A4S
ASSET OWNERS
NETWORK

SETTING A NET ZERO INVESTMENT STRATEGY

Case study: Atos UK 2019 Pension Scheme

THE PRINCE OF WALES'S CHARITABLE FUND

Atos

WHAT?

Atos is a digital solutions and consultancy services provider, offering solutions such as advanced computing, analytics, AI, automation and cybersecurity.

Atos Pension Schemes Limited has oversight of both the defined benefit (DB) and defined contribution (DC) sections of the Atos UK 2019 Scheme. These are managed on a single-employer basis, with 7,926 members and approximately £2 billion assets under management. Our scheme is overseen by two independent trustees using external advisers and asset managers.

In early 2020, we took steps to align our DB pension scheme's climate commitments with that of our sponsor – that is, to achieve net zero greenhouse gas (GHG) emissions across our portfolio by 2035. We decided to focus on our DB scheme first because we had recently restructured the operational side of our DC scheme and wanted to allow the changes to bed-in before making additional changes.

WHY?

The trigger to commence our net zero journey was principally the need to align the pension scheme with our sponsor's net zero commitment. As a business, Atos is deeply committed to transitioning to, and ultimately operating, a net zero business. In June 2020, Atos made its public commitment to reach net zero by 2035, and in February 2021 it raised the ambition to achieve net zero by 2028.[1]

As independent trustees, we observe the increasing appetite for ESG and net zero alignment within the pensions industry and with the corporates we speak to. We are also aware of the importance of delivering our fiduciary duty by actively considering ESG. Having a sole trustee model allows for continuous discussion between the trustees in addition to the usual quarterly meeting cycle. This gave us the agility required to establish the foundations for a net zero investment strategy at pace. We also acknowledge that regulation is moving in this direction with the mandatory implementation of the recommendations of the **Task Force on Climate-related Financial Disclosures (TCFD)**.

In discussion with Atos's Head of Sustainability, we highlighted the opportunity to undertake a net zero transition within the pension scheme by decarbonizing the holdings within the portfolio. The sponsor supported a net zero investment strategy for the pension scheme.

[1] https://atos.net/en/2021/press-release_2021_02_18/atos-boosts-its-decarbonization-ambition-committing-to-net-zero-by-2028

HOW?

After gaining support from the sponsor, our next step was to embed our responsible investment belief statement within our Statement of Investment Principles (SIP). Our updated SIP acts as our ‘North Star’ and we, and our asset managers, use it for every investment decision, from both a traditional and net zero risk/return perspective. This approach has facilitated a smooth adoption of our net zero focus by all members of our governance process. Within the belief statement, we refer to a net zero investment decision framework we developed with our investment advisers.

The framework is based on the Pensions Climate Risk Industry Group guidance[2] on aligning pension schemes with the TCFD recommendations. This advises asset owners to start by establishing – and agreeing with wider key stakeholders – a clear governance framework for investment decisions.

We developed our decision framework with our sponsor, requiring all investment decisions to be appraised through the dual lens of financial risk and return as well as alignment with net zero by 2035. We are in the process of evolving our responsible investment belief statement into a more comprehensive policy that will cover granular detail about our views on how asset managers should approach issues such as engagement versus divestment.

We shared and agreed our evolved SIP with our sponsor. Working with our investment advisers we then developed the steps we would take to deliver on this over the next 12 months, including realigning our asset allocations. We periodically review progress against the plan with our investment advisers and have found that our end point and overall approach needs refining as we revisit metrics or new data is provided.

As a mid-sized scheme without the support of a comprehensive in-house team, we need to rely heavily on our advisers to develop our net zero investment strategy, so it is crucial that we are confident of their experience and expertise in this area. We have extensive conversations with our current advisers to understand their experience of, knowledge of and approach to net zero pension strategies. Some of our questions to them are about how they would assess investments when different asset classes use different methodologies and GHG emission calculations. We are happy with the detailed explanations and possible resolutions they have provided to challenges thus far, such as the aggregation issue. They also supply us with all the metrics we need to support decision making and provide a view of the progress we are making. We are mindful that continual monitoring of the climate competence of our investment advisors – as well as our other service providers – is essential given the fast moving nature in this area. For assessment of our investment advisors, we use the **Guide for assessing climate competency of Investment Consultants** developed by the Investment Consultants Sustainability Working Group (ICSWG).[3]

It has only taken three months from the initial contact with our sponsor to making a public net zero commitment. This is thanks to the simplicity of our governance structure and the fact that our sponsor was highly motivated.

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[2] https://www.gov.uk/government/publications/aligning-your-pension-scheme-with-the-taskforce-on-climate-related-financial-disclosures-recommendations

[3] This working group is a collaboration between investment advisors, formed in 2020 in response to the consultation by the UK Pensions Climate Risk Industry Group (PCRIG) that called on investment consultants to do more to demonstrate their competence. See more here.

Internal stakeholders

To govern our net zero plan, we established a small working group consisting of our two trustees and Atos's Head of Sustainability, pulling in relevant additional internal and external stakeholders on an 'as and when needed' basis. The aim of this group is to provide the space to develop the more granular work such as scrutinizing the climate-related data. This then frees up agenda time at quarterly trustee meetings to focus on the strategic direction of the scheme.

Sponsor

The sponsor has been engaged at all stages of our net zero investment strategy process. We have been keen to move in alignment with the sponsor where possible, and therefore all material updates have been taken to the sponsor for approval. Given Atos's strategic focus on net zero, this has been welcomed by the sponsor. We also have meetings every six months with Atos's Head of Sustainability to provide progress updates and use it as an opportunity to stay aligned with the business's sustainability targets.

Review of existing asset managers

An early exercise we undertook in partnership with our sponsor was to define an investment 'wish list' of both positive and negative portfolio themes, ie investments that align to a 1.5°C pathway and those that do not. We then asked our asset managers to map their strategies to this wish list. This undertaking helped us to monitor the asset managers' stewardship activities with our investee companies. Overall, this was a valuable exercise to help assess whether our asset managers had the right capabilities and volition to support us with adhering to our SIP.

Some asset managers were readily able to complete the exercise while others reported not having the necessary data. Making our expectations clear that we required our asset managers to be able to provide relevant net zero data and deliver such assessments, provided our asset managers with a sufficient driver to stretch their data capabilities and deliver against the wish list. We have been able to minimize our exposure to the negative portfolio themes in our segregated equity and credit mandates as we have a high level of discretion here. We continue to have some exposure in the pooled private debt fund we invest in due to the illiquidity of the holdings. These investments reflect the holdings at the point of investment, which was before we had established a net zero commitment. However, we continue to hold one-to-one meetings with our asset managers to influence their investment choices and plan to use cross-investor calls in the future to help drive collective change within our pooled funds.

DEFINING AN INVESTMENT STRATEGY TO ACHIEVE NET ZERO

To align our asset allocation with our net zero aspirations, we use an asset manager research team segmented by asset class, who have ESG as key criteria they use in their allocation decisions. We do have a divestment strategy, but our primary emphasis is on stewardship and engagement with companies. We document our stewardship policy within our implementation statement, as is required for DB schemes.[4] If companies are not engaging with our requests to formalize decarbonization plans then it is our policy to divest, but we have not yet found ourselves in a position where this has happened. In addition, when selecting our asset managers, we appraise them on their ability to execute investee engagement in line with our investment belief statement, divestment strategy and stewardship policy.

Atos as a business does intend to use voluntary carbon offsets to reach net zero. However, within the pension scheme, we have not considered using these types of offset. We considered and decided against investing in carbon credits at this stage. With an investment lens, we feel that carbon offsetting via credits is likely to have a negative expected financial return, so we would find it hard to justify holding such assets from a fiduciary perspective.

We have taken the following approaches to begin transitioning each of our asset classes to net zero:

1. Equities have the greatest scope for net zero management due to the ability to align the equity allocation to indices that, in our case, track the **Transition Pathway Initiative**.

2. For long-term debt, we use the weighted average carbon intensity calculation to understand our GHG emissions intensity. We hold a segregated account with one asset manager and, as such, can be prescriptive in our guidelines. As well as the exclusion of tobacco-related debt, we exclude issuers with a temperature alignment of more than 4°C. This is calculated by our asset managers, who screen companies against a 4°C threshold using a proprietary method they use in partnership with an environmental consultancy.

3. For short-term debt, we engage with the issuer at the point of refinancing. If the issuer cannot detail a plan for how they will migrate to a more sustainable position, then our asset manager will not refinance the debt.

4. With regard to alternatives, the scheme has made a £100 million allocation towards renewable energy. This decision is motivated both by the compelling investment case for this asset class as well as the clear climate solution that renewables provide.

Due to different net zero investing methodologies and GHG emissions calculations across asset classes, it is challenging to aggregate up to an overall net zero target at a portfolio level. This is a challenge we are still working to overcome

[4] https://www.sackers.com/blog/implementation-statements-what-do-trustees-need-to-do-and-by-when/

As we started our net zero investment approach, we knew data quality and availability would be a challenge. We accepted this at an early stage and took steps to ensure we would not let perfection be the enemy of the good.

We have found it takes time to review and analyse data and reporting. This is especially the case where each of our asset managers reports climate metrics differently, which makes sense in terms of asset class differences, but which also makes it challenging to aggregate and analyse portfolio-level progress. Therefore, we allocate sufficient and focused time for analysis of reports, and schedule this outside of quarterly meetings so as not to lose valuable time for other governance matters.

It is important that we do not get lost in the detail and lose the narrative of the targets we are trying to achieve. We have found that requesting stewardship case studies on what each manager is doing with respect to engagement of underlying holdings has really helped to overcome this.

To start with, we are focusing on company-level scope 1 and 2 GHG emissions for public equities and corporate debt. As GHG reporting matures, we know investee companies will be able to report better on their scope 3 GHG emissions. At this point we will be in a better position to assess how and when we include this data, eg in order to avoid duplication issues at portfolio level if more than one investee company shared the same supply chain. Thinking through what each asset manager does with scope 3 information is important. We do not want to disincentivize our asset managers from working to increase the quality of the data by inadvertently punishing companies that are disclosing more GHG emissions data than their peers.

Overall, when analysing GHG emissions and climate data, we believe that strict rules-based systems are unlikely to work. Instead, we find sitting down with each manager and spending time to discuss and understand what they will measure and how it will change over time has yielded the most value.

NEXT STEPS

Our net zero strategy has been in place for over a year. We are now going to take stock, reflect and review progress. Given the number of industry-specific frameworks that have been published since starting (such as the **Institutional Investors Group on Climate Change's Net Zero Investment Framework**), the scheme's net zero strategy will be assessed against these frameworks to see if any adjustments need to be made.

We are still working on defining what net zero means to us. Given the challenge of reconciling net zero targets from asset class to portfolio level, this will evolve as our – and industry – practice becomes more mature.

We are waiting to engage our members actively on our net zero investment strategy. We are conscious that there are complex issues involved, especially around divestment and stewardship, and so we are taking advice on the best education and engagement approaches.

We will also focus on how best to maximize collective investor action and collaboration, as we believe this is one of the most effective ways to drive material net zero change. However, given the number of initiatives, we want to make sure we collaborate with the right group to maximize our impact.

On the DC side, we are in the process of moving to a master trust. Extending our net zero approach to our DC scheme will form part of the conversations with the appointed master trust.

Since our initial net zero commitment was agreed, our sponsoring employer has committed to an even more ambitious target of net zero by 2028. We agreed with the sponsor, prior to their making this announcement, that the pension scheme would maintain its 2035 target. The rationale is that the net zero deadline change would not change our overall approach. However, the new target did accelerate the sponsor's desire for our scheme to invest in renewable infrastructure.

TOP TIPS

DON'T LET THE PERFECT BE THE ENEMY OF THE GOOD

Data availability has been the biggest challenge for us, but we have not allowed this to be a blocker to implementation.

Accept that data is not perfect and that there is no standard industry-wide taxonomy or framework. We anticipate that, as and when data quality does improve, the GHG intensity of our portfolio will go up too, which is a good thing because it provides more transparency.

TALK TO THE SPONSOR EARLY TO UNDERSTAND THEIR NET ZERO APPETITE

For a single-employer scheme like ours, working in alignment with the sponsor was a key success factor in our ability to initiate a net zero investment strategy.

As independent trustees, we often find employers can overlook the opportunity to achieve net zero within their pension schemes. It can be a great complement to their business's overall net zero ambition.

SET UP A SMALL ESG/NET ZERO WORKING GROUP, INCLUDING TRUSTEES AND SPONSOR REPRESENTATION

We believe this is good governance as this is a vast subject that could otherwise take up a lot of time at main trustee board meetings.

It takes time to review and analyse data and reporting. Especially in the early stages where we are familiarizing ourselves with the types of metrics available.

BE SPECIFIC ON WHAT YOU EXPECT FROM YOUR MANAGERS

Using our portfolio wish list helped us identify those managers who were best placed to support our net zero investment strategy. Being specific on what we did and did not want to invest in enabled us to influence the relevance of data we received, with our managers stretching their data capabilities.

GET IN TOUCH OR FIND OUT MORE

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A4S ASSET OWNERS NETWORK

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