SPRING 2022

ENGAGE

WWW.LPF.ORG.UK

LOTHIAN PENSION FUND

CONTENTS

Welcome 3

Russian Invasion of Ukraine 4-5

Helios Towers 6-7

COP 26 Outcomes 8-9

Supporting Future Asset 10-11

WELCOME

Welcome to Engage issue 5! As ever the team has been busy working on all sorts of issues on behalf of our pension fund employers and members. We were amongst the tens of thousands that attended events around COP26 in Glasgow, the climate conference dubbed "the finance COP". Our ESG champions Gillian and David spent time there with leading financiers and world leaders helping to shape the future of energy systems and the low carbon transition. You'll read more about what happened during COP26 on page 8.

Much of the recent news cycle has been filled with the return of war to Europe. The Russian invasion of Ukraine has shocked the world and forced investors to carefully re-examine geopolitical risk across their portfolios. Lothian Pension Fund has typically had very little exposure to Russia in our internal equity portfolios. This is because, as part of our analysis of Environmental, Social and Governance factors, the portfolio managers have always viewed Russian listed stocks as particularly risky from a governance point of view. The Rule of Law as recognised in Russia is very different from the majority of global markets, so in recognising this risk and minimising exposure, LPF has avoided big direct impacts from the sanctions aimed at the Russian economy. While one of our external managers made a different assessment of the risk resulting in a small direct exposure, we consider it appropriate that our managers are able to do what we pay them to do (manage money) without imposing broad exclusion lists. On page 4, Gillian discusses our exposure to Russia and Ukraine, both direct and indirect, and what it could mean for potential geopolitical dislocations in the rest of the portfolio.

Finally, we're delighted to announce that our Stewardship Report has been assessed by the Financial Reporting Council and meets the requirements to become a UK Stewardship Code signatory. Thanks to all the hard work put in by the investment and legal teams on responsible investment and stewardship over the last few years, without which we wouldn't have such a strong base of examples and evidence on which to base our reporting.

David Vallery
Chief Executive Officer
Lothian Pension Fund

RUSSIAN INVASION OF UKRAINE

As we write this, approaching the sixth week of this conflict, we find the scale of destruction and human suffering incomprehensible. Our thoughts remain with the millions of people who are directly impacted.

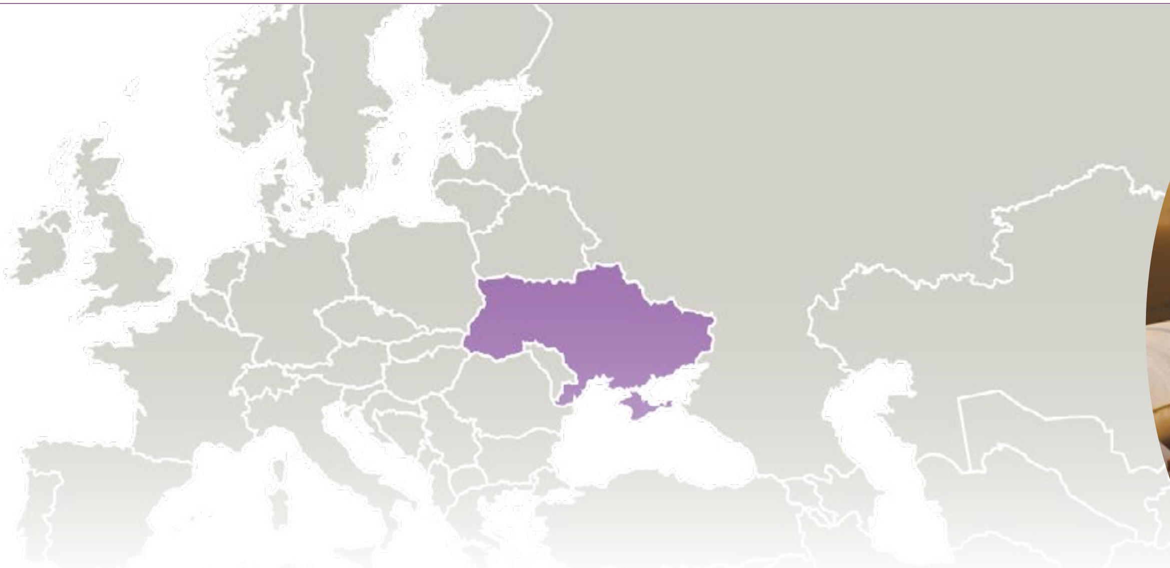
We can't know the duration of this conflict and there's a risk that it will be prolonged, however even if there's a cessation of military action and a withdrawal of Russian forces, it's already clear that this event will have a profound impact on the global economy and trade flows for many years.

In these difficult times our members expect us to remain level-headed and keep focused on making the best investment decisions we can with our long-standing focus on governance within our investment process. We have a very diverse investment portfolio, and in the immediate days following the invasion, we reviewed our investment exposure to Russia, Ukraine and Belarus. This confirmed very minimal exposure (c.0.01% of fund assets invested in Russian stocks), but we also recognised indirect exposure via companies that invest in or trade with Russia and/or Ukraine. For those companies amongst our equity holdings that undertake business connected to Russia, we confirmed that in all cases it was less than 10% of revenues and in the majority of cases less than 5%. We were able to conclude that overall fund exposure was immaterial.

Over the last month we've seen these companies and many others pull out of Russian investments and activities, driven by consideration of their corporate values and the ramifications of sanctions. We are, of course, complying with all relevant sanctions regimes.

Furthermore, our engagement provider, EOS, is engaging with companies with material connections to Russia including mapping of supply chains or partners that could be involved in supporting the conflict, either through products, services or finance, taking into consideration the ownership structure of the entity (e.g. state-owned, dispersed ownership) and the public need for the product/service.

Index providers such as FTSE and MSCI have cut Russian equities



from their indices as they're now considered "uninvestable." Most investment managers have taken the approach of writing down any remaining Russian stock investments to zero. Meanwhile, we remain 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. Whilst the impact on individual stocks has in some cases been significant, our fund position and the equity market as a whole hasn't been impacted to any great extent. The nature of global supply chains and markets, means many of the businesses we invest in will be impacted to an extent.

There has been growing commentary about energy security and the implications for the energy transition. While energy security concerns and higher oil and gas costs support the drive to faster transition to renewables, this can't happen fast enough to immediately eliminate Europe's current dependence on Russian gas. Switching to alternative gas supplies at scale is difficult; Germany has announced new investments in liquified natural gas import facilities, but these won't be operational for two to three years. It's likely that we'll see the closure of coal fired power plants delayed or reversed and it's even possible that we'll see new oil field development in the North Sea (albeit with a <30 year planned operating horizon to align with the net-zero transition).

As markets price in the risk of embargoes or supply constraints, we're now seeing the implications for inflation, not just from higher oil and gas prices, but also food prices (as Russia and Ukraine together account for about 20% of global corn exports, and 25% of global wheat exports while Russia is a major supplier of pbrandonotash and phosphate that are used to make fertilisers). Metal commodity prices are also rising due to the region being a major source of nickel as well as raw materials used to make semiconductors.

However, the ramifications don't stop there. We're also considering whether Russia's aggression sets a precedent that could be emulated by China in relation to Taiwan. Although it's hard to quantify the likelihood of China invading Taiwan, having identified that the risk is non-zero, we've reviewed our exposure to China, Hong Kong and Taiwan and will continue to integrate risk assessment into our investment decision-making.

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/ impacts however, is in many ways superior (albeit hard to evidence, particularly for risks that are expected to play-out over the longer term).

Gillian de Candole
Portfolio Manager
Lothian Pension Fund

'TO DECOUPLE OUR BUSINESS GROWTH – WHICH WE BELIEVE IS PARAMOUNT TO ENABLE CONNECTIVITY FOR MILLIONS MORE PEOPLE – FROM EMISSIONS IS A MAJOR CHALLENGE IN OUR MARKETS. HOWEVER, WE ARE COMMITTED TO REDUCING OUR CARBON FOOTPRINT, AND IN THIS ROADMAP WE SHARE OUR 2030 CARBON TARGET, STRATEGY AND AMBITION FOR NET ZERO.'

HELIOS TOWERS

HELIOS TOWERS

Helios Towers owns and operates telecommunications towers in seven high-growth African markets. Their tenants are typically large mobile network operators and other telecommunications providers who in turn provide wireless voice and data services, primarily to end-consumers and businesses. The mobile industry contributes to all 17 of the United Nations Sustainable Development Goals with Helios contributing most significantly to goals 8 (Decent Work and Economic Growth) and 9 (Industry, Innovation and Infrastructure).

We took the opportunity to attend the Helios Towers "Carbon Reduction Roadmap" investor webcast recently where they opened with the following statements . . .

> *"We are proud that by driving the growth of mobile communications, we are improving lives and livelihoods and contributing to economic growth in Africa."*
>
> *"To decouple our business growth – which we believe is paramount to enable connectivity for millions more people – from emissions is a major challenge in our markets. However, we are committed to reducing our carbon footprint, and in this roadmap we share our 2030 carbon target, strategy and ambition for net zero."*

While the management team discussed the idea that mobile network-enabled technologies form an important part of the decarbonisation solution, enabling rapid emission reductions in other sectors, the purpose of this call was to update investors on Helios Towers' own specific targets.

Helios have a 2030 target of a 46% carbon dioxide equivalent (CO2e) reduction per tenant. This equates to maintaining absolute emissions at 2020 levels. Their carbon reduction strategy comprises of colocation growth, a carbon reduction programme and carbon reduction innovation which feeds into their long-term ambition to have net zero carbon emissions by 2040.

"Project 100" involves $100m investment across the carbon reduction (2022-2026) and innovation (2027-30) programmes. The Carbon Reduction plan will involve optimising grid utilisation, increased battery usage, connecting to the grid where possible and using solar solutions. Over 70% of sites will have hybrid and solar solutions by 2026 (31% in 2020). Carbon Reduction Innovation will involve hydrogen fuel cells, alternative fuels, wind technology, large-scale solar farms and mini-grid community projects. The "road to 2040" is more of an ambition and will require decarbonisation of national grids, a supportive policy environment and carbon financing and innovation in battery technology and solar solutions.

Stewart Piotrowicz
Equity Portfolio Manager
Lothian Pension Fund

HELIOS TOWERS FLOW DIAGRAM

Our 2030 target

46%

CO_2e reduction per tenant

This equates to maintaining absolute emissions at 2020 levels

Our carbon reduction strategy

Project 100
$100m investment in:

Colocation growth + Carbon Reduction Programme + Carbon Reduction Innovation

Our long term ambition

Net zero carbon emissions by 2040

‘TAKING THE CREDIBILITY OF PUBLISHED CORPORATE COMMITMENTS INTO ACCOUNT, LOMBARD ODIER ESTIMATES THAT ONLY 25% OF LARGE CAPS ARE CURRENTLY ALIGNED TO KEEPING WARMING BELOW 2°C, AND ONLY 6% ARE ON TRACK TO KEEPING WARMING BELOW 1.5°C.’

COP 26 OUTCOMES

UN CLIMATE CHANGE CONFERENCE UK 2021

IN PARTNERSHIP WITH ITALY

Last November, the eyes of the world were on Glasgow as it hosted the 26th United Nations Framework on Climate Change Conference of Parties, more commonly referred to as COP26. World leaders, non-governmental organisation (NGOs), think tanks, charities and finance leaders met to hammer out the details of how to limit global temperature rises due to greenhouse gas emissions generated by humans. David Hickey and I were lucky enough to be there, taking part in events and workshops to decide the future path of climate finance. The stated aims of COP26 were to:

- Ratchet-up ambitions from the 2015 Paris Agreement: to strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5°C
- Finalise the rulebook defining how this will be delivered.

COP26 did achieve agreement on a set of reporting frameworks for carbon-emissions accounting and international carbon-trading mechanisms. However, the ratcheting-up of government’s carbon reduction pledges was considered insufficient and governments have been tasked with providing further updates at COP27 in Egypt in November 2022.

Analysis from Climate Action Tracker indicates that pre-COP26, the world was on course for 2.7°C of warming and the announcements made in Glasgow will put us on a path towards between 1.8°C and 2.4°C of warming, depending on the speed of implementation. So countries’ pledges to reduce their emissions are still some distance short of what is needed. To be on track to reach net zero by 2050, it’s generally accepted that there’s a need to halve carbon emissions by 2030. Aggregate pledges to date are only sufficient for a 25% reduction within that timescale. To put this in context: during the covid crisis in 2020, UK emissions dropped 6.5%, but on a global scale the emission reduction was only 2.5%.

Furthermore, decarbonisation in the real economy and the alignment of investable assets with the transition still lag. To deliver on their existing pledges, countries will need to implement policies to:

- Accelerate the phase-out of coal
- Curtail deforestation
- Speed up the switch to electric vehicles
- Encourage investment in renewables.

Additional COP26 announcements:

- **An agreement to phase down the use of coal:** getting to a net zero world requires unabated fossil fuels to be removed from the energy mix as 75-80% of global carbon emissions come from burning fossil fuels. The term “unabated” means without

Why targeting 1.5°C is important

The United Nations Environment Programme lays out the difference between the physical effects of 1.5°C of warming versus 2°C of warming by 2100:

	1.5°C	2°C
Average drought duration	2 months	4 months
Wildfires: % increase in burned area each fire season	41%	61% more
Food production	Wheat, rice, maize, and soybean production reduced	Almost all agricultural production yields reduced
Average sea level rise	48cm	56cm
Impact of sea level rise on people	46 million people displaced	> 46 million people displaced and fewer opportunities for infrastructure adaptation
Impact on nature	70-90% reduction in coral reefs	Virtually all coral reefs lost

Protesters gather outside Glasgow Queen Street Station, Nov 2021

the use of any carbon capture or similar technology

- **Climate finance for developing economies:** $100bn per annum to be mobilised by wealthy nations to help vulnerable nations deal with climate change, plus $40 billion for adaptation to support countries that are already having to mitigate or reduce the impacts of physical climate change
- **Commitment to cut methane emissions by 30% by 2030:** this aims to buy the world extra time to tackle climate change, as although methane is only 9% of greenhouse gas emissions (vs 82% for carbon dioxide) and only persists in the atmosphere for 12 years (compared to c.200 years for carbon dioxide), methane has a more powerful effect on global warming while it's present
- **Pledge to end deforestation:** this was signed by 100 countries with over 85% of the world's forests. It seeks to halt and reverse forest loss and land degradation by 2030. Its focus is on commodity-based deforestation, which is primarily related to farming. This pledge could spur the voluntary carbon-offset market, as avoided deforestation, reforestation, afforestation and more sustainable forest management may be one of the lowest cost, highest impact levers available to accelerate the transition to net zero
- **Carbon markets:** the current system of trading carbon offsets has been in place for quite some time, but it has been criticised for "double counting". The country that's creating an offset, for example through forestry, can count the benefit while the country buying the offset can also count the benefit! The Taskforce on Scaling Voluntary Carbon Markets has now been set up to eliminate double counting and establish robust global governance, setting the stage for a significant growth in carbon markets, as better pricing of the cost of carbon emissions is expected to support more investment into reducing these emissions.

What does this mean for us?

We're working to enhance our climate strategy and reporting in line with the recommendations of the Taskforce for Climate-related Financial Disclosures, as set out in our Statement of Responsible Investment Principles. The challenge for investors is less about directing capital into that small subset of the economy that's already aligned, but more about reducing emissions across the remainder of the economy. This is where the greatest impact will be made and potentially the most attractive transition opportunities will be found.

Gillian de Candole
Portfolio Manager
Lothian Pension Fund

SUPPORTING FUTURE ASSET

An important part of improving gender diversity within the investment industry is to inspire the next generation to pursue a career in investment. LPF is proud to continue working with Future Asset, who strive to do just that. Future Asset is an organisation in Scotland that enables girls in high school to explore how investment can change the world for the better, gain valuable transferable skills and consider the benefits of a possible future investment career. LPF have been a partner of Future Asset since 2019 and have presented at their events, acted as mentors and provided work experience.

Despite improvements in gender diversity over several decades, one statistic highlighted by Future Asset illustrates how much further the investment community still has to go. Within the UK industry there are more funds managed by people called Dave than there are funds managed by women! This highlights why LPF is taking action to support and improve gender diversity and inclusion within the investment industry.

One way we have recently provided support to Future Asset is by joining the judging panel for their Growing Future Asset Investment Competition. The purpose of the competition is to provide an opportunity for girls to learn about investment through researching a company and building an investment case by considering its long-term prospects, profitability, and sustainability. Future Asset received around 60 entries from teams of schoolgirls from across Scotland.

Erin Savage (Senior Pension Employer and Member Manager) and I judged the S3-4 and S5-6 competitions respectively. Our involvement included reading the entry investment reports, watching their elevator pitches, evaluating the teams' work and discussing with other judges to decide which teams progressed to further stages. We were impressed by the standard of the entries and provided positive, constructive feedback to recognise the girls' abilities, build confidence and encourage skills growth.

On International Women's Day, we welcomed two S4 schoolgirls from Craigroyston Community High School for a work shadowing visit. Future Asset arranged this as a reward for the effort this team put into their competition entry. It was a great opportunity for the girls to gain insight into the different areas and styles of investment. Several members of the LPF team met with the girls throughout the day to discuss why they decided to pursue a career in investment, their different career paths, and what motivates them. The day provided the girls with a platform to ask investment professionals questions and build upon their investment industry awareness. We provided advice which the girls can take forward with them as they continue to utilise Future Asset's initiatives and beyond. It would be great if one day we learnt that one or both of the girls had pursued a career in finance or investment.

Natalie Drysdale
Trainee Investment Analyst
Lothian Pension Fund

‘WITHIN THE UK INDUSTRY THERE ARE MORE FUNDS MANAGED BY PEOPLE CALLED DAVE THAN THERE ARE FUNDS MANAGED BY WOMEN!’

NATALIE DRYSDALE

LOTHIAN
PENSION FUND

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

PO Box 24158, Edinburgh, EH3 1GY

Phone: 0131 529 4638
Email: pensions@lpf.org.uk
Web: www.lpf.org.uk