to this Climate 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 be reversed as soon as possible. As such, it is also expected that these circumstances would not materially hinder the ability of the scheme to operate in line with the Climate Policy for any significant period of time.

Our approach to addressing climate change can be summarised as follows:

1. We analyse the climate-related risks in the investments we make on behalf of our members and set our investment strategy to take those risks into account. Limiting climate risk 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 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 among 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 policy. This includes detailed questions of their approach to managing climate risk and their advocacy for climate action. As we move towards monitoring and reporting the climate performance of our funds, we ensure that external managers measure and disclose the carbon footprint of their funds, using consistent methodology.
6. We will fully inform our members and other stakeholders of our actions, commitments and targets for addressing climate change, and the performance of portfolios against those targets, in line with the best practices recommended by the Taskforce for Climate-Related Financial Disclosures (TCFD).
7. We will endeavour to continue to seek member feedback on the scheme's effectiveness of communicating our pathway to net zero.

Investment strategy

In March 2020 the Trustee developed a new Strategic Asset Allocation (SAA) policy for the main default (growth) fund of the SPMT. In time, 76% of the asset allocation is directed towards passive equity products using a customised Environmental, Social and Governance (ESG) index which favours companies with a strong environmental rating and lower carbon footprint relative to companies with a poorer climate profile. In addition, the funds currently used have an explicit climate overlay, targeting a further reduction in harmful emissions and an increase in companies with higher green revenues. Furthermore, the funds currently used have an explicit target of an annual implied temperature reduction from current projections of 0.1 degree Celsius for each year through to 2030. The investments are currently made through specialist pooled funds.

In addition to the explicit climate tilt, the pooled fund manager currently used was selected as the fund provider because of their commitment to climate action and because they are recognised by ESG data providers as a leader amongst major asset managers for climate engagement.

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