LOTHIAN
PENSION FUND

Covering the period 1 January 2022 to 31 March 2023

THE STEWARDSHIP REPORT

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Introduction

Our Principles

A MESSAGE FROM OUR CEO

As a responsible investor, LPF has a long-established commitment to stewardship. This is our third report prepared in accordance with the standards of the Stewardship Code 2020. As a leader in responsible investment amongst Local Government Pension Scheme (LGPS) funds, we've chosen to prepare and submit this report to demonstrate the nature of our commitment to stewardship, for the benefit of our stakeholders.

In the context of a complex and unpredictable world, we think hard about our approach to stewardship and regularly reassess how we should exert our influence as assets owners in an appropriate and consistent manner. First and foremost, we own assets to fund our members' income in retirement, an important social responsibility in its own right, but with ownership comes the opportunity to encourage positive corporate behaviour for the benefit of society. We see this as an additional responsibility, which we address through our voting and engagement activities that are explained in the following pages. This report confirms our adherence to the standards of the UK Stewardship Code. Our commitment is to amplify our influence as a £9.7bn pension fund in an industry measured in the trillions, by working with other asset owners to drive the long-term value of our investment portfolio, and contribute to the long-term health of the financial system.

David Vallery
CEO, Lothian Pension Fund

A MESSAGE FROM OUR PENSIONS COMMITTEE

The role of the Pensions Committee is to ensure that the pension fund is run in a sound and sustainable manner that guarantees we deliver on our pensions promise to our beneficiaries. We do this by investing prudently and carefully. We also do this by striving to ensure that the companies and assets we invest in are well governed and well managed, that they minimise their negative impacts on society and the environment, and that they make a positive contribution to our societies and our communities.

This doesn't happen by accident. It requires us to use our voice and influence, to challenge companies when they fall short of the standards that we expect, and to stand with them and support them when they're developing and implementing strategies that enhance their long-term sustainability and resilience.

Our work to support good governance and engagement is underpinned by our belief in the power of our voice, often alongside others, to lead to positive change that sustains and drives value for our stakeholders today and in the future.

The Pensions Committee has a critical role to play. We want Lothian Pension Fund (LPF) to take meaningful action on a range of issues, notably corporate governance and climate change. We've encouraged the fund to be at the vanguard of asset owners who are committed to moderating climate change. To communicate this to our stakeholders and to policymakers around the world, we became a signatory to the 2022 Global Investor Statement to Governments on the Climate Crisis, an investor initiative (supported by investors managing $42 trillion of assets) that urged governments to commit to real-world decarbonisation policies to limit global warming.

The Pensions Committee welcome this report as a record of LPF's past efforts, outcomes and future areas of focus for improvement. It gives us great pride to see LPF continuing as a leader in responsible investment within the wider financial system on which our current and future stakeholders rely. We continue to encourage, support and commend LPF's work in this critically important area for our members and employers, for a resilient financial system, and for a better world.

STEWARDSHIP IN PRACTICE: CREATING LONG-TERM INVESTMENT VALUE

Our Purpose, Vision and Duty

Our Purpose is to administer the LGPS in Edinburgh and the Lothians. By paying pensions and benefits to members, we contribute to the financial well-being of members and their families in retirement.

Our Vision is to deliver outstanding pension and investment services for the benefit of members and employers.

LPF is the second largest LGPS in Scotland. It's a funded, defined benefit, statutory occupational pension scheme.

LPF's stakeholders are the people and entities with an interest in the assets and activities of LPF. They include the members of the pension scheme (existing and future), their dependants and beneficiaries, as well as the participating employers who contribute to the assets of the fund and our governing bodies. Legally, and morally, we have a fiduciary duty to act in a financially prudent manner and to act in the best interests of our stakeholders.

It's this duty that defines our approach to stewardship. We need to manage our investments responsibly and sustainably so that we can pay pensions and benefits because they'll fall due over many decades to come.

We need to ensure that the risks to our investments are effectively managed and we know that Environmental, Social and Governance (ESG) factors are fundamental considerations in driving the long-term value of our investment portfolio. They matter to society, so they matter to us.

Stewardship as an investment function

So, what does this mean in practice? At its heart, it means that we see stewardship as an investment function. Our core responsibility is to invest in a way that takes full account of the downside risks and the upside opportunities presented by ESG factors. We need to be properly compensated for risks, avoid over-paying for opportunities, and we need to manage and mitigate these risks in our investment portfolio.

This emphasis on the investment implications of ESG issues is reflected in our approach to stewardship. We're unusual among UK asset owners in that responsibility for stewardship sits with our investment teams. It's our portfolio managers and investment analysts who are responsible for engaging with companies and with investment managers. It's our portfolio managers who lead our work with collaborative initiatives, such as with Climate Action 100+.

Stewardship as a collaborative activity

As an asset owner acting alone, our potential for direct influence is relatively modest. While direct company engagement is important and can be influential in situations where we have a significant holding, our biggest impact comes through working with others.

STEWARDSHIP IN PRACTICE: CREATING LONG-TERM INVESTMENT VALUE

Our approach to stewardship therefore includes:

- Collaboration with our industry peers
- Engagement with our investment managers. We challenge our managers on their approach to responsible investment and ESG
- Supporting collaborative engagement and escalations through Federated Hermes EOS (EOS), which derives considerable influence from representing owners of assets worth more than $1.3tn.

LOOKING FORWARD

Our aim, in all our stewardship efforts, is to ensure that the companies we invest in are sustainable and successful over the long-term and create enduring value for us as investors. We have a long track record of voting and engaging on what are often referred to as the traditional corporate governance issues, such as executive remuneration and board independence. These issues remain of central importance. Governance failures can lead to major financial losses for investors, to avoidable job losses or harm to employees or to unpaid suppliers and creditors.

However, the world is changing profoundly. Environmental and social issues have risen up the agenda that shapes our present and our future: the threat of climate change; the harm caused to our environment by plastics and pollution; and the social and political tensions resulting from armed conflict, inflation, inequality and discrimination. These issues and our collective response to them will affect our ability to deliver retirement savings for our existing and future members. As asset owners with a long-term horizon, we take these global issues seriously, we exercise our ability to vote and engage and we exhort others to do the same. We believe the most effective way is to: 'Engage Your Equity, Deny Your Debt'.

Engage your equity, deny your debt

As an organisation, we've outlined our ambition to avoid providing any new financing to companies which aren't aligned with the goals of the Paris Agreement on Climate Change. While the trading of equities (shares) doesn't affect the capital position of a company, subscribing to new bonds and new equity does provide companies with funding. Within our equity portfolio we engage with our holdings, and that engagement includes using the tools and strategies we have at our disposal to influence companies to commit to align with the goals of the Paris Agreement. In our debt portfolios, we aim to deny funding to those non-aligned companies.

OUR PRIORITIES FOR 2023 AND 2024

Our main stewardship priority is to continue strengthening our stewardship approach on environmental and social issues, in particular climate change, while maintaining our focus on ensuring that companies are well governed and well managed. In 2022 we set up our Climate Disclosure and Strategy project to review our approach to climate change and support alignment with evolving regulatory requirements and best practice frameworks. With the Taskforce for Nature-related Financial Disclosures due to publish its recommendations in September 2023, we'll also be looking for companies and investors to improve their understanding of the importance of addressing biodiversity loss alongside climate change.

This is our third stewardship report, and it's intended to meet the principles of the Financial Reporting Council's (FRC) Stewardship Code 2020. We were pleased to be early adopters to the updated Code in 2021 as it provides a context for and a description of our activities with a focus on outcomes. We'll continue to report on our stewardship efforts, and we invite and welcome feedback on our approach.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

OUR PURPOSE

Our purpose is to administer the LGPS in Edinburgh and the Lothians. By paying pensions and benefits to members, we contribute to the financial well-being of members and their families in retirement. For that reason, our primary objective is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment. This means we need to generate the necessary long term cash flow returns to pay promised pensions and to make the scheme affordable to participating employers, now and in the future, while minimising the risk of having to increase contribution rates in the future.

In this report, we set out our assessment of how our purpose, strategy and culture meet the needs of our stakeholders.

Our investment beliefs

With liabilities extending decades into the future, it's in our interests to take our responsibilities as institutional asset owners seriously. To this end, our approach to responsible investment centres on effective stewardship of all assets, with a particular focus on good corporate governance to deliver sustainable value.

As required by LGPS legislation, we maintain a Statement of Investment Principles (SIP) which articulates the investment principles which guide our strategies and decision-making. In terms of those principles, which enable stewardship and lead to sustainable benefits for the economy, the environment and society, we believe:

- Responsible investment supports our purpose and that through robust stewardship and an effective approach to ESG issues, we should reduce the risk associated with the invested assets that LPF owns to pay pensions when they become due
- As a provider of responsible capital, LPF should be an agent for positive change, engaging with companies to help them maintain or adopt best business practices and sustainable business models
- In being transparent about the methods we use to foster responsible investment as an organisation and being accountable for our responsible investment strategy and approach
- Successful engagement adds value to our investment process and that divestment has no effect on company finances in the long term and can produce perverse incentives in the short term
- As responsible owners we should engage with our investee companies and appointed managers, either directly or via collaborative partners. However, we also believe that this 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.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

Finally, we believe that Climate Change is one of the defining issues of our time. We believe that asset owners are uniquely positioned to drive changes in governmental and corporate behaviour to bring about an acceleration in the sustainable energy transition and a decarbonisation of the global economy.

We reiterated this to policymakers around the world by signing the 2022 Global Investor Statement to Governments on the Climate Crisis.

> "By signing the 2022 Global Investor Statement to Governments on the Climate Crisis, we're joining the call for all governments to commit to ambitious climate policy action as we approach COP27. This collaborative engagement activity is aligned with our focus on real world decarbonisation."
>
> **David Vallery**, Chief Executive Officer

OUR STRATEGY

Introducing our Statement of Responsible Investment Principles

To reflect our belief in the importance of responsible investment, we published a Statement of Responsible Investment Principles (SRIP). This describes our sustainable investing beliefs and commitments, and our strategy for integrating those with our investment activities.

Responsible investment remains a core part of the Statement of Investment Principles (SIP), which is required under LGPS legislation. However, in view of the growth in our responsible investment and stewardship activities across all asset classes, we released the first version of LPF's SRIP in June 2020 to inform members and employers more fully. This document is reviewed annually and updated to reflect how we evolve our responsible investment practices.

The SRIP explains how we incorporate ESG issues into investment analysis and decision-making processes, as well as how we seek appropriate disclosure on ESG issues from any entities in which we invest. It also publicly confirms our approach to climate change and the carbon transition.

The SRIP allows us to communicate with our stakeholders to explain our strategy in detail. It sets out how we implement responsible investment on an asset class by asset class basis, as well as detailing how we utilise all the tools at our disposal to achieve our stewardship aims.

Our SRIP supports conversations with external managers and other institutional investors on evolving best practice in responsible investment as well as on implementation challenges and approaches to systemic issues. From oversight and monitoring, to affirming our position on climate change and the carbon transition, we'll provide examples of how we implement the SRIP throughout this report.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

Case study

CLIMATE CHANGE: OUR ROLE IN REAL WORLD CHANGE

As a pension fund with liabilities stretching out decades into the future, we believe that climate change is not only a defining issue of our time but also a threat to our ability to fund pension payments. For the sake of society and our portfolio of assets, we have a responsibility to mitigate the risks associated with global warming, which scientists attribute to greenhouse gas emissions caused by human activities. Ours is a small voice but we contribute it in an attempt to mitigate this systemic risk.

We believe that asset owners are uniquely positioned to drive changes in governmental and corporate behaviour to bring about an acceleration in the sustainable energy transition and a decarbonisation of the global economy. We recognise the critical importance of limiting climate-related emissions and the role that financial institutions can play in helping to achieve that goal, and how this will in turn, contribute to a well-functioning financial system.

Action on climate change

Engaging with policy makers: By becoming a signatory to the 2022 Global Investor Statement to Governments on the Climate Crisis, LPF added its voice, and this was amplified by 603 other institutional investors around the world managing almost $42 trillion in assets (around 40 per cent of global assets under management). The Statement urges governments to raise their climate ambition to limit global warming to no more than 1.5 degrees, implement domestic emissions reduction policies, support effective implementation of the Global Methane Pledge to reduce methane emissions by at least 30% from 2020 levels by 2030, scale up the provision of climate finance for mitigation, adaptation and resilience, and strengthen climate disclosures across the financial system.

Engaging with investee companies: In Principle 9, we provide more information on our engagement with investee companies, including through our voting and engagement service provider and through our external managers. In Principle 10, we highlight collaborative engagement activities through Climate Action 100+ and in Principle 11, we provide an example of escalation of engagement in this thematic area.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

Case study

CLIMATE CHANGE: OUR ROLE IN REAL WORLD CHANGE *(CONTINUED)*

Voting our shares: In Principle 12, we provide details on our voting policies and how we voted, with a case study on “Say on Climate” votes.

Assessment of effectiveness
LPF's signature on the 2022 Global Investor Statement contributes a relatively small amount of assets to the total, but it demonstrates our awareness of the need to manage climate risks, our support for global policy action and our intention to participate in the potentially enormous investment opportunities created by the global net-zero emissions transition. It supports our communication with our stakeholders and investee companies regarding the importance of real-world decarbonisation.

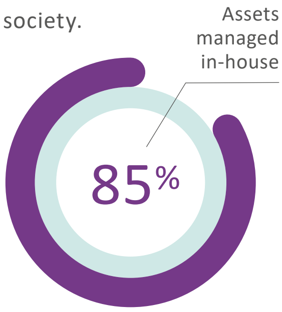
Similarly, our ability to influence investee companies through voting and engagement is limited as a minority investor. However, by collaborating with like-minded investors on engagement and being transparent about our voting actions, we can amplify our influence to drive the long-term value of our investment portfolio and contribute to the long-term health of the financial system.

Next steps
The companies in which we invest need a clear legal and regulatory framework in which to operate. We'll continue to call on governments to deliver consistent policies to support a well-functioning market and an energy transition that mitigates risk. These policies need to adequately discourage the production and consumption of fossil fuels. We'll continue to engage with and encourage our investee companies to develop and implement credible plans consistent with the Paris Agreement. And, as part of our diversified portfolio, we'll continue to make investments where we believe they'll generate both a sufficient return and support the energy transition and avoid financing non-Paris aligned investments.

PRINCIPLE 1: PURPOSE, STRATEGY AND CULTURE

OUR CULTURE

Operating within the public sector means that we're subject to applicable public sector regulations and relevant public law duties. These require LPF to act fairly and transparently and brings us in-scope of the Freedom of Information regime. This promotes a strong degree of discipline and accountability across the organisation. We're always mindful of fulfilling our duties to stakeholders and serving their expectations regarding sustainable benefits for the economy, the environment and society.



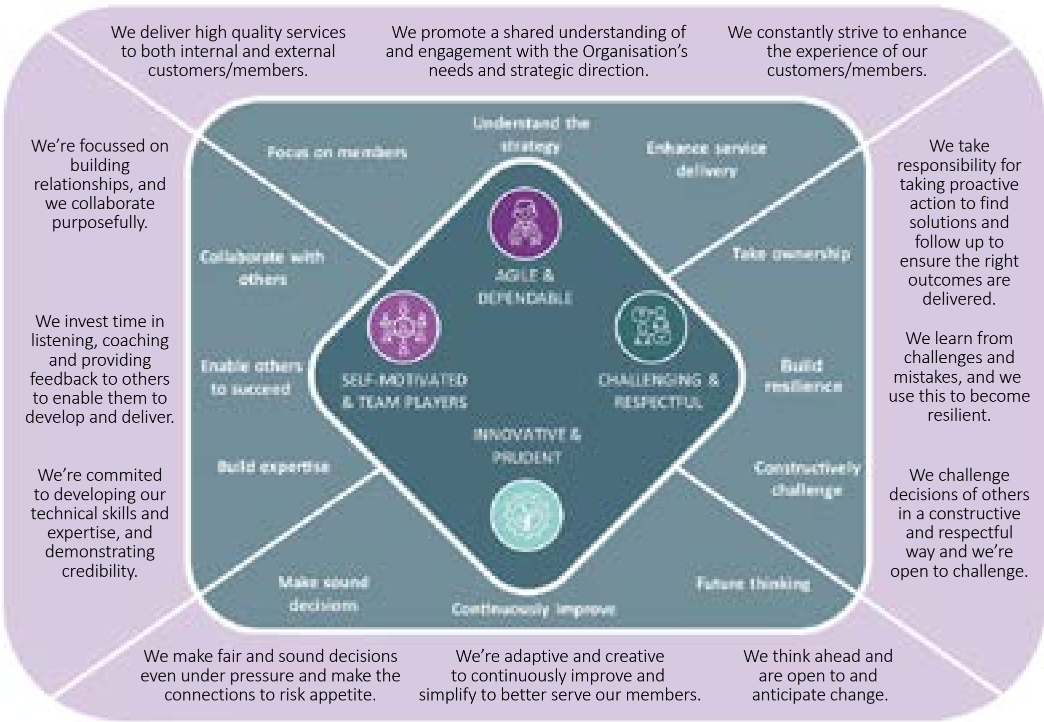
We manage over 85% of assets in-house, through internal equity, bonds and certain real asset portfolios. This aligns our investment decision-makers with the fund's best interests.

As explained in relation to Principle 2 (Governance), operating an FCA-authorised vehicle within the group influences the culture throughout LPF. It allows LPF to build on the in-house investment expertise and promotes accountability and responsibility amongst individuals.

In March 2017, we became the first UK Local Government pension fund to be awarded accreditation by the Pensions Administration Standards Association and have held the Customer Service Excellence Award for the last 10 years. Whilst these accreditations aren't directly relevant to stewardship, they reflect LPF's stakeholder orientated culture.

VALUES THAT SUPPORT OUR PURPOSE

We're passionate about enabling desirable and sustainable pensions, and our values are the enduring principles that inform, inspire and instruct the day-to-day behaviour of individuals working for LPF.



PRINCIPLE 1: OUR CULTURE

These values drive our active stance to stewardship and responsible investment and inform our approach to ESG. For example, our belief in the power of company engagement and the way in which we engage with companies and stakeholders, is relevant to our values of being 'Self Motivated and Team Players' and being 'Challenging and Respectful'.

Our value of being 'Innovative and Prudent' means that we focus on future thinking, which is critical in managing ESG risks today for positive outcomes for current and future beneficiaries.

INCLUSIVITY

We're one team, but we represent many ideas, experiences and backgrounds. We value everyone's contributions and believe that our colleagues should be their whole self at work. We want a diverse, inclusive and respectful workplace.

In 2019, we signed up to Disability Confident and more importantly, committed to review and improve everything we do with respect to recruitment and employment. Through Disability Confident, we work to ensure that disabled people and those with long term health conditions can fulfil their potential and realise their aspirations with us as an employer.

We continue our work with the Scotland chapter of the Diversity Project and the Asset Owner Diversity Charter (See Case Study in Principle 4), which aims to accelerate progress toward a more inclusive culture in the investment and savings sectors across all demographics, including gender, ethnicity, sexual orientation, age and disability.

We continue to work towards our goal of being fully gender balanced across the organisation by 2030:

- As of 31 March 2023, we have, in aggregate, 58% women in our top three leadership layers and across the whole company, 56% of our workforce are women
- Our mean gender pay gap is 20.6%
- Our positive action approach to gender, which is benchmarked externally, is helping to ensure that our people policies and processes are inclusive and accessible, from how we attract and recruit, to how we reward and engage our colleagues. This includes our inclusive gender-neutral parent policy covering maternity, paternity, surrogacy and adoption, which we launched in 2021
- In 2022/23 we recruited 26 colleagues, 58% of these were women.

We're proud to partner with both Future Asset and Girls Are Investors (GAIN). Future Asset is an organisation in Scotland that aims to raise aspirations and confidence in girls in the senior phase of high school, encouraging them to choose ambitious career paths, and informing them about rewarding opportunities in investment.

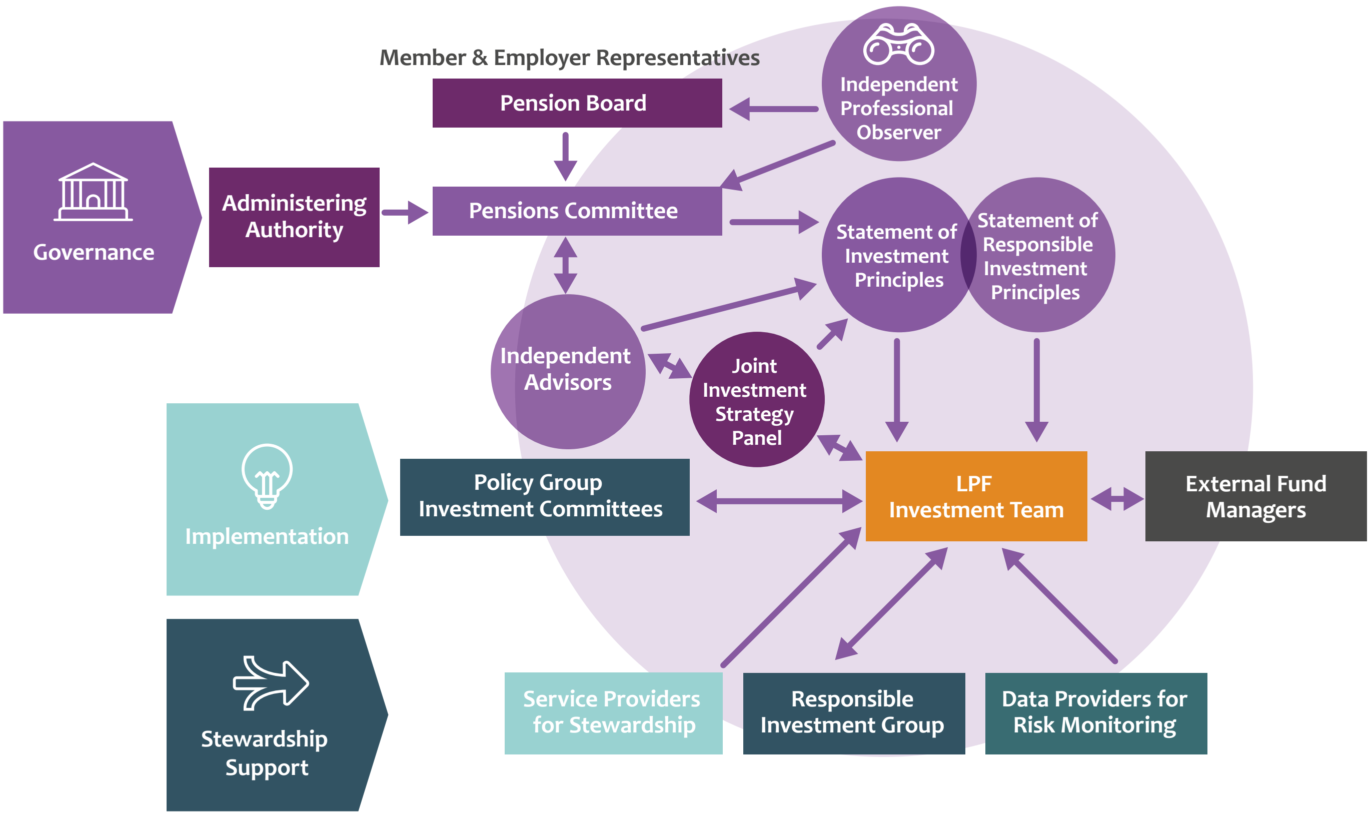
GAIN is a charity set up by investment professionals to improve gender diversity in investment management by building a talent pipeline of entry-level female and non-binary candidates.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Signatories' governance, resources and incentives support stewardship.

A ROBUST GOVERNANCE FRAMEWORK

Relevant to stewardship, LPF has developed a focused and effective governance framework, tailored to the needs and activities of the organisation.



PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Pension Board

Our Pension Board, established in accordance with the Public Service Pensions Act 2013, consists of five member representatives and five employer representatives. The Pension Board's role is to provide oversight of the Pensions Committee to ensure that the pension scheme is meeting its legal and administrative requirements and is being operated in the best interest of its stakeholders.

Pensions Committee

The City of Edinburgh Council (CEC) is the administering authority of LPF. Functions relating to pensions matters are delegated to CEC's Pensions Committee. The Pensions Committee oversees LPF's officers who carry out the operational activities of LPF. The members of the Pensions Committee act as 'quasi trustees' and meet at least four times a year. The Pensions Committee is made up of five elected councillor members (from the administering authority) and two non-councillor members are appointed for a three-year term.

The Pensions Committee is responsible for setting LPF's investment strategy. It formally reviews and agrees the SIP and the SRIP annually. The implementation of the strategy, through more granular investment decisions, and monitoring of investments, is delegated to suitably qualified and experienced individuals employed by LPF, with sufficient time and other resources at their disposal. Reporting to the Pensions Committee focuses on the long-term objectives of LPF and how delegated decisions have contributed to these.

Joint Investment Strategy Panel

Investment strategy guidance is provided to the Pensions Committee by a Joint Investment Strategy Panel (JISP) of advisers, working in collaboration with the Falkirk Council and Fife Council Pension Funds, with input from the internal Asset Allocation Investment Committee. The JISP meets quarterly with senior officers of the three Funds. The external advisers bring significant experience in the investment industry and are used both to complement the skills and experience of the internal investment team, and to provide independent challenge. They provide trusted advice to the officers of the three administering authorities to enable them to fulfil their delegated powers effectively.

Portfolio Managers and Policy Group Investment Committees

The day-to-day management of LPF's assets is performed by internal and external professional portfolio managers. Pension fund officers monitor the assets including mandate and policy group performance quarterly with the support and advice of the JISP and report to the Pensions Committee at its regular meetings. Portfolio manager activities are defined by investment management agreements detailing the portfolio objectives and constraints. Portfolio managers may have discretion to buy and sell investments within the terms of their mandates, or they may require approval from the relevant equity, debt, or real asset policy group investment committee.

Case study

INVESTMENT SERVICES REVIEW

Context

LPF collaborates with other LGPS funds across a range of activities. It provides investment services through LPFI Limited, which is regulated by the FCA. Management initiated a review of these investment services in 2022 to identify any areas for improvement in governance and operations.

How

Two external consultants with relevant regulatory, governance and operational expertise were engaged to undertake the work.

Outcome

A number of recommendations were made to consider changes to governance or operational structure. The resulting project plan is currently implementing suggested enhancements, including minor changes to governance and general upgrades to process documentation through 2023.

Assessment

The review supports the effective stewardship of the assets of LPF and its collaborative partners by focusing on good governance and the efficiency of its operating model.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Fiduciary responsibilities

LPF's activities are guided by the legal principle of fiduciary duty. A legal opinion on the nature and extent of LPF's fiduciary responsibilities was obtained by the Scheme Advisory Board for the Scottish LGPS in 2016. LPF regularly reviews this analysis and monitors legal and regulatory developments as they relate to responsible investment.

Staff resourcing

To support the distinction between LPF's purpose and the functions and responsibilities of City of Edinburgh Council (the administering authority for LPF), in 2015 LPF set up:

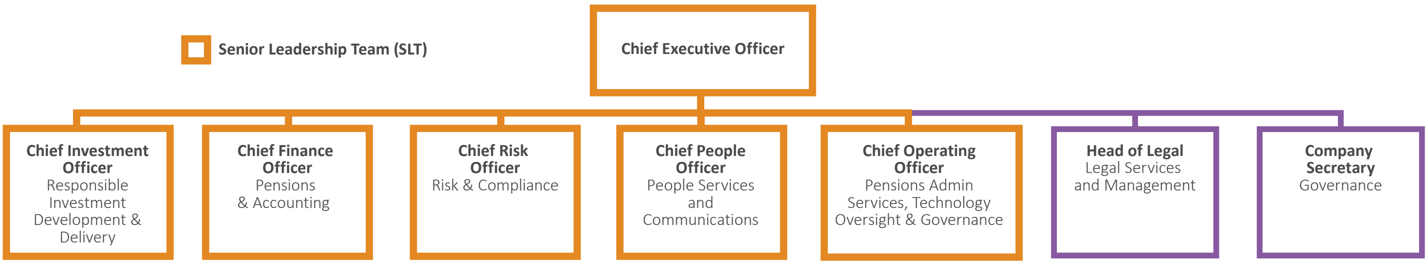
- An employment services company to establish people and cultural controls appropriate to the specialist business LPF carries out (LPFE Limited)
- An investment company that would enable the delivery of regulated investment services to other pension funds and institutional investors, whilst also more generally aligning LPF to higher FCA standards (LPFI Limited).

We've built out a staff structure to best resource our activities and allow us to enhance the exercise of our stewardship. Our headcount of 98 (as at 31 March 2023) includes dedicated teams which support our communication with stakeholders, good governance, stable ICT systems, effective HR and financial management and delivery of legal services.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

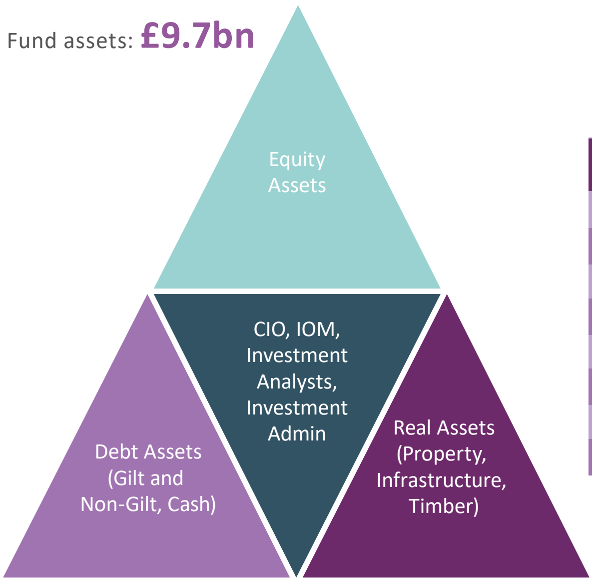
STAFF STRUCTURE

Senior Leadership Team (SLT) as at March 2023



Internal Investment Team as at March 2023

Fund assets: **£9.7bn**



Internal Investment Team of 20	
Chief Investment Officer (CIO):	1
Investment Operations Manager (IOM):	1
Portfolio Manager:	10
Deputy Portfolio Manager:	1
Property Asset Manager:	1
Senior Investment Analyst:	1
Investment Analyst:	3
Investment Administrator:	2

All Portfolio Managers are subject to annual fit and proper assessments and all LPF staff are subject to a Code of Conduct, which sets the minimum expected standards of individual behaviour. A range of relevant professional qualifications are held across the team, including from CFA Institute, MRICS and CISI. At least eight of the internal investment team have over 20 years of experience in investing, which supports a long-term, through market-cycle perspective. We encourage and support members of the team to gain experience, both through professional development and professional qualifications: three of our analysts are part-way through the CFA program. In 2021 the CIO and four portfolio managers completed the Climate Curriculum run by Columbia University's Earth Institute and another portfolio manager completed the Climate Change Risk in Finance course run by Edinburgh University. We monitor the experience and qualifications of external managers as part of our due diligence process.

Furthermore, senior managers have a duty of responsibility to take reasonable care to avoid and / or stop a breach from occurring in the business area that they're responsible for, and such duty is formalised by regulation. All SLT appointments at LPF are subject to the FCA's Senior Managers and Certification Regime.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Internal stewardship resource and Responsible Investment Group

At LPF we see stewardship as an integrated element of the investment function. Our core aim is to exercise our rights and responsibilities as investors; our entitlement to vote provides an opportunity to engage to enhance both corporate governance and investee company prospects. Analysis of ESG factors supports investment decision-making, shedding light on downside risks and upside opportunities.

So, it's our portfolio managers who lead on collaborative initiatives, such as Climate Action 100+ for which we are a co-lead engager, and it's our portfolio managers and analysts who are responsible for engagement and escalation activities with investee companies. These activities are undertaken directly or through our external managers or through our engagement and voting provider (see External Stewardship Resource below).

However, we also utilise stewardship knowledge from LPF's other functional teams. In 2001, our Senior Leadership Team (SLT) undertook a review of individual roles and made an organisational change to ensure that responsible investment activities were owned, championed and implemented more effectively. It established the Responsible Investment Group (RIG) to bring together members of the different functional teams formally and regularly to share diverse perspectives sourced from experience in: ESG investment analysis and research, public policy and advocacy, thematic investment, investment management, investment consultancy, law, actuarial advice and pension trusteeship.

The SLT oversees the RIG, which is comprised of:

- Chief Investment Officer
- Portfolio Managers as Responsible Investment Leads for all the major asset classes
- Representatives from the Legal, Compliance & Risk, Finance and Communications teams

The inter-disciplinary group enables the sharing of knowledge, experience and insight relevant to other areas, while improving the governance and oversight of stewardship activities. By providing stewardship advice to LPF officers and the Pensions Committee, the RIG aims to mitigate risk and identify opportunity, for example by supporting internal and external managers in navigating regulatory changes and shareholder actions.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Members of the RIG have extensive experience in responsible investment roles and have relevant qualifications, undertaking continuing professional development and participating in industry Responsible Investment groups to maintain and build best practice knowledge. Through 2022 the RIG logged over 70 hours of continuing professional development across a range of themes including climate risk, living wage, transition finance, human rights, Russia/Ukraine conflict, sustainable development goals, sustainability in real assets, sustainable securities lending, net zero and biodiversity. The Responsible Investment Lead also led training sessions for the internal investment team and the Pensions Committee on responsible investment topics. The combination of skill sets, backgrounds and practical experience of team members is well suited to the development and execution of our responsible investment policy and integration into LPF's wider investment approach.

Our Responsible Investment Lead's investment expertise and specialist knowledge across the asset classes in which we invest is essential to delivering effective stewardship. They manage the relationships with our voting and engagement supplier and ESG data providers and work with our other internal portfolio managers to ensure material ESG risks are identified, monitored and managed throughout the investment process. They support the oversight and monitoring of external managers, and champion LPF's responsible investment beliefs and stewardship activity in the wider investment industry.

LPF also allocates a budget for the procurement of ESG data to support our integration of these factors into our investment process, including the analysis of climate-related risks and opportunities.

External stewardship resource

To adequately resource our stewardship activities, LPF contracts an external voting and engagement provider, Federated Hermes EOS (EOS) to undertake much of LPF's voting and engagement activities. Engagement focuses on company strategy covering many ESG issues, such as climate change, plastic usage, diversity and labour practices. LPF engages with companies on these issues because they can create significant risks which, if not appropriately addressed, threaten investments with material and permanent capital impairment.

Our investment team interacts with EOS to contribute to the work plan and access the body of knowledge that resides with their engagement professionals. EOS represents owners of assets with a total worth of more than $1.3tn, which creates more influence than LPF would have engaging on its own. In addition, EOS is structured to undertake multi-year engagements, often leveraging its access to engage across multiple themes.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

The EOS team draws on a wide range of skills and backgrounds: senior engagers come from a range of backgrounds including banking, academia, law, corporate governance, sciences, corporate strategy and climate change. The engagement team consists of 30 people (March 2023), supported by four voting specialists, three senior advisers and ten client service professionals. EOS undertakes a skills gap analysis of the wider team with reference to the thematic and sectoral issues covered, to ensure EOS has the right mix of professionals who can represent EOS and its clients' views in engagements with companies. Furthermore, it delivers training to share knowledge across different sectors and themes to facilitate cross-pollination of expertise. EOS has intentionally built a diverse team (63% female/37% male for permanent staff as at 31 December 2022) of experienced and international professionals who have the expertise, language skills (fluency in 18 different languages) and cultural knowledge to access and maintain constructive relationships with company boards across the globe to deliver real beneficial change at companies.

EOS reports on voting and engagement activity across LPF's assets every quarter, as well as annually. Through this regular reporting and dialogue, we're able to ensure that the service is being delivered as expected and in alignment with our responsible investment policies. EOS also engages with regulators, industry bodies and other standard setters to shape capital markets and the environment in which companies and investors operate. We present voting and engagement case studies in relation to Principle 9 (Engagement) and Principle 12 (Exercising rights and responsibilities), later in this report.

External managers

We expect our external managers to engage investee companies on our behalf on material issues including ESG issues and opportunities. We encourage our external managers to enhance stewardship by participating in collaborative engagements (see Principles 9 and 10) and to support best practice disclosure. We receive quarterly updates from our external fund managers, which include updates on company engagements and stewardship initiatives.

PRINCIPLE 2: GOVERNANCE, RESOURCES AND INCENTIVES

Learning and development to support our responsible investment beliefs

Members of the Pensions Committee are required to undertake a minimum of 21 hours training per year. This supports them in fulfilling their role and managing the lobbying they may receive, as elected officers, on a wide range of issues (including aspects of LPF's investment activities).

During 2022, the Pensions Committee received training on a number of stewardship topics including: climate change related risks and opportunities, climate-risk reporting, exposure to and implications of Russia's invasion of Ukraine, and a review of the voting and engagement activities undertaken by EOS on our behalf.

The fund's officers also access a range of resources to support learning and development across responsible investment themes through our membership of collaborative initiatives such as CA100+, IIGCC, PRI, EOS. More details on these are provided in Principle 10 (Collaboration), later in this report.

Performance and reward

We recognise the importance of our people in achieving our responsible investment commitments and stewardship aims, and the need to develop, reward and support them in their roles, within their teams and as individuals.

In terms of staff performance, the role profile for each member of our investment team includes explicit reference to LPF's responsible investment and ESG aims. This makes each person involved in LPF's investment decision-making individually accountable for furthering LPF's responsible investment aims.

The annual performance review for portfolio managers and deputy portfolio managers looks at how they "ensure compliance with the Fund's policies and procedures, including its commitment to responsible investment, which involves company engagement and voting and integration of ESG analysis into investment decision-making."

LPF's remuneration scheme is deliberately structured to align staff with LPF's long-term aims and to avoid incentivising inappropriate risk-taking.

PRINCIPLE 3: MANAGING CONFLICTS OF INTEREST

Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

Our commitment to managing conflicts of interest

In all its activities, LPF acts honestly, fairly and professionally. This approach is aligned to our values of being 'Agile and Dependable', and 'Innovative and Prudent'. As described in relation to Principle 2 (Governance), LPF has adopted the FCA standards across its investment operations, and this includes standards in relation to conflict identification and management. This response focuses on LPF's own investment operations (distinct from any client services delivered by LPFI).

We're aware of the duties owed to our various stakeholders and the range of actual or potential conflicts of interest that may arise while carrying out investment activities. We recognise that effective management of conflicts of interest is fundamental to the effective stewardship of our assets. It also protects the best interests of LPF, our staff and our stakeholders.

Our Conflicts of Interest Policy sets out how we implement and maintain effective arrangements. The policy specifies the required standards and procedural controls for identifying, recording, monitoring and preventing conflicts of interest.

The LGPS structure

One of the most significant conflicts of interest is inherent to our structure, under which a local authority administers a multi-employer pension fund. As administering authority of LPF, CEC acts in a separate statutory capacity which is distinct from its role and responsibilities as a local authority. Pension fund assets are ring-fenced from CEC's operating budget and LPF's operations are entirely funded by pension fund assets.

The objectives of the administering authority, and those of the pension fund, aren't always aligned. For example, CEC (as a local authority) may have an objective to promote jobs and prosperity within Edinburgh. This may conflict with our investment objective of delivering sustainable returns across a diversified range of assets, in line with our fiduciary duty and as reflected in our SIP.

The extent of delegation and separation between CEC and LPF within our governance structure supports the effective management of this conflict.

PRINCIPLE 3: MANAGING CONFLICTS OF INTEREST

Identifying other types of conflicts

Other types of conflicts which may arise are where LPF:

- Is likely to make a financial gain, or avoid a financial loss, at the expense of a stakeholder
- Has an interest in the outcome of a service provided for the benefit of LPF or of a transaction carried out on behalf of LPF, which is distinct from LPF's interest in that outcome
- Has a financial or other incentive to favour the interest of one stakeholder or group of stakeholders over the interests of another stakeholder or group of stakeholders
- Receives or will receive from a third party an inducement in relation to a service provided to LPF, in the form of monies, goods or services other than the standard fee for that service (if any).

The following are non-exhaustive examples of “typical” conflicts of interest that could arise for LPF employees:

- Where a private interest of the employee, a family member or a personal contact influences a decision or recommendation the employee makes in the course of their employment
- Interests or involvement in a business outside LPF, without permission
- Accessing information at work which may assist in a private venture
- Receiving substantial gifts or hospitality in relation to services to be provided to or by LPF, to obtain preferable terms
- Conflicting views on the financial materiality of ESG issues for an investee company.

PRINCIPLE 3: MANAGING CONFLICTS OF INTEREST

OUR STRATEGY

At the organisation level, we use the following measures to support the overall management of actual and potential conflicts of interest:

- The members of our governing bodies (including the Pensions Committee and Pension Board and the corporate boards of LPFI and LPFE) are subject to a Code of Conduct and LPF policies and procedures which set out considerations relevant to managing conflicts. Each member is asked to consider and declare any conflicts of interest at the beginning of any meeting
- The oversight exercised by our Senior Leadership Team supports the operation of independent functions with segregated duties. Management information and reporting procedures are used to deliver effective oversight
- Information barriers are in place to restrict access to records where necessary.

Within LPF, we use the following controls to support the overall management of actual and potential conflicts of interest by individuals:

- Restrictions and procedures relating to personal account dealing, restricted dealing /insider trading, gifts and hospitality, and whistle-blowing
- Maintaining an 'external bodies' register (which records details of any services provided to, or roles held with, organisations outside LPF)
- Maintaining a 'connected persons' register (which captures organisations that LPF may directly transact with, and which may have a material involvement, in the business of the pension fund)
- Providing employees with relevant training, at induction and periodically: LPF Officers are required to set out an accurate explanation of any potential conflict of interest to a member of the Senior Leadership Team or the Risk & Compliance Manager. This requirement applies to all situations where they, a family member, or a personal contact, has a private, personal or financial interest or involvement in outside activities, which may relate to their work and could result in a perceived or actual conflict of interest.

We're clear that it's incumbent on all our people to be alert to potential conflicts of interest and act accordingly. We provide compulsory 'Managing Conflicts of Interest' training for all colleagues. This was most recently completed in Q2 2023 and is part of our annual refresher training.

Case study

IDENTIFICATION AND MANAGEMENT OF POTENTIAL CONFLICTS IN EXERCISING VOTING RIGHTS

Context

LPF manages over 85% of its equities in house and retains voting rights for the majority of its externally managed equities. Where a stock is held in more than one portfolio, there's potential for a diversity of views to be held by the different portfolio managers (PMs) on the prospects for a stock, including different assessments of the financial materiality of identified ESG issues for a specific stock. These different views can be expressed through taking different investment decisions related to the stock in the context of different portfolio mandates. However, when it comes to exercising our voting rights, we seek to maximise benefits to members through consistent application of voting policies and by avoiding dilution/off-setting of our votes.

How

In Q1 2023 we formalised our Equity Voting Process:

1. Our voting and engagement partner, EOS, reviews ISS Institutional Shareholder Services Inc. proxy recommendations, and overlays their ESG policies and knowledge of ongoing engagement activities to provide their voting recommendation. EOS provides alerts to our PMs on potentially controversial or finely balanced issues. All resolutions are voted in line with EOS recommendations by default unless this recommendation is overridden by our PMs. While this is expected to happen only very rarely, significant consideration is given to each issue
2. EOS voting alerts are reviewed by the equity team and escalated to our Responsible Investment Group (RIG) where necessary (for complex situations, or if there's disagreement within the team for stocks owned by multiple PMs). We communicate with EOS about the resolution, to understand the context and rationale for the recommendations being made
3. RIG reviews any escalated vote recommendations to provide a consistent 'house' recommendation. The relevant PMs are notified of the decision and requested to alter the proxy vote instruction if necessary.

Outcome & assessment

While it's too early to make a full assessment of the outcome of the formalisation of our equity voting process, the internal discussions that led to the formalisation, together with the application of a more systematic way of documenting the equity team's discussions about voting alerts, provide more rigour to the important process of exercising our shareholder rights.

PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

IDENTIFYING AND ADDRESSING MARKET AND SYSTEMIC RISKS

As a long-term investor, sustainable, well-functioning markets are essential to our purpose of delivering a valued retirement savings product for our members. They'll enable us to pay pensions and benefits when they fall due over the next several decades.

We ensure that the risks to our investments are effectively managed as we know that Environmental, Social and Governance (ESG) factors are fundamental considerations in driving the long-term value of our investment portfolio.

We're very aware that investment markets can go down as well as up and market conditions can change rapidly. Uncertainties that affect the behaviour of markets within the macroeconomic environment can affect the value of the assets held within a portfolio. When considering or reviewing investments we look at factors such international political developments, market sentiment, economic conditions, circumstances where markets aren't allowed to freely move (due to government controls), changes in government policies, restrictions on foreign investment and currency repatriation, currency fluctuations and other developments in the laws and regulations of countries in which investment may be made.

Given the potential impact on our investment returns, we closely monitor market-wide and systemic risks. We collect information from many sources.

PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

External advisers

- LPF uses the JISP to gain insights on market trends and conditions
- LPF's external managers include market commentary within their periodic investment reports, which LPF reviews in detail
- LPF's actuary may comment on general investment issues as part of the valuation work they do for LPF.

External providers

- EOS supports us in identifying systemic and emerging risks as well as mitigating these risks through engagement. Our Internal Equities team work closely with EOS in our collective approach to engagement, reflecting the areas of stakeholders' interest and concern. We undertake to utilise our voting rights, including those exercised through proxy, to engage with the management of companies in whom we invest, to promote appropriate standards of corporate governance that safeguard shareholder interests and respect stakeholder interests
- The organisations which support LPF's portfolio monitoring for shareholder litigation share insights on market-wide issues relevant to risk.

Reviews

- LPF monitors its counterparties and suppliers to ensure they remain creditworthy and suitably authorised to provide services
- Our investment team monitors the creation of debt within the financial system to identify systemic and non-systemic vulnerabilities.

Collaboration

- Collaborative initiatives are a valuable source of intelligence on emerging risks and ways to mitigate these risks. We have a long track record of collaborating with other investors, asset owners and organisations. By participating in its signatory consultation in Q2 2022, we supported the development of the strategy renewal for the second phase of the Climate Action 100+ initiative, which aims to address systemic climate risk by engaging with the world's largest corporate greenhouse gas emitters to encourage necessary action on real world emissions reduction. We also continued as an active participant in the Occupational Pensions Stewardship Council (OPSC) during 2022, including supporting the development and prioritisation of its work plan as a member of the Engagement Group.

Case study

THE ASSET OWNER DIVERSITY CHARTER - UPDATE

Background
In mid-2021, we were delighted to be part of a group of UK asset owners inviting others to sign the new Asset Owner Diversity Charter to tackle a lack of diversity across the fund management industry.

By signing the Charter, signatories commit to take account of diversity and inclusion records from fund managers when choosing new partners. Diversity questions form part of the overall assessment scores for each bidder. Fund managers have to disclose information and demonstrate how they're tackling diversity and inclusion within their workforce.
Signatories also commit to including diversity as part of ongoing manager monitoring, providing a questionnaire to managers annually for completion.

The Asset Owner Diversity Charter is part of the Diversity Project, championing a diverse and inclusive UK investment and savings industry. The Diversity Project now has over 100 members across asset owners, investment managers, fund selectors, investment consultants, family offices, actuaries, trustees and wealth managers.

LPF Action on diversity
In 2022 LPF partnered with both Future Asset, an organisation in Scotland that enables girls in the senior phase of high school to explore how investment can change the world for the better, gain valuable, transferable skills and consider the benefits of possible future careers and Girls Are Investors (GAIN), a charity set up by investment professionals to improve gender diversity in investment management by building a talent pipeline of entry-level female and non-binary candidates. Our colleagues have volunteered as Judges for the Future Asset competition over the last two years and LPF has hosted successful teams to undertake work experience at our office. In summer 2023 we welcomed two summer interns to our investment team, including one recruited through the GAIN internship programme.

Assessment of effectiveness
While the reception of this initiative has been positive, leading to commitment and implementation of additional reporting on diversity by many large asset managers, it's too soon to assess overall effectiveness. It may take years for actions taken now to address barriers to recruitment and retention of women and minority groups to achieve the aim of a more representative industry. Regular annual collection of data should enable trend analysis and indicate effective practices which can be shared more widely, to accelerate industry wide progress.

Objectives of the Diversity Project for 2021-2026

Gender
- To achieve 20% female fund managers named as the manager of a specific portfolio
- Gender pay gaps reduced by one third from 2019 levels
- Equality in graduate and school leaver recruitment.

Ethnicity
- 90% ethnicity disclosure rate
- Ethnicity goals to be set after review of disclosure rates by gender.

Socio-Economic
- Collection of socio-economic data
- Support of one or more graduate/school leaver recruitment programmes focused on socioeconomic diversity

https://diversityproject.com/about-us/

PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

UNDERSTANDING MARKET AND SYSTEMIC RISKS

We discuss the materiality of each potential risk and agree an action plan for addressing it, including:

- Responding to consultations: engaging with government and industry bodies, for example:
    - We responded to the November 2022 Department of Levelling Up, Housing and Communities (DLUHC) consultation on Local Government Pension Schemes (England & Wales): Governance and Reporting of Climate Change Risks. Having voluntarily reported in line with the guidelines produced by the Taskforce for Climate Related Financial Disclosure (TCFD) framework for several years, we supported the intention to introduce a largely similar framework to that already in place for most UK private sector pension schemes. We provided specific feedback to the consultation questions, noting the evolving understanding of climate risk to financial institutions and data challenges. Unfortunately, feedback from the consultation has been delayed, which has led to some uncertainty in both the timing and content of our future reporting requirements. However, the direction of travel remains clear
- Direct dialogue:
    - Engaging directly with policymakers: through the Scottish Scheme Advisory Board, we've participated in a working group on TCFD reporting and the proposed introduction of more stringent mandatory reporting requirements on climate change risks for the LGPS
    - Engaging directly with companies as part of Climate Action 100+ (CA100+)
- Collaborative initiatives: this includes our membership of IIGCC, CA100+, PRI, OPSC and LAPFF [More details provided in Principle 10]
- Throughout 2022, we participated in workshops organised through the Occupational Pensions Stewardship Council (OPSC) to better understand the implementation of TCFD reporting guidelines for UK occupational pension schemes regulated by the Department of Work and Pensions.
  More details on our collaboration activities are provided in Principle 10
- Advocating for better standards through engagement with our external managers: in 2022 we communicated with our external managers to outline our commitments to responsible investment, introduce enhanced monitoring of primary investments, request updates on their net zero commitments and plans for product-level TCFD reporting, and request completion of the Diversity and Inclusion Questionnaire.

Case study

NAVIGATING GEO-POLITICAL AND MACRO-ECONOMIC CRISES

January 2022: new year uncertainty

As the year began, capital markets were focused on persistent inflationary pressures, the prospects for rate hikes and strict lockdowns in China, all of which threatened a global economic slowdown.

February: Russian invasion of Ukraine

Neither we nor capital markets in general had anticipated the destruction and human suffering that was unleashed by the Russian invasion of Ukraine, nor the policy actions of governments around the world. In the immediate aftermath of the invasion we reviewed our investment exposures to affected markets. This confirmed very minimal exposure to Russia, Ukraine and Belarus across our diverse investment portfolio. It also confirmed that those companies amongst our equity holdings that undertook business connected to Russia generated less than 10%, and in the majority of cases, less than 5% of revenues there. We also focused on ensuring that we complied with all relevant sanction regimes.

Meantime, our engagement provider, EOS, engaged with companies with material connections to Russia, mapped supply chains or partners that could be involved in supporting the conflict, either through products, services or finance, taking into consideration the public need for the product/service. Most investment managers took the approach of writing down any remaining Russian stock investments to zero.

Whilst the impact on individual stocks was in some cases significant, our Fund wasn't directly impacted to any great extent. However, we remained alert to the social and governance issues highlighted by these events, as well as the broader impacts on global supply chains, commodity prices, inflation and prospects for economic growth in the heavily intertwined global economy.

September: UK political and financial turmoil

UK financial markets were rocked after the Chancellor announced a series of unfunded tax cuts. The pound rapidly plummeted close to an all-time low versus the US dollar and yields on longer dated gilts skyrocketed, necessitating intervention by the Bank of England. Gilts are UK government bonds, which are issued to help finance public spending.

Some UK pension funds were impacted by the sudden reduction in value of their “risk-free” gilt holdings, particularly if they had used leverage (i.e. borrowed to enable a larger gilt holding while also maintaining holdings in higher yielding assets such as equities). These Liability Driven Investment (LDI) strategies are designed to maintain a cushion between the value of their assets and liabilities, with the intention of absorbing any losses on the gilts. If losses exceed this cushion, the pension fund is asked to provide additional funds to it. However, many pension schemes didn't have sufficient liquid assets to meet their provider's (very urgent) calls to restore their LDI cushion. This meant that many had to sell gilts, thereby reducing their value further.

While LPF holds gilts as part of our diversified portfolio, we don't use leverage and as such, we didn't suffer from liquidity issues. Indeed, we saw the reduction in the price of gilts as an opportunity to increase the size of our investment in this asset class, which now offered more attractive returns.

The turmoil prompted freshly elected UK Prime Minister Liz Truss to resign after just 45 days in office, paving the way for Rishi Sunak to be named her successor, which restored confidence across financial markets.

Case study

NAVIGATING GEO-POLITICAL AND MACRO-ECONOMIC CRISES
(CONTINUED)

December: Stabilisation
A welcome deceleration in the inflation rate in the US and improved investor sentiment surrounding the relaxation of China's “zero-COVID” policy contributed to more stable markets later in the year. Geopolitics and government policy actions are difficult to predict, but we remain alert to the risks and opportunities that may arise in the future. As we started 2023, the depth and duration of an economic recession in 2023 or 2024 was a hotly debated topic for market forecasters, with expectations of further interest rate hikes in the near term, to be followed by cuts when inflation has been “tamed”.

Assessment of the effectiveness of our approach
2022 was a challenging year for many investors, as fixed income and property investments provided little counterweight to weakness in global equity markets. While we don't attempt to predict short-term market movements, our long-term approach and focus on delivering good risk-adjusted returns as a responsible investor enabled us to navigate these stormy waters.

Our long-standing focus on good governance, consideration of relative value across asset classes (which was the basis for our underweight position to LDI), and deliberate bias to low volatility and value equities supported performance. Our actions to assess and mitigate exposure to geopolitical risk, while also retaining the agility to seek out opportunities during market dislocations served us well.

While past performance is no guide to the future, we continue our approach to responsible investment which is informed by our investment beliefs, policies, and priorities, together with regulations and statutory guidance. We note that there are multiple facets to responsible investment. Sometimes it appears to be reactive, coalescing collaborative engagement or implementing new policies after an event has occurred (with the laudable aim of reducing a recurrence). The process of identifying environmental, social and governance risks (and therefore avoiding or minimising exposure) before they lead to material financial events or impacts is harder to evidence, particularly for risks that are expected to play-out over the longer term, and we remain humble in the knowledge that we can't predict all geopolitical or macroeconomic crises.

PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

HOLDING COMPANIES TO ACCOUNT

In addition to our engagement activities supported by EOS, we recognise shareholder action as another way that we, as an institutional investor, can promote good corporate governance and therefore contribute to well-functioning markets.

Where it's economical to do so, our fiduciary duty may require us to take action to recover funds lost through investments in companies as the result of corporate mismanagement, but we wish to highlight how this can also reduce some systemic risk where corporate reforms can be secured alongside financial recovery. This may be important where there's a void in the role of industry regulators, (due to constrained resources for example) or where changes in political administration can impact the willingness of regulators to take enforcement actions.

We use third party providers to support our portfolio monitoring, to collect information and to undertake legal analysis necessary to make informed decisions about the best options for asset recovery and the wider benefits of participating in potential claims. We have an internal policy to guide our actions, and this considers the significance of a company's wrongdoing, and the wider context of our stakeholder expectations.

Confidentiality restrictions limit how much detail we can provide about specific actions, but LPF continues to actively monitor its loss exposure in relation to class actions, and has previously taken 'lead plaintiff' status for US-based actions.

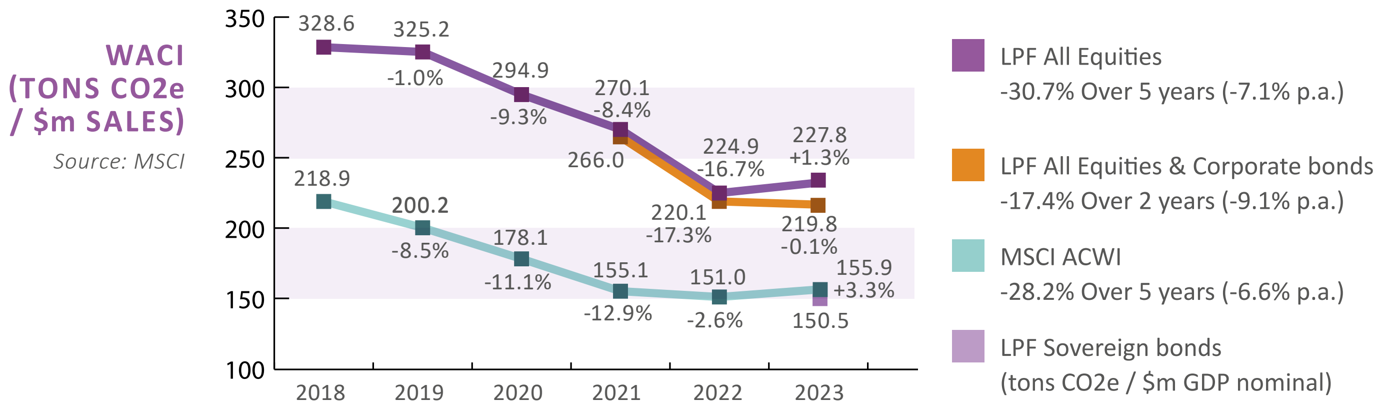
OUR APPROACH TO CLIMATE CHANGE RISK

In Principle 7 we identify Climate Change as our Top Priority for engagement, as a key systemic risk, and stated (in Principle 1) that asset owners are uniquely positioned to drive changes in governmental and corporate behaviour to bring about an acceleration in the sustainable energy transition and a decarbonisation of the global economy. The case study on page 11 (Principle 1) describes how we seek to engage with policymakers on this systemic risk, while further details on how we address climate change risks in our portfolio is covered on page 60 (Principle 7).

PRINCIPLE 4: PROMOTING WELL-FUNCTIONING MARKETS

MEASURING CLIMATE RISK IN OUR PORTFOLIOS

We believe that accurate measurement of emissions is an important element in assessing the climate risk of an investment portfolio. Supported by a research budget specifically allocated to data services targeting ESG and climate-related risks and opportunities, we published our first annual carbon footprint (weighted average carbon intensity - WACI) for listed equities in 2018 and expanded the scope to include our corporate bond investments in 2020/21. In 2022/23 we expanded our analysis further to consider our sovereign bond holdings, so our most recent carbon footprint covered 67.3% of our total fund.



In 2021 the UK Government announced that emissions reporting will be mandatory for occupational pensions schemes by 2025 using specific Department of Work and Pensions (DWP) guidelines based on the TCFD framework. Although this doesn't apply to the Local Government Pension Scheme (LGPS), the UK Government launched a consultation proposing to apply broadly the same requirements to the LGPS.

Legislation is expected to be introduced in 2024 mandating first reporting by the LGPS by December 2025 for the 2024/25 financial year. While there are currently challenges with the cost and availability of emissions data, particularly where we're dependent on the level of information provided by external managers, this is a priority for us, and we support industry-wide efforts to improve the provision and quality of data. During 2022 we proactively wrote to our external managers informing them of our future regulatory reporting requirements and requested information from them on emissions reporting, noting that in-scope investment managers regulated from the Financial Conduct Authority (FCA) are working towards meeting the FCA's TCFD reporting requirements by mid-2024.

PRINCIPLE 5: REVIEW AND ASSURANCE

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

We have a range of internal and external review and assurance processes which support good stewardship. We run our review and assurance in conjunction with other underlying business and compliance processes, such as external manager monitoring programmes, which includes responsible investment governance and stewardship, to assess and ensure responsible investment policies are being implemented (see Principle 8).

REVIEW

We take a formal approach to reviewing our policies and their effectiveness. In relation to responsible investment, examples of such reviews are provided below.

We created our SRIP as a direct result of review and assurance.

During a review of our SIP in 2019, we concluded that it didn't fully describe our approach and commitment to integrating responsible investment in all areas of our investment process. As a result, we decided to provide a supplement to our SIP – our SRIP, described in relation to Principle 1.

ANNUAL REVIEW

Our SRIP is reviewed annually. Potential improvements to our responsible investment approach are suggested by LPF staff, reviewed by our Responsible Investment Group (RIG), and proposed for inclusion in the SRIP. Our JISP advisers appraise any changes and recommend a final version which is then reviewed by the Pensions Committee. The SRIP then becomes official policy when it's approved by the Pensions Committee. The training standards described earlier in this report support the ability of our various governing bodies to provide a meaningful review of our policies. In addition, their fiduciary duty requires them to take proper advice to discharge their function. This means they may need to consider using suitably qualified advisers before revising policies and procedures.

PRINCIPLE 5: REVIEW AND ASSURANCE

ASSURANCE

PRI assessment

As a signatory to the Principles for Responsible Investment (PRI), a United Nations supported network of investors which works to promote sustainable investment through the incorporation of ESG, we agree to allow PRI to undertake a comprehensive annual assessment of our approach to responsible investment. As part of this process, LPF has previously been able to undertake a gap analysis on areas of best practice highlighted by PRI, alongside our evolving responsible investment experience, supported by our internal assurance of our PRI assessment response.

The PRI did not conduct assessments in 2022 due to changes in the PRI reporting tool.

A summary of PRI's latest evaluation of LPF (released September 2022) is shown below. As the scoring methodology was changed, it's incomparable with scores from previous PRI assessments. The modules are scored with a numerical grading system and a star rating. The highest rating is five stars, which is awarded to those signatories who demonstrate leading practices within the responsible investment industry. While this new PRI assessment doesn't provide a peer comparison, we were awarded 3 or 4 stars (out of 5) in most modules which would imply our responsible investment behaviour is judged to be in line with or slightly ahead of the PRI's expectations for asset owner signatories across all categories measured.

We use the detailed assessment (which we publish on our website) alongside a transparency report which details our responses to conduct a gap analysis, to assess progress and highlight areas for further improvement towards industry best practice. Further significant changes to the PRI Reporting Framework are planned for 2023.

PRINCIPLE 5: REVIEW AND ASSURANCE

SUMMARY SCORECARD

Module Score / Star Score	AUM Average	0 25 50 75 100
Investment & Stewardship Policy ★★★★		85
Direct - Listed Equity- Active Quantitative - Incorporation ★★★	>=10 and <=50%	59
Direct - Listed Equity- Active Fundamental - Incorporation ★★★	>=10 and <=50%	62
Direct - Fixed Income- SSA ★ (not measured)	<=10%	0
Direct - Real Estate ★★★★	<=10%	76
Indirect Listed Equity - Active ★★★	<=10%	52
Indirect Fixed Income - Passive ★★★	<=10%	50
Indirect Fixed Income - Active ★★★	<=10%	48
Indirect - Real Estate ★★★	<=10%	55
Indirect - Infrastructure ★★★	>=10 and <=50%	58

SSA (above) stands for Sovereigns, Supranational and Agencies

UK Stewardship Code (2020)

As part of the process of producing our second Stewardship Code report in 2022, we addressed feedback on our successful first submission from 2021 and internally assessed our stewardship policies, processes and reporting. We continue to develop better practice, such as the re-introduction of disclosure of our voting records (see Continuous Improvement section below).

Retaining our status as a signatory to the UK Stewardship Code (2020) in February 2023 with our latest submission (which was submitted in October 2022) itself provides external assurance that we're meeting the standard expected of an institutional investor of our scale.

Case study



GREEN APPLE AWARDS

Context & objectives
LPF has a direct property portfolio of around £400m, which we actively asset manage. This means we work closely with our consultants, facilities managers and tenants on a wide array of matters including environmental initiatives. During 2022, we submitted two of our direct property assets for Environmental Best Practice assessment by The Green Organisation, which is an independent, international, non-political, non-profit environment group dedicated to recognising, rewarding and promoting environmental best practice around the world.

The aim of the Green Apple Awards is to improve environmental performance, encourage the efficient use of resources, enhance the competitiveness of organisations, support the wider goals of sustainable development including social benefits through community and staff involvement, and help Green Apple Award winners to benefit from their environmental endeavours.

The Green Apple Environment Award can be awarded to any company, organisation or individual that has helped the environment. There are several categories of awards: Green Champions, Gold, Silver and Bronze. Winners are presented with a Green Apple Award Trophy.

Outcome
LPF were Green Apple Environment Award winners for the following direct property assets:

- Bishops Court Retail Park, Exter – Gold Award
- Neptune Business Park – Bronze Award.

The awards were granted for biodiversity improvements, including installations of bird boxes, insect hotels and planting wildflowers.

Assessment and future plans
Independent assessment and award success provides assurance that our environmental endeavours are positively impactful and supports the continuation of these asset management activities across our direct property portfolio.

During 2023, we're looking to put forward submissions for three other property assets.

"Initially we thought it's a challenge to bring anything green to an industrial estate within a stone's throw from the M25 and Dartford Crossing. The fact that it's an industrial and largely concrete area makes Neptune Business Park a worthy winner."

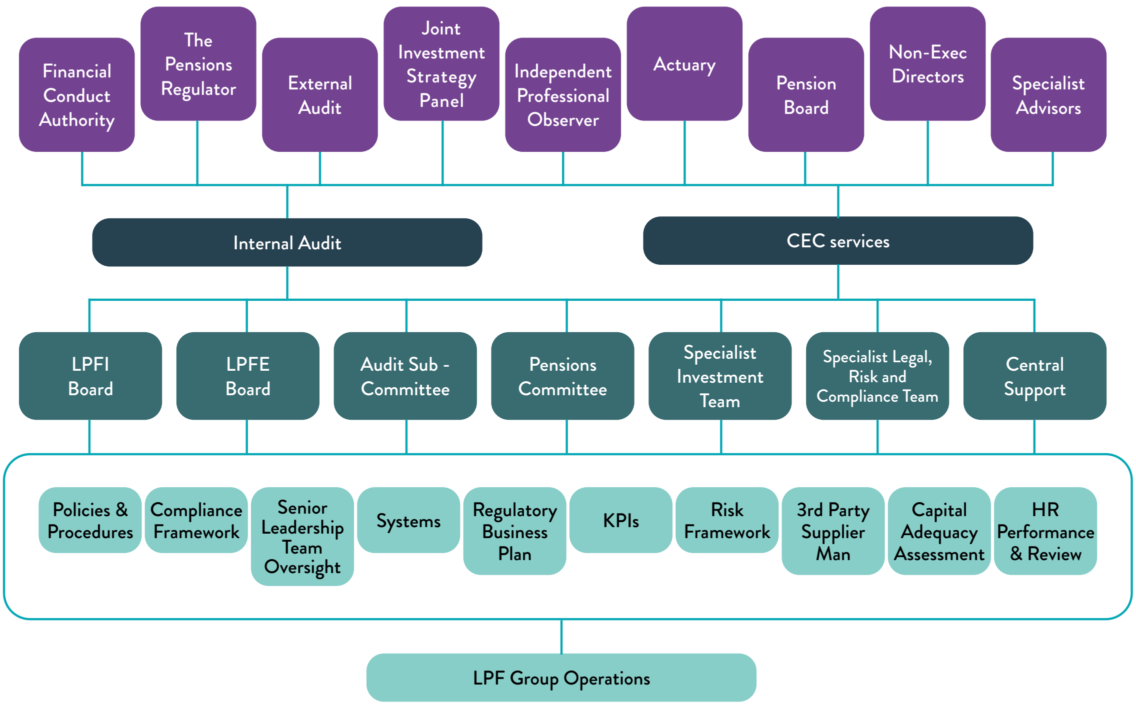
Katie Dickerson, Facilities Manager at JLL

PRINCIPLE 5: REVIEW AND ASSURANCE

OUR ASSURANCE MAPPING PROCESS

We manage assurance as part of an “assurance stack” and we review its effectiveness and efficiency regularly to continuously improve.

LPF GROUP ASSURANCE STRUCTURE

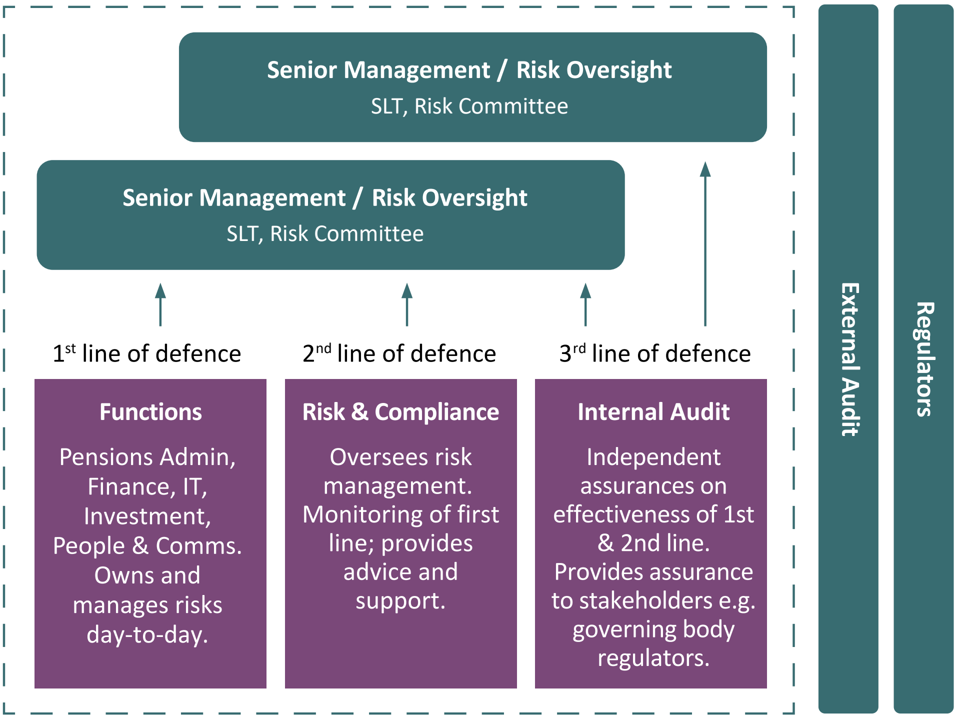


We maintain an assurance overview and mapping document which is designed to ensure that we meet our objectives, are adequately resourced, manage to high professional standards, meet legislative requirements, and deliver high levels of customer satisfaction.

The LPF group's assurance map is categorised in accordance with the 'four lines of defence' model, as illustrated below.

PRINCIPLE 5: REVIEW AND ASSURANCE

GROUP LINES OF DEFENCE OVERVIEW



** Internal Audit is provided in conjunction with external consulting firm PWC*

LPF's Risk and Compliance function is accountable for maintaining an assessment of the assurance framework and, in conjunction with the SLT, ensuring that the framework continues to align with recent developments and LPF's risk appetite. They also ensure awareness and oversight of the assurance map, distillation of its principles throughout LPF's operations and culture and seek to address any perceived gaps or over-extensions.

LPF operates a separate Audit Sub-Committee to review and scrutinise matters, such as internal audit, the financial accounts and regulatory compliance in greater detail, as well as all risks, including information security and cyber risks. The Audit Sub-Committee meets three times a year and reports to the Pensions Committee.

The assurance overview produced by LPF's Risk and Compliance function is considered by the Audit Sub-Committee and the Pensions Committee annually, as part of its Systems and Controls update. It's also tabled once a year to the boards of LPFI and LPFE.

PRINCIPLE 5: REVIEW AND ASSURANCE

TRANSPARENCY AND REPORTING

LPF welcomes external scrutiny of its activities to support its assurance and review processes. In line with the expectations of a public sector organisation, many of our policies and procedures are available on our website. We also publish our PRI assessment results, our PRI transparency report, our Stewardship Report and our voting records on our website.

We recognise the importance of external reporting, which facilitates independent assessment of our practices. Internally, LPF commits senior resources to supporting the quality of such reporting. For example, related to responsible investment:

- Our Responsible Investment Lead has day-to-day ownership of our reporting commitments such as the PRI and the FRC Stewardship Code, with oversight from the Responsible Investment Group
- Our Risk and Compliance and Communications teams ensure accuracy, regulatory compliance, clarity of message and public communication of reporting, as necessary
- Our Senior Leadership Team, specifically our CEO and CIO, are chief sponsors and have responsibility for approving Responsible Investment communications and reporting.

Within our annual report we include information on our approach to climate-related risks and opportunities, following the guidelines produced by the Taskforce for Climate related disclosures. In addition, we submit an annual UK Stewardship Code Report to the FRC.

As reflected in our governance structure, we have multiple layers of regulation and oversight. We prepare extensive internal reporting across all aspects of the organisation. Together, this reporting brings strong discipline in ensuring we review our policies, assure our processes and assess the effectiveness of our activities.

CONTINUOUS IMPROVEMENT

Having improved the availability of our responsible investment policy and guidance documents in 2020 with the publication of our SRIP, which is reviewed and updated annually, and the creation of our responsible investment e-zine, ENGAGE, we further improved the governance of our responsible investment activities by creating our Responsible Investment Group in 2021 (as described in Principle 1). We set up our Climate Disclosure and Strategy Project in 2022 to review our climate change strategy and reporting practices, recognising that best practice and regulatory reporting obligations are evolving in this area.

We've reinstated full disclosure of our quarterly voting records on our website, which includes rationale for votes against management, abstentions and shareholder resolutions. While our stakeholders previously signalled that publication of company-level voting data was hard to consume (with details on specific companies lost amongst the scale of disclosure), we recognised growing interest in specific votes, such as “Say on Climate” votes and shareholder resolutions (see Case Study in Principle 12) as well as the development of best practice disclosure guidelines by the Vote Reporting Group, which was established by the FCA in November 2022.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

TRANSPARENCY AND REPORTING

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

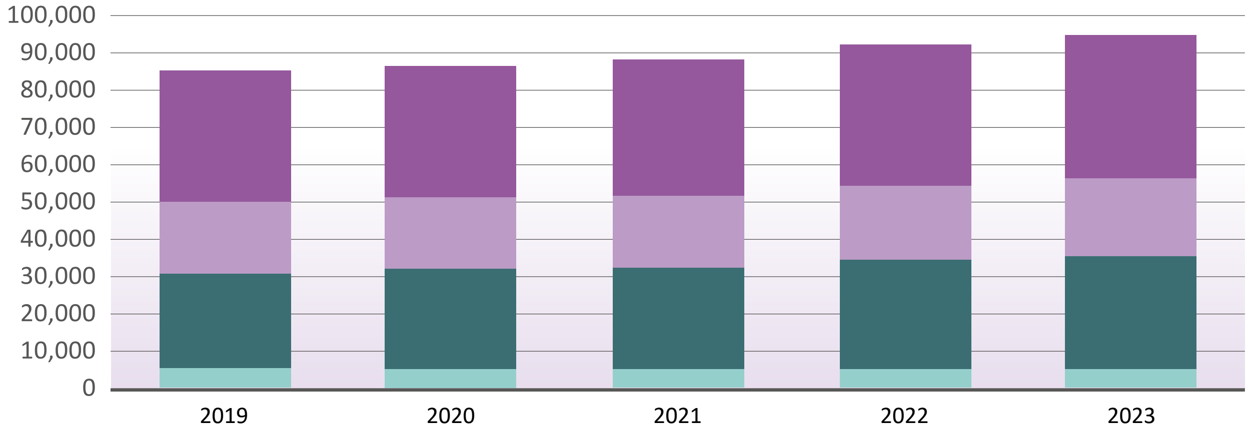
As mentioned earlier in this report, LPF is the second largest Local Government Pension Scheme (LGPS) in Scotland, which is a funded, defined benefit, statutory occupational pension scheme. We refer to our stakeholders, rather than clients and beneficiaries. LPF's stakeholders are the people and entities with an interest in the assets and activities of LPF.

Our stakeholders include the members of the pension scheme (existing and future), their dependants and beneficiaries, as well as the participating employers who contribute to the assets of the fund, and our governing bodies.

OUR MEMBERSHIP

The table and bar chart below shows a breakdown of the membership of our defined benefit scheme. As at 31 March 2023, the number of members in the scheme was 91,996. The average age of our members at the latest actuarial valuation in March 2020 was approximately 53.8 years (active and deferred members average was 51 years old while our pensioners average was 67 years old). As at 31 March 2023, the average age of our members had risen to 54.9 years.

LOTHIAN PENSION FUND MEMBERSHIP DATA



	2019	2020	2021	2022	2023
Active	35,014	35,874	36,149	37,207	37,614
Deferred	19,094	19,098	19,049	19,832	20,427
Pensioner	25,627	27,091	27,843	28,870	29,800
Dependant	4,199	4,229	4,173	4,161	4,155
Total	83,934	86,292	87,214	90,070	91,996

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Investment time horizon

The Pensions Committee considers the duration of LPF's liabilities when it sets the investment strategy to ensure that there's sufficient cash flow to pay pensions when they fall due. The Fund is open to new members and contributions which means that we'll be paying pension benefits to today's youngest members in several decades time. However, the Fund is a multi-employer fund, so we consider the different needs of those employers and offer different investment strategies to reflect their investment time horizons and cash flow needs, which vary significantly based on the maturity profile of their pension liabilities. These investment time horizons range from a few years to several decades. The different employer strategies are described on the following page.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

AN OVERVIEW OF OUR INVESTMENT APPROACH

Employer strategies

LPF is a multi-employer pension scheme and not all employers are alike. To address their differing funding requirements the fund operates four distinct investment strategies. The assets in each strategy are shown in the table below.

EMPLOYER GROUP STRATEGIES 31 MARCH 2023

Main Strategy **94.1%** (£9,075m)
Buses Strategy **5.3%** (£513m)
50/50 Strategy **0.4%** (£37m)
Mature Employer Strategy **0.2%** (£15m)

TOTAL WEIGHT 100%
TOTAL ASSETS £9.7bn

Employers fund their liabilities with the strategy that reflects their ability to tolerate risk within an appropriate time horizon, considering the maturity of their liabilities.

Most employer liabilities are funded under the Main Strategy, which adopts a long-term investment strategy, aiming to generate an investment return that will minimise the cost to the employer within reasonable and considered risk parameters. The Main Strategy maintains significant exposure to real investments, such as Equities and Infrastructure, which have a history of protecting and growing purchasing power.

A small number of employers are funded in the Mature Employer Strategy, which invests in a portfolio of UK index-linked gilts to reduce funding level and contribution rate risk as they approach exit from the fund. The liabilities funded by the Mature Employer Strategy represent approximately 0.2% of total liabilities.

The 50/50 Strategy enables another small group of less mature employers to fund liabilities with a 50/50 mix of the Main Strategy and the Mature Employer Strategy. The liabilities funded by the 50/50 strategy represent a further 0.4% of total liabilities.

The Buses Strategy, which was created when the assets and liabilities of Lothian Buses Pension Fund were consolidated into the Lothian Pension Fund on 31 January 2019, is a 55/45 mix of the Main Strategy and the Mature Employer Strategy. The liabilities funded by the Buses strategy represent approximately 5.3% of total liabilities.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Policy groups

The investment strategies are described in terms of allocations to broad asset classes, or policy groups, which are the key determinants of risk and return. These policy groups are Equities, Real Assets, Non-Gilt Debt, LDI (Gilts) and Cash. Although individual investments within each group will have different risk and return characteristics, each policy group targets a long-term return in relation to the return from UK gilts. The return target provides perspective on the expected risk of each group in relation to Fund liabilities.

The table below presents the policy group target allocations of the four investment strategies at end March 2023 along with the total Fund strategy, which is the weighted average of the four employer strategies.

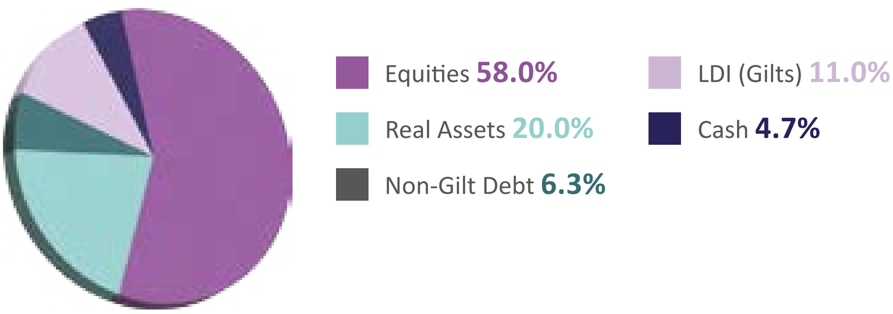
LOTHIAN PENSION FUND 31 March 2023	Main strategy	Mature Employer strategy	50/50 strategy	Buses strategy	Total fund strategy
Equities	60.0%	0.0%	30.0%	33.0%	58.3%
Real Assets	20.0%	0.0%	10.0%	11.0%	19.4%
Non-Gilt Debt	10.0%	0.0%	5.0%	5.5%	9.7%
LDI (Gilts)	10.0%	100.0%	55.0%	50.5%	12.5%
Cash	0.0%	0.0%	0.0%	0.0%	0.0%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Note: Numbers may not sum due to rounding

The LDI policy group comprises index-linked and nominal gilts. It doesn't use financial leverage, which caused some pension funds to become forced sellers of assets in the autumn of 2022. This is the lowest risk, lowest expected return policy group as it's possible to match the cash flows of gilts with the pension payments that the Fund expects to pay in the future. The purpose of the other policy groups is to generate a return in excess of the gilt return to make the Fund affordable to employers. The other policy groups, therefore, are expected to generate higher returns over the long term - the actuary models 20 years into the future. These higher returns come at the cost of higher risk or volatility.

The Pensions Committee delegates implementation of investment strategy to the Fund's officers, who are tasked with investing each policy group within prescribed ranges. These are laid out in our SIP. The actual allocation at end March 2023 is presented in the pie chart below. The largest deviation from strategy is the overweight position in cash (+4.7%), which reflects continuing caution about the valuation of other assets, though is considerably lower than last year following recent opportunities to increase allocation to Real Assets and LDI at more favourable prices. The Fund's exposures to Equity and Real Assets, which should help protect against inflation, are broadly in-line with target. The Fund has operated comfortably within the prescribed ranges over the year.

ACTUAL ASSET ALLOCATION TOTAL FUND 31 MARCH 2023

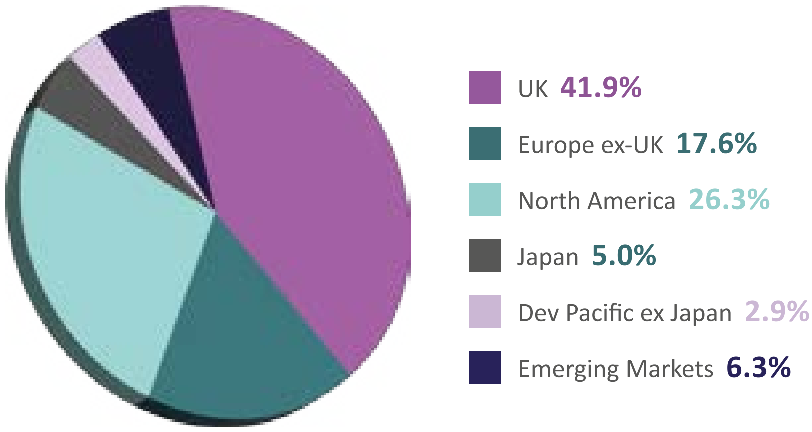


PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

OUR GEOGRAPHICAL EXPOSURE

The pie charts below show an estimated breakdown of the investments of the total fund by geography and asset class at 31 March 2023.

PORTFOLIO ANALYSIS LPF 31 MARCH 2023



PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Stakeholder views

Due to the complexity and breadth of responsible investment topics, we don't seek to directly survey our members' views on these topics. However, we benefit from deep integration of member representatives within our Pension Board and Pensions Committee, who provide the important insight that we require about our stakeholders' needs with constructive two-way dialogue.

The Pension Board's role is to provide oversight of the Pensions Committee to ensure that the pension scheme is meeting its legal and administrative requirements and is being operated in the best interest of its stakeholders. Our Pension Board consists of five member representatives and five employer representatives (although we had one employer vacancy at 31 March 2023). The member representatives are union representatives from different unions (who bring insight from their constituent members in different industries but represent all pension members when they sit on the board). We ensure both large and smaller employers are represented on the Pension Board.

We also have an employer representative and a member representative on our Pensions Committee, alongside the five elected members of City of Edinburgh Council (CEC). Pensions Committee members are quasi trustees. Committee papers and minutes are publicly available for all our stakeholders to read, with a link to the relevant CEC website page provided on the LPF website. Contact details for the Pensions Committee are also provided there. The Pensions Committee therefore acts as a conduit for stakeholder views.

Our Senior Leadership Team (SLT) engages with stakeholders (including employers, elected members, Scottish Scheme Advisory Board and The Pension Regulator) in listening exercises to understand their expectations.

Stakeholder needs

Through this stakeholder engagement, we believe our stakeholders' primary needs to be:

- The provision of a secure pension entitlement for members
- Stable contribution rates for employers
- Recognition of LPF as a Responsible Investor.

Our investment approach and operating plan is driven by what is required to meet these needs. Our strategic goal to “Earn an appropriate risk adjusted investment return as responsible investors” reflects our belief that Responsible Investment and stewardship should reduce the risk associated with the invested assets that the Fund owns to pay pensions when they are due.

LPF has been a signatory to the Principles of Responsible Investment (PRI) since 2008 and demonstrates good stewardship through our Stewardship Report. In accordance with the UK Stewardship Code (2020) our latest Stewardship Report is published on our website, with signatory status confirmed in February 2023.

As explained above, we have four different employer strategies to meet the needs of our different employers, reflecting their maturity profile and hence the needs of the underlying beneficiaries. This ensures investment is aligned with an appropriate investment time horizon.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

COMMUNICATION

We believe that transparency in terms of investments, communication, access to information and cross-industry collaboration are key components in protecting our stakeholders' interests and ensuring we continuously improve.

At LPF, we support our stakeholders on both a proactive and a reactive basis. Considerable time and effort is spent on proactive engagement designed to support our stakeholders. It means that we can provide clear, carefully constructed responses to frequently asked questions, demonstrating understanding of the issues, and provide insights into the work that we do and the work that's done on our behalf by third parties and collaborative partners.

Specifically on the subject of proactive responsible investment communications, we've created a library of publicly available resources on our website, including:

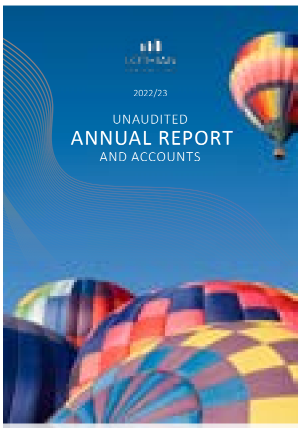
Statutory reporting:

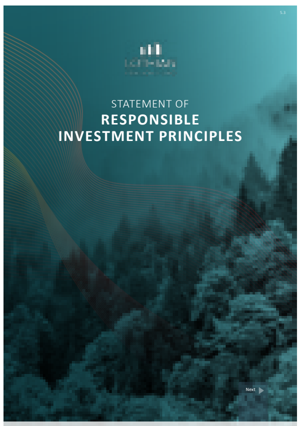
- The Annual Report and Accounts (which voluntarily includes reporting aligned with Taskforce for Climate-related Financial Disclosures)
- The Statement of Investment Principles (SIP)

Voluntary reporting:

- The Statement of Responsible investment Principles (SRIP)
- PRI Assessment (and Transparency) report(s)
- Stewardship Report
- Voting data
- Engagement case studies
- Internal equity approach to responsible investment
- The *ENGAGE* responsible investment newsletter

We encourage members to read, listen and understand these resources to be well informed about the nature of investing and LPF's approach to responsible investing.





PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

LPF is both responsive to, and proactive in its approach to media engagement and external communications. Our Responsible Investment Lead takes an active role in contributing to media articles, through leadership and speaking events.

This included involvement in the following:

- Appearing on a Pensions and Lifetime Savings Association (PLSA) Local Authority conference panel on Renewable Infrastructure's Role in the Energy Transition
- Participating as judges for the GAIN (Girls Are Investors Network) Investment Competition
- Appearing on a PLSA Investment Conference panel on Targeting Net-Zero in Fixed Income
- Participating in a roundtable with the Pensions Minister to discuss how UK pension funds can invest in support of the transition in emerging markets
- Participating in the Engagement Group (steering committee) for the Occupational Pensions Stewardship Council (OPSC).

We also undertake reactive engagement in three broad categories:

- Freedom of information requests
- General and stewardship enquiries
- Indirect general enquiries through Councillors/MSPs/MPs.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

ENQUIRIES

Both the direct and indirect general enquiries typically follow a similar format. They're enquiries either generated by a website form or downloaded from a website, suggesting that it should be directed to a local political representative. Often these enquiries are from individuals unrelated to the pension fund.

In these instances, we support busy councillors by providing standardised responses. This ensures consistent responses, speed, and greater efficiency and time savings for councillors, committee members and officers alike, as well as upholding the levels of service our stakeholders expect.

We make a pledge to our members that, when they contact us, we'll:

- Deal with the query promptly, efficiently, fairly and in an easy-to-understand way
- Communicate our service standards
- Reply as quickly as possible with information if we can't answer the query on the spot
- Treat all queries with respect
- Treat our members as individuals.

Evaluation of effectiveness

Our proactive and responsive communication strategy combined with the make-up and role of the Pension Board and Pensions Committee in our assurance structure ensures stakeholder engagement with representatives from all our key constituencies. This supports our understanding of stakeholders' needs.

Based on the enquiries from Councillors and the Pensions Committee about LPF, we also believe that our public communication channels are working effectively. While we recognise that some of these enquiries may be from individuals who aren't members of LPF, we note that this engagement can be useful in reflecting broader views on emerging issues.

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Taking account of stakeholder views

LPF follows a two-year strategic planning cycle, and our planning process begins and ends with a focus on our members through an ongoing feedback loop of listening to our members when we engage with them on administration matters, and in asking for feedback through our complaints and compliments process. The process to develop our 2022-2023 Business Plan included consulting with the Pensions Committee prior to its formal consideration and approval by our Pensions Committee in March 2022 on behalf of our members and employers.

The plan centres around four broadly defined strategic goals, each with more detailed objectives and accompanying targets and measures to allow us to monitor our progress.

STRATEGIC GOALS 2022-2023

How we achieve the sustainability that our multi-generational obligations require

OPERATING PLAN GOALS

Develop and deliver a member and employer proposition for service excellence

- Continue to target external validation including the Pensions Administration Standards Association (PASA) accreditation, the Customer Service Excellence (CSE) award and CEM Benchmarking
- Delivery of our digital strategy to further improve our service proposition for both members and employers
- Preparation for the launch of the Pensions Dashboard and responding to the requirements of the McCloud judgement

Earn an appropriate risk adjusted investment return as responsible investors

- Deliver sufficient investment returns over the long term to meet funding targets
- Seek to have a positive impact on the economy and society by continuing to integrate ESG into our investment processes
- Demonstrate good stewardship of our assets

Extend collaboration and services to existing partners and deepen where possible

- Continue to collaborate through successful investment partnerships
- Offer reliable and impartial advice to policy makers including the Scheme Advisory Board

Achieve greatness in our people, teams and culture

- Empower a broad range of talents to meet organisation priorities
- Cultivate leadership competencies and develop succession plans across the team
- Give our people capacity and encouragement to contribute to our communities

PRINCIPLE 6: CLIENT AND BENEFICIARY NEEDS

Through engagement with stakeholders, we recognised the need for LPF to be recognised as a responsible investor and to demonstrate good stewardship meeting the requirements of the UK Stewardship Code (2020). We published our first Stewardship Report in Q4 2021. This document is our third Stewardship Report.

We have also recognised the views of our stakeholders by taking on board their need for information on climate risk. This led to the creation of Responsible Investment Group (RIG) in 2021 and the initiation of the Climate Disclosure and Strategy project, which progressed through 2022 and continues in 2023. This encompasses a review of evolving best practice and regulation as well as implementation challenges. One of the outcomes of reviewing evolving best practice was the reinstatement of full disclosure of our voting records on our website.

Implementation

Implementation of our investment strategy is achieved using both internal and external managers. We assess all our investments with a view to meeting a required level of financial return in the context of achieving an appropriate level of risk diversification. ESG issues are an integral part of that assessment. The benefit of having an experienced portfolio manager as our in-house Responsible Investment Lead is that we're able to integrate our stewardship and our investment decisions across the fund, according to asset type (see Principle 7).

Debt denial

We recognise that our ambition (as described in our SRIP) to avoid providing new financing to companies or projects that are incompatible with the aims of the Paris Agreement is a leadership position for asset owner climate policy. Substantial research is taking place across the investment industry on how to determine whether certain companies or specific projects are aligned (or aligning) with the aims of the Paris Agreement. Some frameworks and tools exist (such as the Transition Pathway Initiative and Science Based Targets), but their coverage is incomplete.

For externally managed assets, such as corporate bonds, we're dependent on our external managers to implement this policy on our behalf. We initiated a programme to proactively write to all our managers in 2022 outlining our responsible investment policies and commitments, requesting an update on their policies and commitments (particularly regarding net zero alignment), enhanced reporting on new (primary) financing investments, and their timelines for including product level emissions data in standard reporting. In addition, we also sent our managers the Asset Owner Diversity Project diversity and inclusion questionnaire in accordance with our commitments to this initiative. Monitoring our external managers' responses and provision of enhanced reporting is being progressed through 2023.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

The purpose of our pension fund is to pay pensions to members as they fall due over a multi-decade timeframe. As an early signatory to the PRI, we've incorporated environmental, social and governance issues into our investment decision-making since 2008. We see stewardship as an essential and integral part of our investment process.

- Our stewardship activities inform us about how companies are performing on specific ESG issues, about how proactively these issues are being managed, and about companies' wider approach to strategy and risk management
- Our stewardship activities often encourage better disclosures to support our investment research and decision-making on ESG issues
- Our investment process identifies risks and opportunities both at a stock and sector level, providing us with a prioritised list of issues to focus on in our engagement
- Our dialogue with companies often generates wider insights about trends, drivers, best practices, and relative company performance, informing ESG analysis.

"There is no such thing as a risk-free investment. ESG issues are central drivers of investment risk and return. Our job is to be aware of the relevant risks, to ensure that we're being paid for the risks we're taking, and to manage and mitigate these risks."

Gillian de Candole
Portfolio Manager and Responsible Investment Lead

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

As discussed in Principle 2, our stewardship efforts are purposely managed and led by our investment team, so that they're embedded in the investment process systematically. We don't treat this as a separate activity. We encourage company management teams to improve their practices and give them time to do so. This support is not open-ended or unquestioning; if we feel progress is too slow, and the prospect of financial risk to us is increasing, we'll withdraw our support and reduce or exit an investment.

We integrate stewardship and ESG issues into our investment analysis and decision-making process.

ESG and stewardship integration

Implementation of our investment strategy is achieved using both internal and external managers. We assess all our investments with a view to meeting a required level of financial return in the context of achieving an appropriate level of risk diversification. ESG issues are an integral part of that assessment. The benefit of having a portfolio manager as our in-house responsible investment lead is that we're able to integrate our stewardship and our investment decisions across the fund, according to asset type. How ESG issues are incorporated into investment analysis and decision-making processes varies according to the asset category (but not geography) and whether the mandate is internally or externally managed. The following table explains our approach by asset category and mandate type:

Internal Equity Investment	Our portfolio managers analyse ESG data as part of the stock selection process and, on an ongoing basis, monitor ESG developments at underlying investee companies. Data and rating changes from independent providers trigger stock reviews. We aim to provide new financing only to companies or projects that are compatible with the aims of the Paris Agreement. We engage with existing portfolio companies to ensure climate risk is accounted for and to encourage the development of realistic transition plans. Our internal managers invest directly in listed markets and private market funds, and they monitor public and private markets with the benefit of having integrated ESG analysis into investment decision-making for many years. Our internal managers are ideally looking for investments where ESG- related improvements are in evidence with long term benefits likely to accrue to shareholders. For example, our internal managers assess and monitor the capital spending on green energy noting that much of it is undertaken by the incumbent energy providers (the diversification of carbon-extractive companies and carbon burning utilities). Through our engagement activity, we encourage positive outcomes for asset owners through good capital allocation decisions.
Internal Sovereign Bond investment	Our portfolio managers analyse ESG reports and respond to government and market consultations, either directly or with our collaborative partners.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

External Managers	During the appointment process, we assess the approach of managers to incorporate ESG issues into their investment analysis and decision-making processes. We monitor the managers' implementation of the approach on a quarterly basis alongside all other investment matters, with ESG a standing agenda item. We engage regularly and review the PRI transparency reports of external managers, where available. Managers are encouraged to join PRI as signatories where they're not already members and also to become signatories to the UK Stewardship Code, where appropriate.
External Equity	We assess how our managers incorporate ESG into their investment process and stewardship activities. Our ambition is to appoint managers who won't provide new financing to companies or projects that are incompatible with the aims of the Paris Agreement because of the investment risks we believe it presents. We engage regularly to discuss and review holdings.
External Corporate Debt	We assess how our managers incorporate ESG into their investment process and stewardship activities. Our ambition is to appoint managers who won't provide new financing to companies or projects that are incompatible with the aims of the Paris Agreement because of the investment risks we believe it presents. We engage regularly to discuss and review holdings.
Internal Direct Property Investment	During the selection and monitoring process, we assess the environmental efficiency and sustainability credentials of properties, including physical climate risks and transition risks (investment needed to meet tightening energy performance standards). In conjunction with an appointed property manager, we ensure that ESG initiatives to mitigate risk and maximise opportunities are implemented at every stage of the ownership cycle. ESG improvement targets and performance will be incorporated into strategy through asset management plans for owned assets and all new investment acquisition appraisals. As part of our monitoring and review of direct property assets, we engage directly with tenants and build long-term relationships with them.
Real Asset (Infrastructure, Property and Timber) Investment	During the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes. We monitor the managers' implementation of the approach on a quarterly basis alongside all other investment matters, and review PRI transparency and GRESB reports of external managers, where available. Where appropriate, we seek improvement to both the management and implementation of that approach. Managers are encouraged to join PRI as signatories where they're not already members.

Case study

ESG INTEGRATION IN DIRECT PROPERTY

Background
One example of the financial materiality of ESG issues is provided by a series of legislation affecting the UK property sector, including the Minimum Energy Efficiency Standards (MEES) for UK commercial property and the requirement for an Energy Performance Certificate (EPC).

The MEES restricts commercial landlords from letting (and hence generating an income or financial return from) energy inefficient buildings. The EPC rating is a measure of the notional energy capability of a building, based on its CO^2 emissions. These legislative initiatives support the drive to net zero as commercial buildings are estimated to contribute 20% of the UK's carbon footprint.

Initially introduced in 2015 in England and Wales, the MEES has the following implications for commercial property:

- 1 April 2018 – Unlawful to grant new leases of commercial property with an EPC rating of below E (the minimum standard)
- 1 April 2023 – Unlawful to "continue to let" commercial property with an EPC rating of below E (the minimum standard)
- 1 April 2025 – Requirement to register a valid EPC for let, commercial property (proposed regulation)
- 1 April 2027 – The minimum standard raised to EPC rating C (proposed regulation)
- 1 April 2028 – Further requirement to register a valid EPC for let, commercial property (proposed regulation)
- 1 April 2030 – The minimum standard raised to EPC rating B (proposed regulation)

Actions taken
Ahead of these regulations coming into force, we reviewed the EPC status of all direct property assets and prepared a plan to meet the 2023 regulations.

A key initiative in 2022 was the refurbishment of an office building in Winchester, where the EPC was an E rating. With the ability to gain vacant possession following a lease expiry, we budgeted material capital expenditure to refurbish the building, including improvements to the heating, ventilation and air conditioning systems (replacing an old inefficient water-based system with a new, highly efficient hybrid system) and installing energy-efficient light emitting diodes (LEDs) throughout the property. The EPC was improved to an A rating and the building was certified as “BREEAM Very Good”. BREEAM stands for 'Building Research Establishment Environmental Assessment Methodology' and is the world standard for environmental assessment and rating of buildings. On completion of the refurbishment two thirds of the building was let, demonstrating tenant demand for energy efficient buildings.

Case study

ESG INTEGRATION IN DIRECT PROPERTY (CONTINUED)

Outcome

The fund was fully compliant with the MEES regulations ahead of the 1 April 2023 deadline, with the improvements made since December 2021 shown in the table below:

	Dec 2021	Dec 2022
EPC Risk Rating Red	24	0
EPC Risk Rating Amber	76	93
EPC Risk Rating Green	19	26

Assessment and Outlook:

Our proactive approach enabled us to meet the 2023 standards ahead of the deadline. However, we continue to improve the EPC ratings of the assets within our direct property portfolio to ensure compliance with proposed regulations anticipated to come into force in future. As at May 2022, a total of 82% of our baseline (Dec 2021) EPC ratings have been improved, both through refurbishment and through engagement with tenants to improve how efficiently the buildings are used.

We're also conducting interviews and receiving proposals from EV charging operators to provide up to 84 EV charge spaces across seven of our direct property assets. These won't only provide income generation but also provide a service to both tenants and their customers, demonstrating the value of integrating ESG considerations into investment decision-making.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

PRIORITY ESG ISSUES

We've identified 12 financially material ESG issues or themes that represent our engagement priorities for 2023-25. These guide our voting and engagement activity both internally and through our external engagement provider, EOS (for more information, see Principle 9). We believe they're important issues that will impact shareholder value and so deserve focus in any investment analysis.

- Climate change action
- Circular economy and zero pollution
- Natural resource stewardship
- Human and labour rights
- Human capital
- Wider societal impacts

- Board effectiveness
- Executive remuneration
- Investor protection and rights
- Business purpose, strategy and policies
- Risk management
- Corporate reporting

LOTHIAN PENSION FUND

OUR TOP PRIORITY: CLIMATE CHANGE

Governments and regulators are grappling with a hugely complex, global systemic risk.

We address climate change risks in two ways – through our investment selection process and through our engagement and voting activities. As part of the stock selection process for the fundamentally managed portfolios, any material climate-related risks and opportunities (such as carbon pricing and the low carbon transition) are individually assessed by the managers before acquisition and monitored once they're portfolio holdings. Both the fundamental and quantitatively managed equity funds utilise engagement with investee companies to improve practices.

In our meetings with company management, we routinely discuss how they'll align their businesses with the aims of the Paris Agreement. We encourage our external managers to do likewise and to report on their engagement activity. We believe that accurate measurement and disclosure of corporate emissions and clarity of strategic direction are key to accurately assessing the climate risk and return potential of company shares. Encouraging better disclosure remains a standard part of our dialogue with companies. Data quality remains variable depending on geography and publicly listed companies are generally more transparent than private companies.

We align our stewardship activities to achieve shared outcomes

Carbon intensity numbers are currently treated as outputs of our investment process rather than targeted inputs into the investment process. This is because these numbers are fundamentally easy to “game”. For investors, reported portfolio carbon intensity metrics could easily be lowered simply by selling the most carbon intensive stocks and replacing those investments with lower emission stocks. This may be optically attractive, but companies will continue to emit carbon in the same manner whether our, or any other, fund sells or retains the shares.

Climate Action 100+

Strengthening corporate reporting on climate change has therefore been a key focus of our engagement efforts. We work with Climate Action 100+ to encourage better, more meaningful corporate carbon reporting from companies.

Through EOS we've had a formal climate change voting policy in place since 2019 targeting climate change laggards. This policy was strengthened in 2021 with the emergence of formal shareholder votes on companies' responses to the climate crisis and in 2022, further specificity was introduced as to how The Transition Pathway Initiative (TPI) assessments are used to identify climate laggards. We support proposals that demonstrate robust target-setting, and that are aligned with external frameworks and accreditations such as the Science-Based Targets initiative. We also want to see a clear and credible strategy in place to achieve the stated targets.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

We need good data to build a clear roadmap of risks, opportunities and implications of climate change, so we can make informed decisions in the long-term interests of our stakeholders.

While we assess and manage climate-related risks and opportunities for all our assets, our approach differs by asset class. Above, we describe how we use available data and tools to assess climate change risks and engage, often in collaboration with like-minded investors, to address this systemic risk. Below we provide a spotlight on how we integrate ESG considerations, including climate risk, in infrastructure investment.

We recognise the contribution that some specific sectors and industrial activities make to climate change. While there's a tendency to label companies in carbon-intensive industries as 'bad' and those in low-carbon and alternative energy businesses as 'good', investment is more nuanced than this.

We have a policy of engagement rather than exclusion and divestment. This allows us to exert influence on companies to improve their business practices, align with the Paris goals, and disclose internal management of climate-related risk and opportunity with TCFD compliant reporting.

Finance theory indicates that exclusions may result in lower risk-adjusted returns while the body of empirical research reaches different conclusions depending on the time period chosen. Our inference is that divestment is a sub-optimal strategy as it provides no incentives for management to change. On climate change specifically, divestment may be having the unintended effect of shifting ownership as well as finance to "pollution havens". LPF's approach is to consider investments on their merits, taking into consideration risk and returns available from owning shares in entities capable of directing capital into renewables or back to shareholders, as well as to fossil fuels. We have also invested in a number of pure play renewable energy projects within our infrastructure portfolio, which can be an easier and/or cheaper route to access renewables exposure than listed companies.

Our approach to engagement with companies involved in the extraction of fossil fuels is explained in more detail in Principle 9.

PRINCIPLE 7: STEWARDSHIP, INVESTMENT AND ESG INTEGRATION

SPOTLIGHT ON RESPONSIBLE INVESTMENT IN INFRASTRUCTURE

Our infrastructure investments have the potential to generate attractive risk-adjusted returns, with cash flows often linked to inflation.

13.8%

Infrastructure investments represented 13.8% of the value of Lothian Pension Fund assets at 31 March 2023, comprising one of the largest and most diversified allocations among UK LGPS funds. Of the total infrastructure investment of £1,324m (31 Mar 2022: £961 million), the majority is invested in the UK.

Integrating ESG in infrastructure investment

In addition to being a PRI signatory, we also subscribe to GRESB (an investor-led, sustainability benchmarking provider for real assets, covering real estate and infrastructure assets) to further enhance our analysis of ESG issues. We use the PRI and GRESB annual surveys of managers' ESG policies and activities to support our engagement with our managers, which drives improvements and implementation of best practice.

At 31 March 2023, 88% of the infrastructure portfolio value was invested in assets/funds which were also signatories of the PRI and 20% of funds participated in the 2022 GRESB Infrastructure Assessment. Most of our infrastructure funds also publish an internal ESG policy, outlining the consideration given to ESG issues within the decision-making and ongoing investment monitoring process, and this has become a standard consideration for manager selection.

Within the GRESB Infrastructure Assessments, participating funds and assets report annually to GRESB on their internal controls and policies. GRESB validates the submitted data and assesses the fund or asset with reference to a series of performance indicators, including the sustainability of its investment strategy, stakeholder relations and level of gender/diversity reporting. We use the GRESB scores to benchmark performance of these funds and assets against their peer groups.

Funds and assets across all infrastructure sub-sectors can participate in the GRESB Infrastructure assessments, but Transport and Renewable Power assets currently have the greatest participation rate within our portfolio.

We've taken a position on environmental and social factors

We recognise the role infrastructure investment can make to address part of the current environmental challenges related to climate change. Approximately 23% of the infrastructure portfolio is invested in renewable energy. During the year, the fund allocated c.£349 million to investments in social infrastructure, transport, renewables, utilities, environmental services and data infrastructure. New opportunities continue to be appraised.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

Signatories monitor and hold to account managers and/or service providers.

LPF's Supplier Management Framework sets out our consistent approach to the management and oversight of third-party suppliers in a manner which is proportionate to the contract value and importance of the service.

Prior to engaging a supplier, contractual protections which allow LPF to exercise effective oversight are incorporated into the legal terms. For example, LPF secures:

- Clear performance and quality standards applicable to specified services, and measurement of these using 'key performance indicators' where appropriate
- Regular review meetings/calls
- Documented escalation procedures applicable where standards aren't met, with specified supplier personnel dedicated to our client relationship
- Continuous improvement initiatives to improve the efficiency and effectiveness of the service.

Key suppliers relevant to our stewardship of assets include our JISP, our global custodian, the provider of our order management system software, our engagement and voting service providers, and the providers of data and research services, including ESG information.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

MONITORING OUR ENGAGEMENT AND VOTING SERVICE PROVIDERS

We use EOS for the provision of engagement work and as our proxy voting advisor across the bulk of our listed investments. We frequently discuss voting-related issues with EOS, especially during voting season when there's a concentration of activity. We also review global developments in governance standards with them each year so we can be sure our engagement and voting policies are updated and aligned as appropriate.

EOS provides regular updates on its voting recommendations and progress on engagement activity with companies, regulators and public policy makers:

- Confidential alerts and reports provide timely updates for use by our internal portfolio managers
- Quarterly reports and an Annual Review of our voting and engagement activities are provided which we publish to our website to enable us to keep our stakeholders informed
- We participate in EOS' biannual client advisory meetings, which are an effective means of reviewing current practices, monitoring performance and providing meaningful input into engagement priorities
- We undertake regular update meetings with our client team at EOS to ensure services have been delivered to meet our needs and strive for further improvements. Key Performance Indicators include:
  - On demand access to EOSi portal
  - Timely and proactive provision of voting alerts, thematic ESG alerts, engagement progress updates and individual company case study reports
  - Execution of voting rights in line with our policy to vote 100%* of our shares
  - Scale of engagement programme coverage - details enable us to prioritise our direct and other collaborative engagements (e.g. through CA100+) on holdings not covered by EOS
- In 2022 EOS engaged with 227 companies in our portfolio on 1,137 environmental, social, governance, strategy, risk and communication issues and objectives – see Principle 9
- In 2022 EOS provided LPF with voting recommendations for 552 company meetings (8,002 resolutions) – see Principle 11.

*99% of LPF's ballots were voted in 2022. The variation was due to two unvoted meetings: one required an administrative declaration and the failure to make this declaration caused the whole ballot to fail. EOS subsequently amended their instructions and procedures for votes that require an administrative declaration. The other related to a company with Russian connections, where our policy was not to vote.

Following a review and streamlining of our internal processes, we didn't miss any votes due to share-blocking in 2022: in certain markets investors can't trade shares in the period between registering a vote and the shareholder meeting taking place. This can create liquidity issues for investors if the voting process becomes protracted.

In addition, we have regular discussions with our external managers in this regard. A proportion of our equity investments are managed by Baillie Gifford, who carry out their own voting and engagement. As well as providing information in a quarterly questionnaire, Baillie Gifford include voting, governance and engagement information within their quarterly reporting. We meet with Baillie Gifford on a quarterly basis where we discuss in more detail various elements of their voting and engagement – in particular, areas which at first glance appear to be deviating from their stated policy. Notes of these meetings are written up for the investment team to view and any areas of interest are discussed at a formal quarterly meeting and followed up if required.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

INTERNAL MANAGER MONITORING

Portfolios managed by the in-house investment team are monitored at different levels and at different intervals. Daily reconciliations of assets between custodial and front office systems confirm that portfolios are being managed within the relevant constraints. Systems are coded to prevent managers from breaching those parameters and to alert the Compliance function of potential or actual breaches, which could occur. The Chief Investment Officer attends monthly meetings of investment groups, which are arranged by policy group, providing oversight and scrutiny of portfolio construction and transactions. The Chief Executive Officer and the Chief Investment Officer review all mandates and reports on a quarterly basis.

All quarterly reports include detail on portfolio risk and return, portfolio construction, transactional activity, ESG analysis and engagements. The external independent advisers on the JISP review all reports every quarter and meet with each of the portfolio managers annually to provide assurance that the mandates are being managed in-line with expectations. At the annual review meeting the external independent advisers on the JISP expressed satisfaction with the internal management over 2022, including ESG integration.

The benefit of managing a substantial proportion of assets internally is that we have full transparency and that our internal managers are fully cognisant and aligned with our policies.

EXTERNAL MANAGER MONITORING

We monitor all our external managers to ensure they continuously maintain their own responsible investment and stewardship commitments.

Equities and debt

- During the appointment process, we assess the approach of managers to incorporating ESG issues into their investment analysis and decision-making processes and in their active ownership
- We monitor the managers' implementation of the approach, in addition to their performance against the mandate and related investment matters (with any subsequent amendments) on a quarterly basis. MiFID 2 was intended to enhance investor protections and it specifies some of the content which our managers must include in their quarterly reports, but we agree the extent of additional content we require to be included in such reports upon appointment. In addition to the quarterly reports that managers provide, we issue a quarterly questionnaire to address other material points, including ESG issues
- Members of our internal investment team also meet with external managers quarterly to understand any changes that might affect the management of the mandates. Both the Chief Executive Officer and the Chief Investment Officer review all external mandates with the internal investment team after these meetings.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

Private markets fund managers

- To monitor our diversified portfolio of private market funds, the largest portion being infrastructure assets, we review each manager's quarterly updates of activity, performance and portfolio construction to demonstrate adherence to the fund's agreed strategy. Monitoring includes performance, risk, ESG issues and portfolio construction relative to diversification constraints
- Our portfolio managers are in regular contact with our fund managers, attending annual investor meetings and reviewing the periodic reporting and updates received. In some cases, an LPF representative sits on the advisory board of the fund to review matters such as management of conflicts of interest which require investors' consent. This can provide greater transparency and a forum for challenge.

General

- Where available, we review the PRI transparency or GRESB reports
- Internal reports on our external managers are submitted for senior oversight, with any issues and escalation actions discussed at the quarterly JISP meetings.

We don't always expect external fund managers to be the "finished article". In some instances, we'll consider selecting fund managers with less-developed approaches to responsible investment if we can be assured that there's a present and demonstrable road map towards improvement and development. One example where this may be the case is in relation to infrastructure and real estate investments, where ESG and responsible investment reporting may not be as established as in other asset classes. We believe we can add value in working with managers at this level if we're confident in the investment case and their overall philosophy.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

HOLDING MANAGERS AND SERVICE PROVIDERS TO ACCOUNT

In the past year, all of our contracts with our managers and service providers were fulfilled to our expectations, but we continue to engage with our providers on how their service provision can further improve. For example, in April 2022 we raised an issue with one of our providers regarding the formatting of their reports: in line with regulations governing the accessibility of documents for public sector websites, we asked for more accessible formatting to improve their functionality for our stakeholders. This turned out to be a complex issue, requiring significant manual intervention. However, we've asked our provider to work with their design company to incorporate accessible formatting for future documents. Some progress has been made on this over the last year, reducing the requirement for manual reformatting. We'll continue to advocate for accessible formatting for all the documents we publish to our website as a part of our commitment to diversity and inclusion.

Evolving expectations on climate reporting

Following the announcement of our ambition to avoid funding companies whose business models aren't aligned with the goals of the Paris agreement, we began engaging with our managers on steps that they could take to align their practices with our aims and objectives. This is a complex area and work is currently ongoing with all our external managers.

Our monitoring (and selection) processes for external managers incorporate ESG assessments, which continue to be refined as the industry evolves. Our policies and expectations change over time, and this is no more evident than in the climate-related commitments that we've made in our SRIP. Our approach is to work with managers, requesting change where required, and we've found a willingness to evolve alongside us, through reporting on ESG analysis and engagements, followed by discussions to gain a better understanding to ensure we're aligned.

In early 2022 we reviewed our manager monitoring process and devised additional questions for our quarterly manager questionnaire to support alignment/assessment of alignment with our ambition. This was implemented through 2022.

Extract from our updated quarterly manager questionnaire:

"Please list all stocks or bonds purchased during the quarter that raised new equity or new debt for the company (eg. rights issues, IPOs, new bond issuance or bond conversions)."

"Please state whether your organisation or this product has made a net-zero commitment."

Where we're not aligned, we would ultimately terminate the mandate. We haven't had to do that over the last year. We monitor private market funds in a similar way, engaging to promote higher standards of reporting and identifying managers with whom we won't invest in the future due to concerns over their approach to managing climate risk.

PRINCIPLE 8: MONITORING MANAGERS AND SERVICE PROVIDERS

Monitoring our managers' diversity performance

Another area we seek to address relates to the severe lack of diversity within the fund management industry. This is an ESG issue that we as asset owners and responsible investors feel strongly about both in terms of our values and our role as a manager of managers. It also links to our commitment to promoting well-functioning markets, with a better investment industry. This is why we worked with other asset owners to establish the Asset Owners Diversity Charter (see Principle 4). As a signatory to this initiative, we've recognised that diversity for asset managers is at a critical tipping point and that asset owners have a crucial role in holding them to account. We've committed to:

- Incorporate diversity questions into manager selection
- Incorporate diversity into ongoing manager monitoring
- Lead and collaborate with others in the investment industry to identify diversity and inclusion best practice.

Charter signatories will increase the pressure on fund management firms to share information about diversity, so that industry progress can be benchmarked.

"Diversity, Equity and Inclusion is increasingly being considered a business imperative in the investment and savings industry to better reflect society at large, create better financial outcomes through diversity of thought; and build a pipeline of diverse talent for the future."

Gillian de Candole
Portfolio Manager and Responsible Investment Lead

PRINCIPLE 9: ENGAGEMENT

Signatories engage with issuers to maintain or enhance the value of assets.

As discussed in Principle 7, we believe that a proactive combination of collaboration, engagement and voting supports our mission to pay pensions over the long term. We believe that successful engagement adds value to the investment process by promoting best practice governance and by highlighting and promoting best practice in dealing with environmental, climate change and social issues.

Also discussed in Principle 7 are the 12 key ESG issues or themes which we focus on in our engagement and in our investment research. We've chosen these because of their actual or potential financial significance to our portfolios.

Where material risks remain following engagement activity, we retain the ability to reduce our position size or sell to mitigate our exposure to these risks. We discuss divestment in more detail below.

Our view on divestment from companies involved in the extraction of fossil fuels

LPF is often challenged about its approach to responsible investment, including requests to promote a policy of divesting from companies involved in the extraction of fossil fuels. We don't reduce our position size or sell existing holdings for purely non-financial reasons. Nor do we exclude companies from our investment universe for purely non-financial reasons. We do, however, believe that environmental, social and governance issues can affect the financial performance of the companies in which we invest. We take these issues seriously and integrate them into our decision-making processes.

We have a policy of engagement with companies and policymakers rather than a policy of exclusion or divestment. By engaging with the companies in which we own shares, we strive to improve the sustainability of corporate strategy to the benefit of shareholders, and to the benefit of wider society. We believe that a policy of divestment potentially passes shares to less responsible or less active share owners, who are less likely to hold the company's managers to account on planning for and managing significant transitions in their businesses over the next decades. In our view, this achieves nothing in terms of real-world sustainability.

We recognise the outsized impact that some specific sectors and industrial activities have on climate change by virtue of the magnitude of their greenhouse gas emissions. While some prefer to label companies in carbon-intensive industries as 'bad' and those in low-carbon and alternative energy businesses as 'good', history shows that firms need to reinvent themselves to survive. We therefore strive to influence and support positive changes by corporate leaders to achieve sustainability for their firms and for society.

Our policy of engagement allows us to exert influence on companies to improve their business practices, align with the Paris goals, and disclose their climate-related risks and transition plans as well as their investments in solutions, with TCFD compliant reporting.

PRINCIPLE 9: ENGAGEMENT

OUR APPROACH TO ENGAGEMENT

We commit significant resources to engagement activity, which we divide into four distinct elements as shown in the table, below.

We use a variety of engagement approaches, including written correspondence, face-to-face meetings, voting and public communications. Our preference is for direct engagement as it allows us to set out our expectations and to fully explain our interests and motivations. Irrespective of the engagement approach, the goal is always to achieve good financial outcomes for our stakeholders and to encourage positive corporate behaviour.

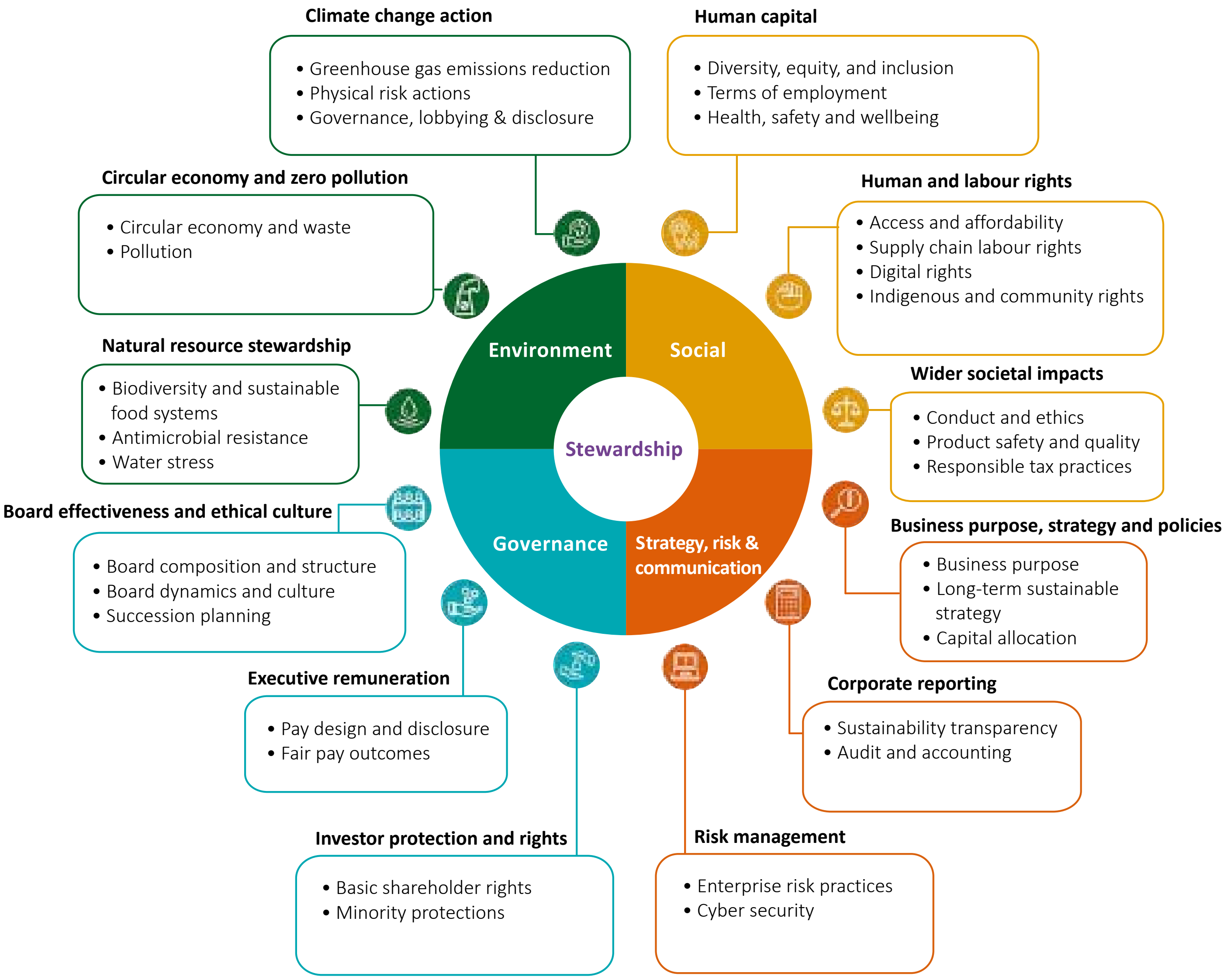
Direct engagement with companies and issuers	In situations where we have significant holdings or where companies have financially significant ESG issues, we'll look to engage directly with these companies to understand their approach. In Principle 12 we discuss how we vote our shareholdings, including how we engage with companies on proposals relevant to ESG issues that have been the subject of either direct or collaborative engagement.
Indirect engagement with companies and issuers through our investment managers	We encourage our external investment managers to engage with the companies and other entities in which they invest. As we discuss in Principle 7, we assess external managers' approaches to engagement and stewardship as part of the manager selection process. We then review each manager's approach on a quarterly basis alongside all other investment matters, and we also review the PRI transparency reports and Stewardship Reports of these external managers, where available. We regularly challenge our managers on their approach, to understand the goals and effectiveness of their engagement activities. We routinely ask our managers to sign up to the same efforts that we sign up to. This includes PRI (as required in PRI Principle 4), and Climate Action 100+.
Collaborative engagement with other investors	We recognise that there are limits to the influence that we can achieve as a single investor and the resources that we can reasonably commit. We therefore collaborate with other investors to raise awareness of and to encourage systemic change on a range of ESG issues. We provide more detail in Principle 10.
Indirect engagement with companies through an engagement service provider	We recognise that engagement can bring important benefits to our investment portfolio and the wider market. We also recognise that we, our investment managers, and the collaborations that we support, cannot cover every ESG issue at every company, with the detail and care that's needed to ensure that engagement is effective in driving improvements in company practice and performance. Working with EOS provides us with a breadth and depth of coverage that we couldn't achieve alone. In 2022, EOS engaged with 227 of the companies in which we're invested on 1,137 environmental, social, governance, strategy, risk and communication issues and objectives. We present some data and examples of the EOS engagement below, including the outcomes that have resulted from this engagement.

PRINCIPLE 9: ENGAGEMENT

WE HAVE AN AGREED ENGAGEMENT PLAN WITH EOS

Each year, we consult with EOS to develop an engagement plan that aligns our priority issues and supports the wider goal of driving higher standards of corporate behaviour. In 2022, we agreed that EOS would focus its 2023-2025 engagement on the 12 main priority themes set out in Principle 7 and illustrated below, with 37 related sub-themes. We agreed that we would support EOS's public policy engagement (explained later in this section), as we recognise that many ESG and sustainability issues require policy interventions.

ENGAGEMENT THEMES



Case study

EOS ENGAGEMENT REPORT
COLGATE-PALMOLIVE

Colgate-Palmolive is an American multinational consumer products company that specialises in the production, distribution and provision of household, health care, personal care and veterinary products. Due to its global presence, the company has tremendous opportunities and important sustainability challenges.

Objective

In 2019, as the lead engager for the CA100+ collaborative, we had a call to introduce the initiative to the vice president of global sustainability and the senior vice president of investor relations. We shared the initiative's goals, including strong climate change governance, action to limit global warming to well below 2°C and disclosure in line with the TCFD. Later in 2019, we encouraged the company to consider linking its 2025 sustainability targets to executive compensation to drive greater accountability.

"Colgate's climate strategy is externally aligned with the Science Based Targets initiative"

Discussion

We continued to engage with the company through 2019-2022. This included sending a letter to the CEO and lead independent director calling on the company to take urgent action and disclose a net zero strategy. We followed up on this letter in a meeting with investor relations and the chief sustainability officer, encouraging them to report in-line with the recommendations of the TCFD. We submitted a statement at the company's 2021 annual meeting urging the board and senior management to engage in a proactive dialogue with EOS and CA100+.

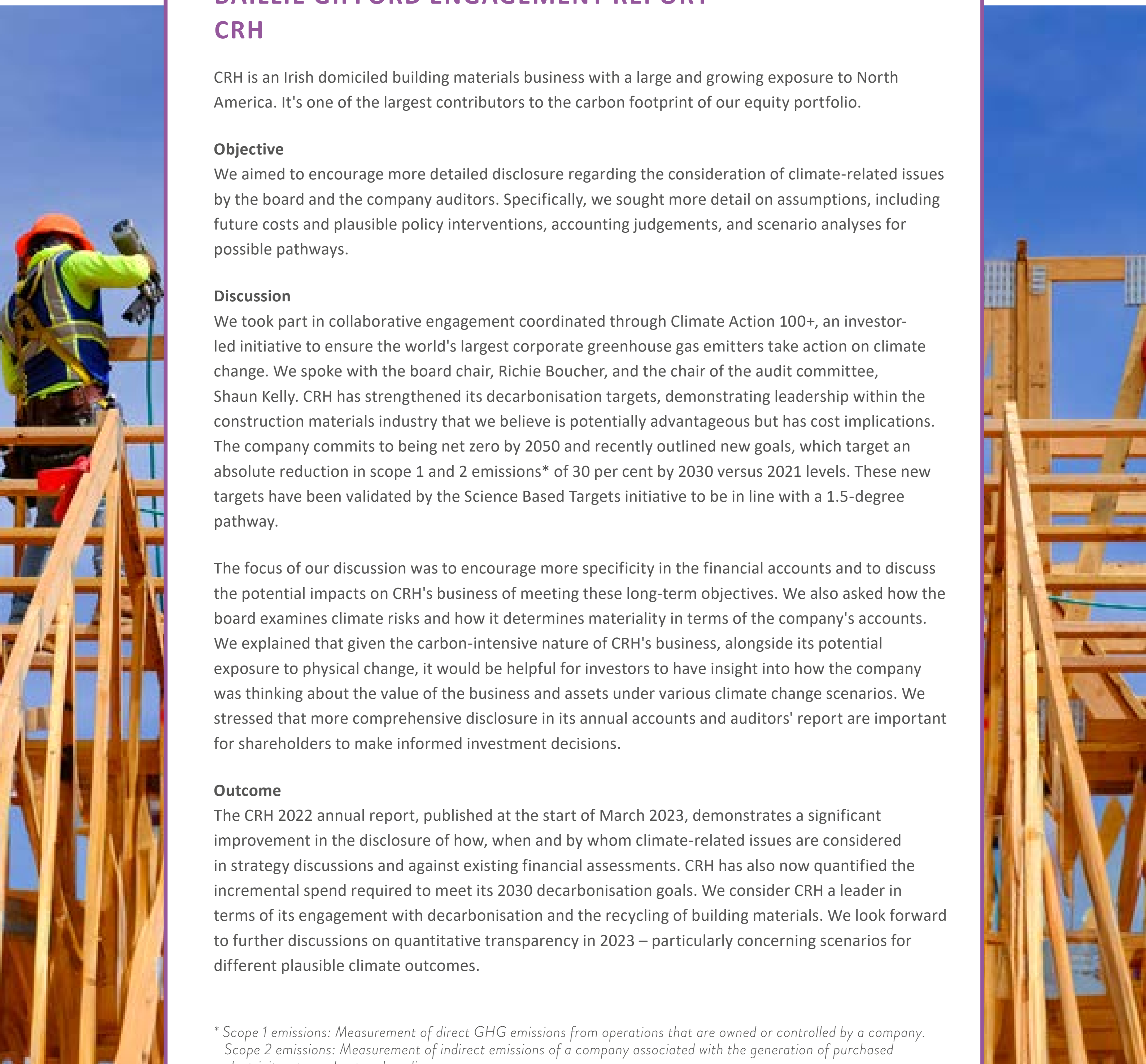
In December 2021, during a group call, we again encouraged a TCFD-aligned reporting, and we were pleased to learn that the company was working towards publishing its first TCFD report in the first half of 2022 and was committed to formalising the link between its climate strategy and executive compensation.

Outcome

In April 2022, Colgate-Palmolive published its first TCFD aligned report which outlined the company's strategy for managing climate-related risks and opportunities. The report included climate-related scenario analysis to understand how climate change may impact the company's business and what actions can be taken to avoid climate risks (both physical and due to the transition) or to capture opportunities.

Colgate's climate strategy is externally aligned with the Science Based Targets initiative and addresses five key areas: supply chain engagement, Net Zero carbon operations, sustainable products and consumers, business resilience and society & nature. The board added performance measures to the 2022 annual incentive programme tied to Colgate's sustainability and diversity, equity and inclusion progress. We continue to engage on the company's strategy for reducing its supply chain emissions.

Emily DeMasi, EOS North American engagement lead



Case study

BAILLIE GIFFORD ENGAGEMENT REPORT
CRH

CRH is an Irish domiciled building materials business with a large and growing exposure to North America. It's one of the largest contributors to the carbon footprint of our equity portfolio.

Objective

We aimed to encourage more detailed disclosure regarding the consideration of climate-related issues by the board and the company auditors. Specifically, we sought more detail on assumptions, including future costs and plausible policy interventions, accounting judgements, and scenario analyses for possible pathways.

Discussion

We took part in collaborative engagement coordinated through Climate Action 100+, an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take action on climate change. We spoke with the board chair, Richie Boucher, and the chair of the audit committee, Shaun Kelly. CRH has strengthened its decarbonisation targets, demonstrating leadership within the construction materials industry that we believe is potentially advantageous but has cost implications. The company commits to being net zero by 2050 and recently outlined new goals, which target an absolute reduction in scope 1 and 2 emissions* of 30 per cent by 2030 versus 2021 levels. These new targets have been validated by the Science Based Targets initiative to be in line with a 1.5-degree pathway.

The focus of our discussion was to encourage more specificity in the financial accounts and to discuss the potential impacts on CRH's business of meeting these long-term objectives. We also asked how the board examines climate risks and how it determines materiality in terms of the company's accounts. We explained that given the carbon-intensive nature of CRH's business, alongside its potential exposure to physical change, it would be helpful for investors to have insight into how the company was thinking about the value of the business and assets under various climate change scenarios. We stressed that more comprehensive disclosure in its annual accounts and auditors' report are important for shareholders to make informed investment decisions.

Outcome

The CRH 2022 annual report, published at the start of March 2023, demonstrates a significant improvement in the disclosure of how, when and by whom climate-related issues are considered in strategy discussions and against existing financial assessments. CRH has also now quantified the incremental spend required to meet its 2030 decarbonisation goals. We consider CRH a leader in terms of its engagement with decarbonisation and the recycling of building materials. We look forward to further discussions on quantitative transparency in 2023 – particularly concerning scenarios for different plausible climate outcomes.

** Scope 1 emissions: Measurement of direct GHG emissions from operations that are owned or controlled by a company. Scope 2 emissions: Measurement of indirect emissions of a company associated with the generation of purchased electricity, steam, heat and cooling.*

Case study

LPF ENGAGEMENT REPORT
RIGHTMOVE

Rightmove is a UK-based company which runs rightmove.co.uk, the UK's largest online real estate property portal. In May 2022, Peter Brooks-Johnson, its chief executive officer (CEO), announced his intention to leave the company in 2023. During his leadership, Rightmove cemented its dominant position in its market, and delivered strong returns to shareholders.

Rightmove has a history of internal promotions: Peter Brooks-Johnson joined Rightmove in 2006 and became its chief operating officer in 2013 before he was promoted to the top role in 2017. Therefore, the announcement in October 2022 that his successor would be an external appointment drove us to initiate engagement.

Objective

As a long-term investor in Rightmove, we were keen to articulate our concerns around this being the first external appointment to the CEO role at Rightmove. We aimed to gain a better understanding of Rightmove's succession planning, executive recruitment processes and the remit given to the new CEO by the Board. Importantly, we were keen to ensure that at a senior level, the company was fully aware of our thoughts, concerns, and expectations in relation to this matter. Furthermore, we sought reassurance on the cultural fit of the incoming CEO, Johan Svanstrom.

Discussion

In Q4 2022, we met with the out-going CEO, Peter Brooks-Johnson. While the discussion was wide-ranging, the main focus was on his succession. We've been holders of Rightmove shares since late 2009, during which time there have been three CEOs – each of which has been an internal appointment. We articulated our nervousness around this being the first external appointment, elevated by the fact that the incoming CEO, Johan Svanstrom, was previously a partner at EQT (a private equity / venture capital firm). We discussed our preference for internal succession, as an internal successor, particularly one with longevity with the company, will typically have a far better understanding of the business model and feel for the culture of the organisation.

We continue to like the Rightmove business model and we think it works very effectively. Our concern is that when there's an externally appointed CEO, they often feel like they need to 'put their stamp' on the business and change things unnecessarily. The potential for a cultural mis-match due to Johan's private equity background gave us additional cause for concern. Following our discussion and given the importance of the situation, Peter facilitated a one-to-one call with the Chairman, Andrew Fisher, to discuss further.

"Rightmove greatly appreciates the dialogue with Stewart Piotrowicz and the LPF Team regarding our CEO succession. LPF have always been a proactive shareholder seeking to understand the rationale for any governance matters and consistently evidencing the highest levels of stewardship."

Andrew Fisher, Chairman, Rightmove

Outcome

Our call with Andrew Fisher was very helpful and gave us the opportunity to make our views very clear. Andrew discussed the background to the recruitment and the process itself. He provided his thoughts on Johan, with whom he has previously worked, which gave us some comfort on the cultural fit. Johan had only been with EQT for a few years and wanted to be more "operational", having previously worked at U.S. based online travel shopping company Expedia Group. Andrew completely understood our perspective, and was very much in agreement with our sentiment. We concluded the meeting feeling that the Chairman's views were aligned with our own which is reassuring and gives us confidence in Rightmove's ability to deliver on the long growth runway ahead of them.

Johan Svanstrom joined Rightmove as an executive director on 20 February 2023, before assuming the CEO role in March when Peter Brooks-Johnson stepped down as planned. We continue to monitor closely as the situation develops.

Stewart Piotrowicz, LPF Portfolio Manager

PRINCIPLE 9: ENGAGEMENT

LPF ENGAGEMENT WITH MANAGERS

As mentioned in Principle 8, in 2022 we began engaging with our managers on steps that they could take to align their practices with our Responsible Investment aims and objectives, in particular, our ambition to avoid funding companies whose business models aren't aligned with the goals of the Paris agreement. This is a complex area and work is currently ongoing with all our external managers.

PRINCIPLE 9: ENGAGEMENT

2022: AN OVERVIEW

An overview of the engagement EOS conducted on our behalf in 2022 is presented in Figure 1, with Figure 2 showing the geographic coverage of this engagement.

Figure 1.

In 2022, we engaged with 227 companies on 1,137 environmental, social, governance, strategy, risk and communication issues and objectives. Our holistic approach to engagement means that we typically engage with companies on more than one topic simultaneously.

We engaged with 227 companies over the last year.

- Environmental **31.0%**
- Social and Ethical **27.1%**
- Governance **30.5%**
- Strategy, Risk and Communication **11.4%**

Figure 2.

We engaged with 22 companies over the last year.

- Environmental **34.0%**
- Social and Ethical **17.0%**
- Governance **35.9%**
- Strategy, Risk & Comms **13.2%**

We engaged with 6 companies over the last year.

- Environmental **18.4%**
- Social and Ethical **34.2%**
- Governance **26.3%**
- Strategy, Risk & Comms **21.1%**

We engaged with 54 companies over the last year.

- Environmental **34.8%**
- Social and Ethical **24.5%**
- Governance **31.2%**
- Strategy, Risk & Comms **9.5%**

We engaged with 101 companies over the last year.

- Environmental **30.1%**
- Social and Ethical **30.1%**
- Governance **27.8%**
- Strategy, Risk & Comms **11.9%**

We engaged with 42 companies over the last year.

- Environmental **28.9%**
- Social and Ethical **26.0%**
- Governance **35.3%**
- Strategy, Risk & Comms **9.8%**

We engaged with 2 companies over the last year.

- Environmental **33.3%**
- Governance **66.7%**

PRINCIPLE 9: ENGAGEMENT

EOS also provide data on the progress (or success) of the engagement conducted on our behalf. Its data, shown in the figure below, suggests that significant progress was made in 2022, with over 200 examples of companies moving forward by at least one milestone, where the milestones are defined as follows:

MILESTONE 1: Concern raised with the company at the appropriate level

MILESTONE 2: The company acknowledges the issue as a serious investor concern

MILESTONE 3: Development of a credible strategy/stretching targets set to address the concern

MILESTONE 4: Implementation of a strategy or measures to address the concern.

Milestone status of engagement

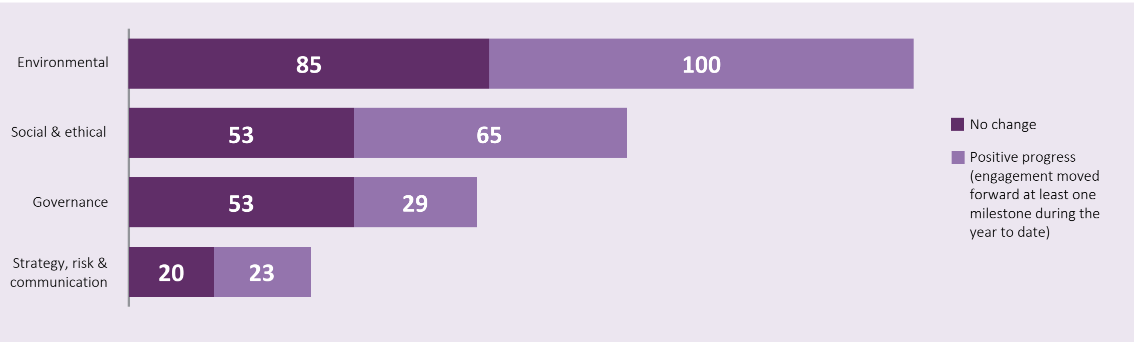
The table below shows the milestone status of our engagement objectives by theme.

Theme	Total Engagement Objectives*	Engagement objective stage (last milestone completed)			Closed engagement objectives	
		Milestone 1	Milestone 2	Milestone 3	Completed	Discontinued
Environment	185	36	69	40	31	9
Social and ethical	118	27	44	23	14	10
Governance	82	16	17	16	18	15
Strategy, risk and communication	43	5	11	11	11	5
Total engagements	**428**	**84**	**141**	**90**	**74**	**39**

**includes objectives which were live in the period. Objectives are live when Milestone 1 has been completed.*

The rationale for a discontinued engagement includes "company unresponsive", "company disagreed", "no longer relevant/material" and "restarted as new objective/issue.

At least one milestone was moved forward for about 51% of our objectives during the year. The following chart describes how much progress has been made in achieving the milestones set for each engagement.



PRINCIPLE 9: ENGAGEMENT

ENGAGEMENT WITH POLICYMAKERS

EOS engages with policymakers for a more sustainable financial system. This is achieved through engagements and meetings with government officials, financial regulators, stock exchanges, industry associations, and other key parties. It also participates in public consultations. In 2022 EOS undertook several public policy engagements, including multiple engagements focused on Methane Emissions and Biodiversity. As mentioned previously, LPF supports EOS's public policy engagement, as we recognise that many ESG and sustainability issues require policy interventions.

EOS participates in sign-on letters on ESG policy topics which it supports, typically as one of a few collaborative industry bodies and initiatives around the world, in which it's an active participant.

LPF also participated directly in advocating for a number of changes to public policy and market best practice by asking governments to commit to more ambitious climate targets and policies through signing the Investor Letter to Governments ahead of COP27 (see case study on Climate Change: Our Role In Real World Change in Principle 1) and through responding to consultations, such as the November 2022 Department of Levelling Up, Housing and Communities (DLUHC) consultation on Local Government Pension Scheme (England & Wales): Governance and Reporting of Climate Change Risks.

PRINCIPLE 10: COLLABORATION

Signatories, where necessary, participate in collaborative engagement to influence issuers.

LPF is committed to working collaboratively to increase the reach, efficiency and effectiveness of our Responsible Investment activities. We work with a host of like-minded partner funds, service providers and related organisations striving to attain best practice in the industry and to improve industry standards. A list of our collaborative partners and their roles is publicly available on our website.

We work with others towards common goals

There are limits to the influence that we can achieve as a single investor and the resources we can reasonably commit. We recognise that progress can be best achieved on ESG issues through collaboration with other investors and organisations and we take a very active role in several of the Responsible Investment initiatives below.

Collaboration in furtherance of the Principles for Responsible Investment (PRI)

We've been a signatory of the UN-backed PRI since 2008 and align our practices and processes to their six principles and definition of Responsible Investment. Our SRIP formally acknowledges the role and integration of the PRI's six principles within our investment process. PRI's Principle 5 is relevant: “We will work together to enhance our effectiveness in implementing the Principles.” The collaborative activities below evidence our continuing commitment.

CA100+ is an international collaborative initiative by institutional investors representing over $55 trillion in assets. Signatories to Climate Action 100+ engage with the boards and senior management of companies to take necessary action on climate change [See case study below for more details].

IIGCC is a network of over 400 European investors representing over $65 trillion in assets. We joined IIGCC in 2020 to further the work we do alongside other like-minded asset owners. The workstreams at IIGCC include: the Policy Programme; the Corporate Programme; the Investor Strategies Programme. We're assessing the organisation's investor guide on the 'Net-zero Investor Framework' and its suitability for implementation.

TPI is a global initiative led by asset owners and supported by asset managers. It assesses companies' preparation for the transition to a low-carbon economy, supporting efforts to address climate change. In our SRIP, we've committed to benchmarking holdings against TPI's assessment as a measure of financial risk.

GRESB is an investor-led, sustainability benchmarking provider for real assets, covering real estate and infrastructure assets. It's a key driver of transparency regarding energy consumption data, particularly for standing real estate. We support this collaborative initiative as an investor member.

We've been clients of EOS since 2008 and they manage most of our voting and engagement activity. Our Internal Equities team work closely with EOS in our collective approach to engagement, reflecting the areas of stakeholder interest and concern. Through working collaboratively with EOS, and alongside EOS's international client base, we're able to have a stronger voice when engaging with our investee companies. We provide more detail in our text on Principle 9.

LAPFF is a collaborative shareholder engagement group, comprising over 80 UK local authority pension funds and six of the LGPS pension fund pools in England and Wales. A member of LPF's Pensions Committee is on the executive board of LAPFF, representing LAPFF and its member funds in high level engagement with company management.

LOTHIAN PENSION FUND

We also work closely with other asset owners in several semi-formal working groups including:

UK Pension Fund RI Roundtable

The UK Pension Fund RI Roundtable is a long standing collaborative endeavour, first convened by the Environment Agency Pension Fund, which brings together UK Asset Owners from the public and private sector, alongside charitable bodies and endowments, to work together to establish best practice in RI. LPF is an active participant.

Occupational Pensions Stewardship Council

The Occupational Pensions Stewardship Council was launched in July 2021. It's coordinated by DWP and ShareAction, and supported by the FRC and Department for Levelling Up, Housing and Communities (DLUHC). It aims to be a forum to share learning, identify areas of joint interest, signpost to relevant activities elsewhere, and, where no pre-existing activity has been identified, facilitate collaborative engagement. LPF is an active participant and a member of the engagement group, which acts as a steering committee.

asset owner diversity charter

DIVERSITY PROJECT

The Asset Owner Diversity Charter was formed with an objective to formalise a set of actions that asset owners can commit to in order to improve diversity, in all forms, across the investment industry. Signatories collaborate to build an investment industry which embodies a more balanced representation of diverse societies. It's now part of the Diversity Project, which aims to accelerate progress toward a more inclusive culture in the investment and savings sectors across all demographics, including gender, ethnicity, sexual orientation, age and disability.

And with charities:

FUTURE ASSET

Working with high school girls throughout Scotland to promote careers in investment management, Future Asset strives to open up the industry to poorly represented pools of talent. The investment industry has a well-known gender diversity problem, and LPF's investment professionals support Future Asset events acting as presenters and mentors for the girls, as well as providing work experience as a Future Asset partner.

"Thank you for welcoming high school students to LPF for work experience. It is exactly the sort of opportunity that Future Asset is encouraging firms to offer and LPF have led the way in providing practical experiences and inspiring young women to believe they can work in investment management ."

Helen Bradley, Programme Manager, Future Asset

GAIN Girls Are INvestors

Girls Are INvestors (GAIN) is, a charity set up by investment professionals to improve gender diversity in investment management by building a talent pipeline of entry-level female and non-binary candidates. In 2022 LPF joined their internship programme to offer a summer 2023 internship.

Case study

COLLABORATIVE ENGAGEMENT: CLIMATE ACTION 100+

Climate Action 100+ has notched up five years of collaborative engagements with the world's biggest greenhouse gas emitters and is now entering its second phase. Since December 2017 the collaborative engagement initiative has been striving to bring the world's biggest corporate emitters into line with international ambitions for a 1.5-degree world.

Signatories to CA100+ request the boards and senior management of companies to:

- Implement a strong governance framework which clearly articulates the board's accountability and oversight of climate change risks and opportunities
- Take action to reduce greenhouse gas emissions across the value chain, consistent with the Paris Agreement's goal of limiting global average temperature increase to well below 2°C above pre-industrial level
- Provide enhanced corporate disclosure in line with the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), to enable investors to assess the robustness of companies' business plans against a range of climate scenarios, including well below 2°C, and improve investment decision-making.

LPF committed internal engagement resource to CA100+ by becoming a participant member of CA100+ in 2020 and co-leading engagements with a focus company. In addition to direct engagement as part of CA100+, we encourage our external managers to support the initiative.

Our engagement provider, EOS is also a significant supporter of CA100+, leading or co-leading engagement at 24 of the CA100+ focus companies across Europe, North America, and Asia.

Case study

COLLABORATIVE ENGAGEMENT: CLIMATE ACTION 100+

(CONTINUED)

For example, EOS met repeatedly with BP management, including the CEO, to challenge the strategy put forward. EOS also made a statement at the AGM with other co-leads, supporting the company's efforts but also identifying areas where further progress is needed. At TotalEnergies, EOS determined that the climate strategy remained materially below CA100+'s sector-specific expectations and escalated by pre-declaring the intention to recommend a vote against the climate change progress report. At Chevron, as co-lead of the CA100+ engagement, EOS requested a report on the company's methane emissions. EOS successfully urged the board to support this resolution, and we supported EOS to file an exempt solicitation with the US Securities and Exchange Commission to publicly encourage investors to vote for the board's recommendation. The resolution ultimately passed with 98% support.

Outcomes
By participating actively in the CA100+ initiative, our officers and service providers have influenced real change, including an accelerated timetable for methane emissions reductions and a change to the corporate lobbying practices of companies with significant carbon emissions.

Assessment
We believe that such collaborative engagement actions have assisted the target companies in becoming better prepared for a net-zero world. Equally, we recognise that CA100+ focus companies still have significant work to do to align their businesses to achieve a net-zero world. It seems clear that government policies rather than investors' voting and engagement activities alone are needed to drive change.

In January 2023, CA100+ reflected on its progress to date, driven by engagement from its investor signatories:

- **75%** of focus companies have committed to achieve net zero emissions by 2050 or sooner across all or some of their emissions footprint. In addition, over a third of focus companies have set long-term targets that align with a 1.5°C pathway
- **92%** of focus companies have some level of board oversight of climate change
- **91%** of focus companies have aligned with TCFD recommendations either by supporting the TCFD principles or by employing climate-scenario planning.

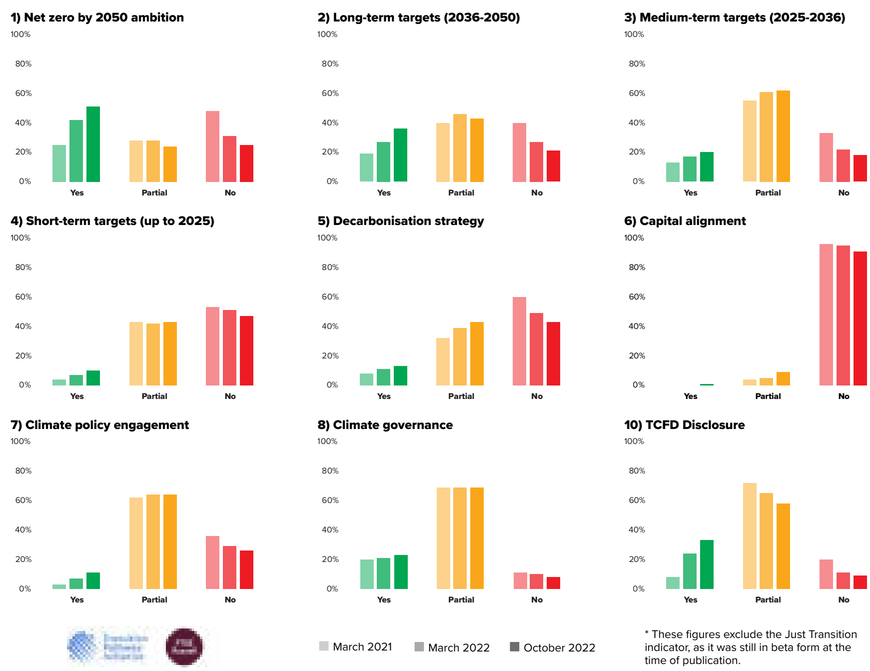
Case study

COLLABORATIVE ENGAGEMENT: CLIMATE ACTION 100+ (CONTINUED)

However, the encouraging uptake of net zero commitments isn't matched by the development and implementation of credible decarbonisation strategies. As a priority, investors need to see corporates outlining the practical actions on how they'll begin to meet their net zero commitments. Specifically, the assessments reveal:

- An absence of short and medium-term emissions reduction targets aligned with limiting warming to 1.5°C. Whilst 82% of focus companies have set medium-term targets, only 20% have established ambitious medium-term targets and only 10% have set short-term targets (up to 2025) that are aligned with a 1.5°C scenario and cover all material emissions
- Net zero targets are often not supported by strategies to deliver them
- Scope 3 emissions remain absent - only half (51%) of focus companies have comprehensive commitments for net zero by 2050 or sooner that cover all material GHG emissions
- Alignment of capex strategies with net zero transition goals largely remain missing - only 10% of companies have committed to fully align their capex plans with their emissions targets or the Paris Agreement.

Disclosure Framework results at a glance



Reference: https://www.climateaction100.org/progress/progress-update/

Case study

COLLABORATIVE ENGAGEMENT: CLIMATE ACTION 100+

(CONTINUED)

Looking ahead

CA100+ aims to move beyond disclosure during its second phase from 2023-30. It will be pushing for focus company action to develop and implement Paris-aligned transition plans backed by credible, sufficient investment.

It's introducing a significant upgrade to the benchmark to assess progress, with a greater focus on emissions reductions, alignment with 1.5°C pathways and net-zero transition planning, which will include a deeper assessment of capital allocation and asset-level changes.

The second phase will also introduce new measures to enhance collaborative participation from investors and encourage more transparent planning and escalation strategies across the co-leads for focus companies.

PRINCIPLE 11: ESCALATION

Signatories, where necessary, escalate stewardship activities to influence issuers.

We aim to engage proactively and constructively in public and private markets, with companies directly or via external managers. As we illustrate in this report, our stewardship activities include:

- Direct engagement with investee companies and issuers
- Collaborative engagement with companies, including with CA100+
- Abstaining or voting against management (including against specific directors and against the annual report and accounts)
- Using the media and other forums to challenge companies
- Using the insights from engagement to inform our investment research and decision-making.

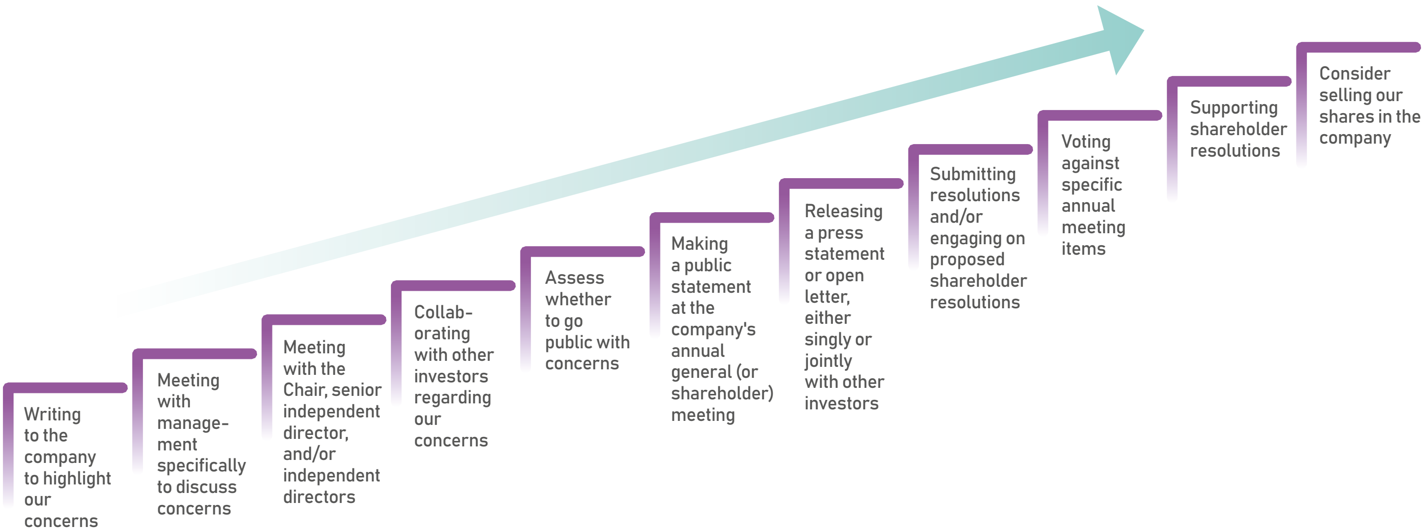
Given the range of assets in which we invest, we don't have a universal escalation policy. Instead, we tailor our approach to the investment type and the scale of the issues identified. We prefer to engage through dialogue for improvement, but we'll escalate our concerns if necessary improvements aren't forthcoming.

PRINCIPLE 11: ESCALATION

Escalating concerns with companies in which we invest

We expect companies to advise us when there are material changes and issues which impact long term shareholders. Our initial position is to support the board and management to improve their corporate strategy to the benefit of shareholders.

When appropriate and where we have concerns, we'll begin a dialogue (either directly or through EOS, our engagement and voting service provider, or other collaborative initiatives) and put forward proposals for the board's consideration. If our concerns aren't adequately addressed, we may consider a range of escalation options as part of an escalation process illustrated below:



As no two engagement escalations are the same, different steps may be taken at a different order for different cases. However, selling our shares isn't among the first steps. It's often the last step on the long escalation ladder, as engaging and addressing an issue in an undervalued firm, can create financial returns for long-term investors.

PRINCIPLE 11: ESCALATION

Escalating ESG concerns with external managers

We also set clear expectations of stewardship in our mandates with external investment managers. We challenge them if we feel that they're not delivering on the stewardship commitments they've made to us. If we're concerned about an investment manager's performance (which we'll capture in our monitoring reports), and if the investment manager hasn't improved following feedback from us, we've a range of escalation options available to us, as outlined in below.

Typical escalation options:

- Notifying the external manager about their placement on a watch list
- Engaging the external manager's board or investment committee
- Reducing our exposure to the external manager until any non-conformances have been rectified
- Terminating the contract with the external manager (or not reappointing them) if failings persist over a period of time.

Escalating concerns through our engagement and voting provider

As we discuss in Principles 9 and 12, EOS provides us with an engagement and voting service which involves engaging with the publicly listed companies in our portfolios and providing us with voting recommendations for these holdings. Generally, EOS' preference is to engage with companies. This is generally only escalated into voting against management in situations where engagement is proving to be ineffective. However, in 2021 EOS introduced a more proactive approach to use voting to target laggards on climate change and in 2022, EOS introduced another policy to consider voting against relevant directors where there are significant concerns about a company's actions relating to human rights. We strongly support this approach. We generally support EOS' voting recommendations, but we scrutinise all recommendations and do, infrequently, vote in a different way (e.g. if we think it's premature to escalate or if we think that it's time to escalate and EOS hasn't recommended it). In 2022 there were no occasions where we voted differently from EOS' recommendations (see Principle 12).

Escalating concerns in private markets

While the options available to us in terms of escalation of stewardship activities to influence issuers in closed ended investment funds (private equity, private debt, infrastructure and indirect property asset classes) are more limited, we do make it clear that concerns or a lack of transparency will feed into the assessment of subsequent investment opportunities presented by that manager.

LOTHIAN PENSION FUND

Case study

ESCALATION WITH NATIONAL GRID

Background

National Grid plc is a multinational electricity and gas utility company with operations in the UK and the US. Its principal activities are operating electricity and natural gas networks as well as production and supply of electricity and gas. We consider National Grid to have a critical role in decarbonising UK electricity, while also recognising the risk that grid capacity issues and new connection delays could slow the deployment of clean energy.

Engagement

As part of our collaborative engagement efforts through CA100+, we co-lead engagement with Finnish utility Fortum and participate in the utilities working group, alongside like-minded investors who are the lead or co-lead engagers for other European utilities. These engagements aim to encourage and support corporate managers to identify and unlock potential barriers to their decarbonisation strategies.

Escalation

In Q4 2022, we supported an escalation of engagement with National Grid by co-signing a letter to the Chair, Paula Reynolds, calling on the company to enhance its commitment and collaborative efforts to accelerate the transition to a cleaner and more secure energy future. The letter appealed for urgent, ambitious and proactive action to be taken in regard to decarbonisation and requested specific responses to a number of climate policy questions.

In Q1 2023, the CA100+ co-lead engagers repeated requests for greater transparency from National Grid on its climate lobbying. Our voting and engagement service provider, EOS, also met with National Grid's head of sustainability and head of strategy to amplify the request for improved disclosure in this area. Companies need to have strong governance of their climate-related lobbying, and to identify and act on any misalignment between their own goals and trade association lobbying, to avoid this creating a barrier to legislative reform for an orderly low-carbon transition.

On 19 June 2023, ahead of National Grid's Annual General Meeting, one of the co-lead engagers publicly pre-declared its intention to vote against the re-election of both the Chair and the CEO due to the company's lack of climate lobbying disclosure, noting that National Grid was one of only two European utilities engaged by CA100+ to have failed to provide investors with this disclosure. CA100+ flagged this as part of its policy to flag shareholder proposals and other votes aligned with the goals of the initiative.

Outcome

On 30 June 2023, National Grid released an updated responsible lobbying policy and publicly committed to review its membership of all trade associations and their alignment with the company's climate change strategy, and to take action to resolve misalignment where necessary. This was welcomed by investors and those that had predeclared intentions to vote against the CEO and Chair due to this issue, reversed plans in recognition of this response.

Assessment and next steps

While our role in this escalation was fairly minor, by co-signing the letter we signaled our support for real-world action on decarbonisation. National Grid has committed to publishing the findings of its lobbying review by the end of its 23/24 financial year. We look forward to reading this and will continue to engage, either directly or indirectly (through EOS or through CA100+) to support the goal of transitioning the real economy to net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius by 2100.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

Signatories actively exercise their rights and responsibilities

We believe that responsible investment involves exercising our rights and responsibilities as an active owner. We consider voting to be an integral part of our engagement with companies.

We aim to vote on all resolutions tabled at the General Meetings of our investee companies (listed equity) and also on all LPF consent matters within the funds we've invested in (across private market asset classes). We also hold our managers to account on how they exercise rights and responsibilities on our behalf, for example, how our debt managers exercise their responsibilities to integrate ESG in credit investment through the negotiation of ESG-linked ratchets into loan documentation.

In Principle 8 we explain how the practice of share-blocking in certain geographies (e.g. Norway) can impact our ability to fully exercise our rights and responsibilities in these markets due to potential liquidity constraints. However, following a review and streamlining of our internal process for approving votes in share-blocking markets, we didn't miss any votes due to share-blocking in 2022.

In Principle 4 we provide examples of exercising our rights and responsibilities by engaging with policymakers and responding to industry consultations. In Principle 7 we provide a case study on ESG integration in direct property which includes exercising of our rights and responsibilities to meet increasingly stringent minimum energy efficiency standards as a commercial landlord.

Our voting policy for listed equity investments

Voting, in combination with engagement, can reinforce the message we send to company management about how they're running their businesses. While much focus tends to be on controversial votes and votes against management, we think it's equally important to signal our support for management in situations where management is doing a good job of navigating risks, challenges and complexities. As can be seen from our voting data below, we recognise that, in most cases, boards are managing these issues effectively and we continue to support them in their endeavours.

We subscribe to a specialist third party service (EOS) to provide engagement (see Principle 9) and to provide proxy voting recommendations to us which covers approximately 96% of our listed equity investments (the remainder of our equity assets are in funds where our external managers undertake voting in accordance with their voting policies, which we monitor quarterly). Through EOS we monitor what shares and voting rights we have and apply an ESG lens informed by active engagement over the top of proxy voting recommendations provided by Institutional Shareholder Services Inc. (ISS), a proxy voting service provider whose primary research and proxy voting infrastructure is utilised by EOS.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

EOS' Global Voting Guidelines act as a policy to inform EOS' voting recommendations. EOS applies local market conventions in 20 markets around the world as a final overlay in the voting decision-making process, where EOS has developed region-specific principles due to different governance conventions across global market. These set out the fundamental expectations of companies, including on business strategy, communications, financial structure, governance and the management of social and environmental risks in each region. Generally, we follow EOS's voting policy and voting recommendations which are informed by their engagement with companies.

However, we reserve the right to override EOS voting recommendations. In recognition of the value of active engagement, EOS works with our internal and external fund managers to co-ordinate and execute voting instructions. We require EOS to provide our portfolio managers with notice of voting instructions and allow them to override any EOS recommendation.

Whenever there's a controversial vote (e.g. a recommendation to vote against management) or when there's an issue that we're concerned about (e.g. a governance risk identified through our own investment research and direct engagement activities), we'll communicate with EOS about the resolution, to understand the context and their reasons for the recommendation being made. In practice the number of voting recommendations that we override each year is minimal. In 2022 we didn't override any, but significant consideration is given to each issue (as explained in the case study in Principle 3). EOS voting alerts are reviewed by the equity team and escalated to our Responsible Investment Group (RIG) where necessary.

Case study

“SAY ON CLIMATE” VOTES

Background

The Say-on-Climate initiative works with companies to establish robust net zero transition plans with shareholder feedback in an annual advisory vote. Launched by hedge fund activist investor Chris Hohn through the Children's Investment Fund Foundation, major companies have agreed to put their climate plans to a vote.

2022 was the second year for formal shareholder votes on companies' responses to climate change, with an increase in the number of management-proposed Say-on-Climate proposals.

There were also several climate-related shareholder resolutions, including some filed by Follow This (a Dutch non-governmental organisation of activist shareholders), requesting that companies set comprehensive greenhouse gas emissions targets that are consistent with the goals of the Paris Agreement.

When exercising our equity voting rights, we're guided by EOS's proxy vote recommendations which consider both global best practice and regional governance requirements. EOS applies a rigorous case-by-case approach to assessment of transition plans and progress reports, only recommending support of plans that demonstrate robust targets and a clear and credible strategy to achieve the stated targets.

Voting activity and outcomes

Examples of how we voted on climate plans or emission reduction targets are presented in the table with an explanation and assessment below.

	Management proposed "Say on Climate " vote	LPF Vote	Vote Result	Follow This Vote	LPF Vote	Vote Result
Mining companies						
Rio Tinto	Climate change report	For	84% support	n/a		
Glencore	Climate change progress	Against	76% support	n/a		
Energy companies						
TotalEnergies	Sustainability and climate change transition plan	Against	89% support	n/a		
BP	Climate change report	For	88% support	Yes	Against	15% support
Shell	Energy transition progress report	Against	80% support	Yes	For	20% support
Equinor	Energy transition plan	Against	98% support	Yes	For	4% support
Chevron	n/a			Yes	For	33% support
ConocoPhillips	n/a			Yes	For	39% support
Exxon Mobil	n/a			Yes	For	28% support

Case study

"SAY ON CLIMATE" VOTES *(CONTINUED)*

Assessment

Strong support from shareholders for management-proposed "Say-on-Climate" votes coupled with waning support (compared to 2021) for resolutions filed by climate activist groups such as Follow This, indicated a general pattern of investors being willing to support companies for incremental progress on climate plans in the context of increased concerns about energy security and affordability in 2022. Our voting record shows we continued to exercise our voting rights in alignment with our identification of climate change as a key systemic risk, while being willing to recognise leadership:

- We voted in favour of BP's climate change report due to the comprehensive nature of its targets and overall leadership in the sector: BP was the only oil major to have a long-term net-zero goal as well as short and medium-term targets across its own operating emissions and its Scope 3 emissions (produced when the energy products it sells are used). Furthermore, BP was projecting that by 2030, 50% of its capital expenditure will be in 'transition growth' businesses, indicating a major shift in its business. We didn't support the Follow This shareholder resolution, as we assessed it as lacking additionality given the progress made at BP following a similar resolution which was passed in 2019.

- We voted in favour of Rio Tinto's climate change report in recognition of its significantly increased ambition and updated 2030 targets, including a commitment to reduce absolute Scope 1 and 2 emissions by 50%. The company has also developed targets relating to customer engagement to control its Scope 3 emissions (mainly related to emissions generated by its industrial customers of its iron ore and bauxite products to produce steel and aluminium). In contrast, we opposed Glencore's climate progress report, assessing its progress as insufficient given the company's ongoing exposure to coal, although also recognising that 80% of its capital expenditure is now focused on producing metals such as copper, cobalt, zinc and nickel which are needed for clean energy technologies.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

We report on our voting activities, including the number of votes cast, the votes for and against management and controversial votes. We report this information alongside information on our engagement activities because we believe that the two activities work together, not as discrete, stand-alone activities.

Stock lending

Our stock lending programme uses our existing asset base to generate an additional source of income. The programme is managed in accordance with our responsible investment policies. During 2020 we updated our policy for securities lending. We now automatically recall all securities on loan for voting purposes. This enables us to vote 100% of our holdings for our entire holding at 100% of the relevant meetings, which adds significant weight to the influence we exercise as shareholders.

Co-filing activity

We're prepared to file or co-file shareholder resolutions on important issues at our investee companies. However, we weren't involved in filing any resolutions in 2022.

DATA AND STATISTICS: EOS ADVISED FUNDS

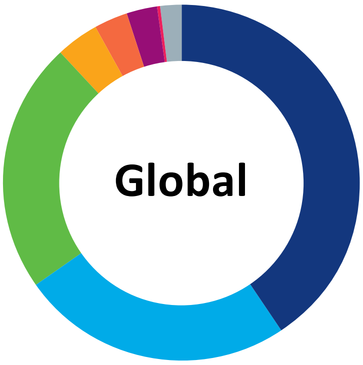
We publish information on our voting activities and its relationship to engagement on our website: www.lpf.org.uk.

We've reinstated full disclosure of our quarterly voting records on our website, which includes rationale for votes against management, abstentions and shareholder resolutions. While our stakeholders previously signalled that publication of company-level voting data was hard to consume (with details on specific companies lost amongst the scale of disclosure), we recognised growing interest in specific votes (such as “Say on Climate” votes) as well as the development of best practice voting disclosure guidelines in the UK.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

99% of LPF's ballots were voted in 2022. This meant we voted on 8,002 resolutions at 522 meetings. The variation from our target of 100% was due to two unvoted meetings [as explained in Principle 8]: one required an administrative declaration and the failure to make this declaration caused the whole ballot to fail; the other related to a company with Russian connections, where our policy was not to vote. At 322 of those meetings, we opposed one or more resolutions. We abstained from voting on eleven resolutions due to concerns related to inappropriate membership of committees or potential conflicts of interests.

The issues on which we voted against management (in-line with EOS recommendations) are presented below.



We recommended voting against or abstaining on 890 resolutions over the last year.

- Board structure **40.8%**
- Remuneration **24.6%**
- Shareholder resolution **23.0%**
- Capital structure and dividends **3.9%**
- Amend articles **2.9%**
- Audit and accounts **2.7%**
- Poison pill/Anti-takeover device **0.3%**
- Other **1.9%**

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

Reflections on the 2022 voting season

Shareholder resolutions on social issues were in the spotlight during the 2022 voting season, as soaring inflation eroded the purchasing power of take-home pay globally, while paid sick leave and reproductive rights were important issues in the US. It was also the second year for formal shareholder votes on companies' responses to climate change, with a steep rise in management say-on-climate proposals. We also maintained our voting attention on two more traditional areas: board diversity, and executive remuneration. We offer some reflections on these topics below.

Board diversity

We tightened our diversity and inclusion voting policies in 2022, encouraging greater representation of women and ethnic minorities on boards and in leadership teams. In the US we expect women and ethnic minorities to make up at least 40% of the board at the largest companies, with a minimum of 30% gender diversity. For example, we opposed proposals for insufficient gender and ethnic diversity at US electricity utility, NextEra.

We enforced our guidelines for ethnic diversity on UK boards and were pleased to see great progress by FTSE 100 companies in meeting minimum standards of representation. We continued to oppose chairs where this wasn't the case, for example at Glencore.

Executive remuneration

We saw a resurgence in some executive pay packages in 2022. In Europe, we pushed for greater shareholdings for executives (to improve alignment of interests), and improved disclosure particularly where pay awards were substantial. For example, at pharmaceuticals giant, GSK, we were amongst the significant minority (38.2%) of shareholders who didn't support their executive remuneration policy which proposed increased bonuses of up to 3x annual salary (a substantial increase from the previous policy which capped bonuses at 2x).

In North America, we opposed the majority of say-on-pay proposals on the basis that practices across the region remained materially misaligned. For example, we opposed pay proposals at Caterpillar, Chevron, ExxonMobil, Meta, Mondelez International, Netflix, Visa and Walmart. This was mainly for excessive quantum, without adequate disclosure of the additional value created for long-term shareholders when paying the CEO significantly above the labour-market median. At Netflix, 73% of shareholders rejected the pay proposal, so we expect a robust response from the compensation committee in the coming year.

PRINCIPLE 12: EXERCISING RIGHTS AND RESPONSIBILITIES

SHAREHOLDER ACTION

We describe our approach to shareholder action in relation to Principle 4: Promoting a well-functioning financial system. We consider participating in class actions to be another way that we exercise our responsibilities as asset owners. Taking action to recover assets lost through investments in companies as the result of corporate mismanagement or wrongdoing is an aspect of our duty to stakeholders.

Exercising rights and responsibilities in private markets

For our private market investments across private equity, private debt, infrastructure, forestry and property funds, we scrutinise corporate actions which require investor approval (such as fund term extensions) and vote in accordance with our fiduciary duty. We'll engage with our external managers to understand their rationale for such requests. Where we're able to obtain a position on the investors' advisory committee for a fund (e.g. through the size of our investment) we'll secure additional rights and responsibilities (such as being consulted on proposed changes to the fund's investment guidelines, approving certain matters such as changes to key executives, scrutinising potential or actual conflicts of interest and the related mitigating actions). We aim to use our rights and responsibilities to improve the value of the assets in our portfolio, in line with our fiduciary duty

Exercising rights and responsibilities in direct property

For our direct property portfolio, we aim to improve the value of the assets in our portfolio in line with our fiduciary duty. This includes consideration of health and safety issues and other regulations to ensure we're a good landlord. As detailed in the case study in Principle 4, we took a proactive approach to meeting the 2023 Minimum Energy Efficiency Standards and we continue to improve the energy performance of our assets to ensure future compliance with proposed regulations.

GLOSSARY	
CEC	City of Edinburgh Council - administering authority for LPF
COP	Climate Change Conference of Parties - 'the parties' refers to the 197 nations that agreed to a new environmental pact, the United Nations Framework Convention on Climate Change, at a meeting in 1992
DWP	Department of Work and Pensions
EOS	Federated Hermes EOS - engagement and voting provider for LPF
ESG	Environmental, Social and Governance
FRC	Financial Reporting Council - an independent regulator responsible for setting the UK's Corporate Governance and Stewardship Codes
GRESB	An investor-led, sustainability benchmarking provider for real assets, covering real estate and infrastructure assets
IIGCC	Institutional Investors Group on Climate Change - a leading global investor membership body and the largest one focusing specifically on climate change
ISS	Institutional Shareholder Services - a proxy voting service provider
JISP	Joint Investment Strategy Panel (of advisers to the Fund)
KPI	Key Performance Indicators
LGPS	Local Government Pension Scheme
LPF	Lothian Pension Fund
OPSC	Occupational Pension Stewardship Council - UK initiative to promote and facilitate high standards of stewardship of pension assets
PLSA	Pensions and Lifetime Savings Association
PRI	Principles for Responsible Investment - an international network of investors, supported by the United Nations, working to promote sustainable investment through the incorporation of ESG
SIP	Statement of Investment Principles
SRIP	Statement of Responsible Investment Principles

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