SPRING 2021

ENGAGE

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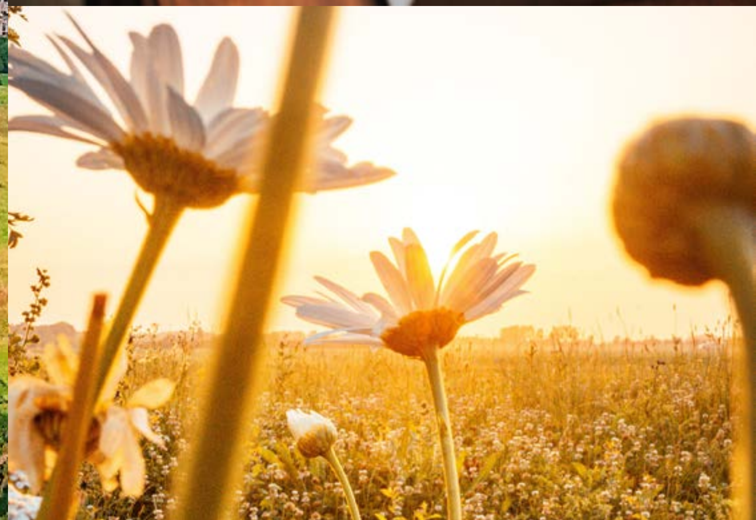
LOTHIAN PENSION FUND



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DOUG HERON, CEO,
LOTHIAN PENSION FUND

FOREWORD

2020 has been a momentous year that will live long in our memories. My team and I have been out of the office since 16 March, and at present have no confirmed date as to when we might be back together. Despite the challenges we faced, we continued to deliver for our members and employers. We:

- **Paid out £165,786,532 to 33,667 members and welcomed 4,204 new members (as of 30 November 2020)**
- **Issued 53,500 online pension statements**
- **Received 13,104 emails from members, 22,987 items of mail, and 2,678 documents uploaded via My Pension Online**
- **Achieved 51% sign up from active members and received 57,104 sign ins to our online service**
- **Achieved 96.8% overall customer satisfaction**
- **Completed AV2020, our triennial actuarial valuation to determine our funding level, which is now above 100%**

With the vaccines beginning to roll out (see page 6), it's possible to start looking forward to what 2021 and beyond will bring. The chief challenge in responsible investment remains Climate Change, and all eyes in the world will be on Scotland in 2021 as it hosts the delayed COP26 event scheduled for Glasgow in November.

COP26 will include the first five-year review of progress made since the signing of the Paris Agreement in 2015. The key to success in these progress reports is the continuous evolutions to countries' Nationally Defined Contributions, or NDCs. These NDCs set out what individual countries plan to do to play their part in decarbonising economies.

At the beginning of December we joined 77 other businesses and investors in calling for more ambitious NDCs in line with the UK's 2050 net zero target. Ten days later, the UK published a new set of NDCs, setting an aggressive 68% reduction in economy wide greenhouse gas emissions by 2030 (vs. 1990 levels).

We continue to work with government on behalf of our stakeholders (including on recent work to change the definition of inflation, see page 8), because we want to protect their values alongside the value of their pensions. Assessing stakeholder values was part of Mark Carney's excellent Reith Lecture series of 2020, which gave our investment team a lot to think about over the coming years.

We continue to engage with our company holdings, both directly and through our engagement partner EOS at Federated Hermes. Our Statement of Responsible Investment Principles (SRIP) reflects our belief in the value of engagement, where we influence companies to deliver enhanced ESG outcomes. We've explained our approach to this in previous issues of ENGAGE. We take the stance of being a critical friend to management teams and give advice, time to act, and the encouragement to do so. But engagement must lead to action and where we feel progress is too slow, and the prospect of financial risk to us increases as a result, we're willing to withdraw our support and end our investment.

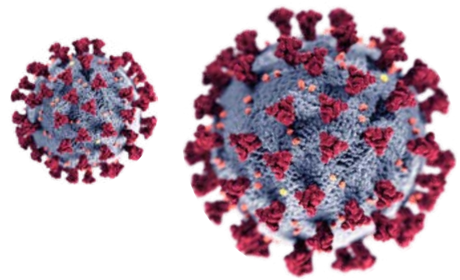
Finally, as part of our commitment to collaboration and engagement, we've joined the Institutional Investor Group on Climate Change (IIGCC). IIGCC have a number of workstreams that will enable our portfolio managers to further our influence on responsibility and sustainability within the finance industry, as we look to make positive real-world impacts alongside generating positive investment returns.

Doug Heron
Chief Executive Officer
Lothian Pension Fund

‘FOR THE PFIZER VACCINE TO BE DEVELOPED FROM SCRATCH, CLINICALLY TRIALLED, APPROVED BY REGULATORS, MASS-PRODUCED, DISTRIBUTED AND ADMINISTERED TO PATIENTS IN THE UK WITHIN JUST 12 MONTHS, IS NOTHING SHORT OF REMARKABLE. HISTORICALLY, NEW VACCINES HAVE TAKEN UP TO 10 YEARS FROM DEVELOPMENT TO MASS IMMUNISATION.’

IAN WAGSTAFF

INVESTING IN OUR GLOBAL HEALTH



Pfizer, the global pharmaceuticals giant in which Lothian Pension Fund have a £70m investment, has just created history by developing a vaccine in the shortest ever time to combat the coronavirus pandemic. They’ve done this is in partnership with German biotechnology firm BioNTech.

The first case of SARS-CoV-2 (to give it its official name) was only reported to the World Health Organisation (WHO) in December 2019. For the vaccine to be developed from scratch, clinically trialled, approved by regulators, mass-produced, distributed and administered to patients in the UK within just 12 months, is nothing short of remarkable. Historically, new vaccines have taken up to 10 years from development to mass immunisation.

The technology used is ground-breaking, as the vaccine uses “messenger” RNA (mRNA) rather than being grown from the live virus. Unlike conventional vaccines, which can take months to produce by growing weakened forms of the virus, RNA vaccines can be constructed quickly using only the pathogen’s genetic code, which can be sent across the world by computer in an instant. Only small quantities of virus are needed for gene sequencing and vaccine testing.

Unlike conventional vaccines, where a piece of the virus is injected into the body to stimulate the immune response, the RNA simply provides “instructions” to the immune system to produce antigens, which then go on to stimulate the antibody production necessary to fight the disease.

Pfizer is acting ethically in choosing not to profit excessively from its work and will introduce differential pricing by country depending on its GDP and ability to pay. This ensures that all nations around the world benefit rather than just the wealthiest. Albert Bourla, the CEO of Pfizer, said the company will have tiered pricing for the middle-income countries (including, India) and will give the vaccine free in Africa.

It’s not all about Pfizer. Herculean efforts are being made by other companies to develop alternative/ complementary vaccines, and there are more than 50 candidates undergoing clinical trials. This is appropriate given the sheer scale of the task to immunise a high proportion of the entire world’s 7.8bn people. Lothian Pension Fund has significant investments in a number of these, including Moderna, AstraZeneca, GlaxoSmithKline, Sanofi and Johnson & Johnson.

Ian Wagstaff
Equity Portfolio Manager
Lothian Pension Fund

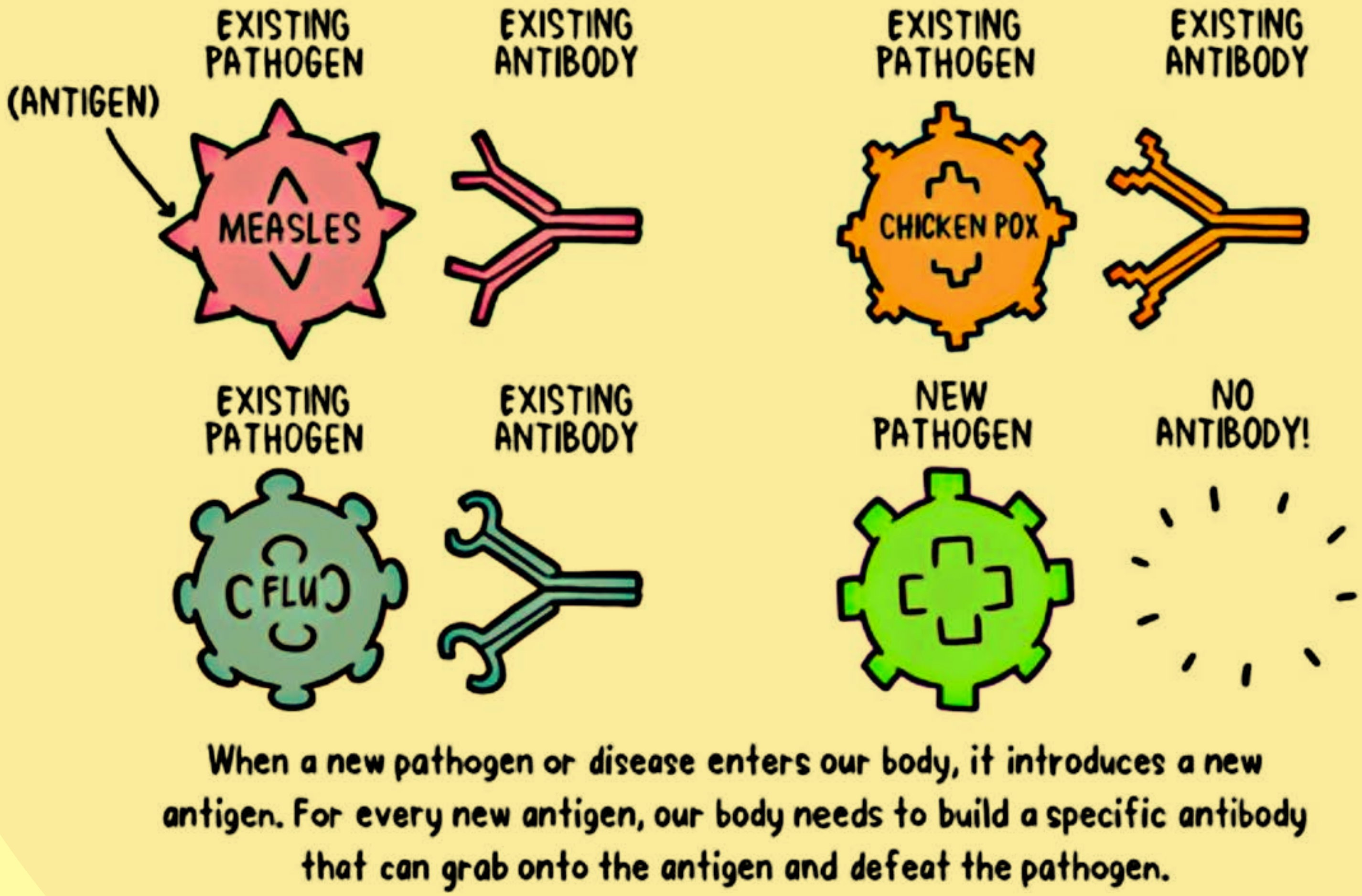


Image courtesy of the World health Organization.

INFLATION REFORM ENGAGEMENT

While engagement is often associated with companies, ESG issues come up at a government level too. As a long-term investor in government bonds, we continuously monitor and review monetary, fiscal and macro-economic policy as they relate to governance. One such focus is in the measurement of inflation in the UK, and how it relates to the value of the index linked government bonds we invest in.

The UK differs to many countries in its use of the Retail Price Index (RPI), as opposed to the Consumer Price Index (CPI), to measure inflation. The RPI tends to increase at a faster rate, impacting those that depend on it to index prices such as pensioners, pension funds, businesses and other investors. The difference between the two indices, known as the "wedge", has been intensely debated over the last decade. The RPI is widely understood to be statistically flawed, and its continued use has created uncertainty around when and how to rectify the situation as fairly as possible.

Last year the government determined to align the RPI with CPI-H (CPI including owner occupiers' housing costs). The way in which the alignment is made affects the value of index-linked government bonds and the smooth functioning of the market for these securities and has significant long-term implications for the modelling of pension fund liabilities.

We were pleased to take part in the consultation that the government jointly ran with the UK Statistics Authority on how best to make the transition.

In response to the questions asked of participants in the consultation, we set out our view on how the proposed change and possible timelines for implementing it could impact pension funds such as our own. In particular, we highlighted the significance of the timing of doing the reform by either 2025 or 2030 and in doing so, how that would help reduce uncertainty about the future measurement of inflation. Our view is there should be no uncertainty in the measurement to ensure that index linked government bond markets remain liquid and orderly in the long term.

By engaging with the UK Treasury and Statistics Authority, we sought to influence positive change in financial markets with minimal disruption to their effective functioning. Where possible, we use our knowledge and experience to assist policymakers on ESG issues (in this instance a governance issue) of national importance.

Ross Crawford
Portfolio Manager
Lothian Pension Fund

‘BY ENGAGING WITH THE UK TREASURY AND STATISTICS AUTHORITY, WE SOUGHT TO INFLUENCE POSITIVE CHANGE IN FINANCIAL MARKETS WITH MINIMAL DISRUPTION TO THEIR EFFECTIVE FUNCTIONING. WHERE POSSIBLE, WE USE OUR KNOWLEDGE AND EXPERIENCE TO ASSIST POLICYMAKERS ON ESG ISSUES OF NATIONAL IMPORTANCE.’

ROSS CRAWFORD

CLIMATE CHANGE AND THE TRANSITION TO A LOW CARBON ECONOMY

At Lothian Pension Fund, we assess the investment risks and opportunities arising from climate change and the transition to a low carbon economy. Opportunities exist beyond renewable energy projects as the low carbon transition will impact almost all sectors. Large UK companies are required to report publicly on their energy use and emissions, and the pressure is growing on smaller companies and non-public entities (such as property investments and infrastructure projects) to report similar statistics.

One of the challenges is accessing, collating and interpreting energy data across different investments. In commercial real estate, tenants are typically responsible for their utility bills, as well as on-going maintenance of the buildings they rent, and historically tenants haven't been incentivised to share their energy consumption or carbon emission information with the building owner or more publicly due to commercial competition concerns.

Green Leases are a relatively recent concept and include ESG-specific requirements such as providing access to data on the management and consumption of energy, water and waste to the building owner (who can then collate this information and report asset level and portfolio level data to their investors, such as pension funds). Building owners can also engage with their tenants and negotiate commercial arrangements to support their tenants to reduce emissions from existing buildings e.g. through sharing the cost of installing onsite renewable energy and/or improving the energy efficiency of their buildings.

Beyond the risk of physical damage to buildings from more frequent or stronger storms due to climate change, there's growing understanding that the value of buildings can be impacted by their energy performance:

- **Inefficient buildings cost tenants more, so tenants should be prepared to pay more in rent for more energy efficient buildings (and vice versa)**
- **Inefficient buildings may require substantial capital expenditure to bring them up to minimum energy efficiency standards (particularly if governments ratchet up minimum standards) and risk becoming "stranded assets" which are unlettable until major capital expenditure has been undertaken**
- **Many corporates have set their own Net Zero targets leading to growing demand for energy efficient buildings.**

While Green Leases are not yet common practice, LPF is involved in investor collaborations such as GRESB, IIGCC and PRI, which enable us to continue to push for greater transparency and reporting on energy performance across our investments. Transparency should benefit stakeholders by enabling benchmarking, target setting, progress measurement, scenario analysis and repricing of assets as the low carbon transition progresses.

Gillian de Candole
Portfolio Manager
Lothian Pension Fund

‘LPF IS INVOLVED IN INVESTOR COLLABORATIONS SUCH AS GRESB, IIGCC AND PRI, WHICH ENABLE US TO CONTINUE TO PUSH FOR GREATER TRANSPARENCY AND REPORTING ON ENERGY PERFORMANCE ACROSS OUR INVESTMENTS.’

GILLIAN DE CANDOLE

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If you'd like more information on our ESG activities, please visit our website www.lpg.org.uk.

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