Climate Change Strategy Statement

This is our strategy on climate change. It sets out how we intend to achieve net-zero total portfolio carbon emissions by 2050, including how we integrate climate change-related risks with managing the Scheme's assets on behalf of our members.

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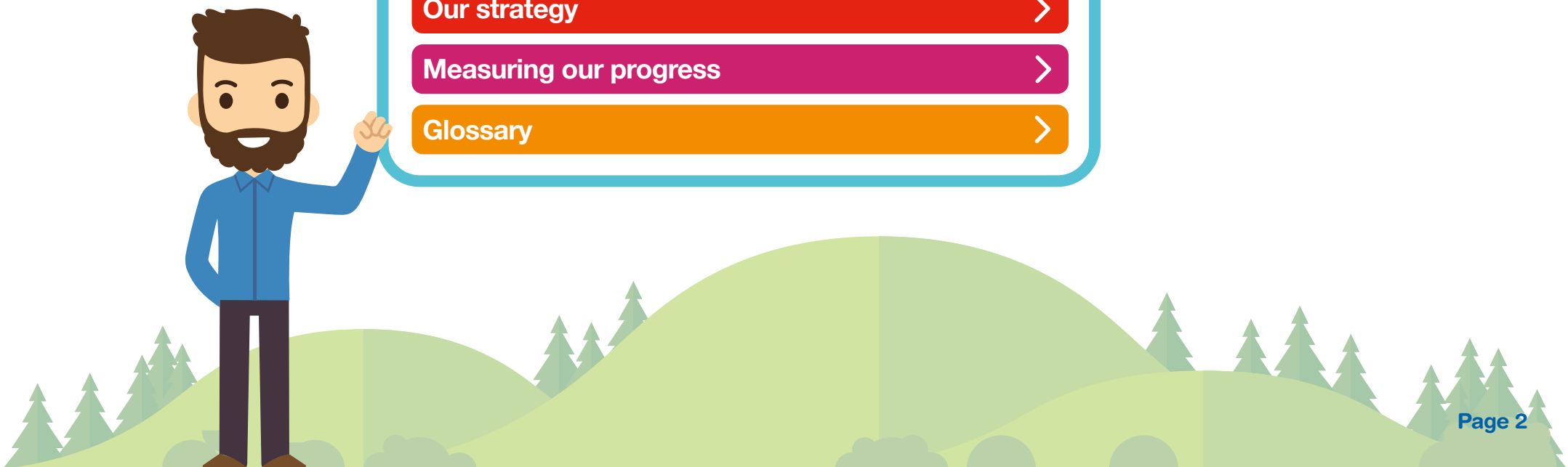


An introduction from the Chair

The Scheme has set itself ambitious but necessary goals to tackle climate change risk.

We aim to do that by adopting a series of approaches to achieve a portfolio of assets with net-zero carbon emissions by no later than 2050, or earlier if possible, which are aligned with National Grid's own ambitions in this area.

These include divesting from companies involved in thermal coal, reducing other carbon-intensive holdings and investing more money in companies that are developing solutions such as renewable energies and low-carbon technologies. The strategy is in line with the ambitions of the **Paris Agreement** to limit the average temperature increase to 1.5°C above pre-industrial levels.

Why are we taking these steps? Our number one priority is to the members who rely on us for safeguarding the Scheme's investments and making sure that pensions and benefits are paid in full as they fall due. We need to be able to do this in a way that creates value and promotes sustainable growth so that we can fulfil our long-term funding obligations.

It's becoming increasingly apparent that the result of unchecked climate change will, over time, have negative financial repercussions for pension schemes such as ours, while the transition to a low-carbon economy brings investment opportunities.

We believe that, as Trustees, we can better serve our members by choosing how and where we make our investments, in a way which helps to address climate change and reduces the risks associated with it. It's in the best interests of the Scheme to do so. Moreover, when combined with similar actions taken by other pension funds, it presents a powerful opportunity to generate a positive impact for society more broadly, and to help to steer the economy towards lower carbon emissions in a way that will help address the climate crisis facing us all.

This document explains the context around our climate change strategy and the actions we're taking to meet our goals. (There's a glossary at the back covering some of the technical terms.)

Paul Trickett
Chair of the National Grid UK Pension Scheme

What we're doing

We've put in place a strategy to achieve our goals based on the following approaches and actions:

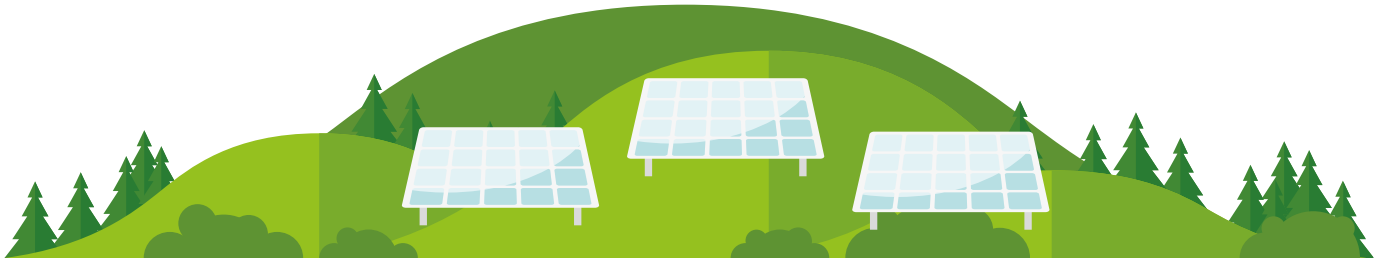
Divest from thermal coal-related assets by 2022 – coal mining and coal power generation are the biggest sources of **greenhouse gas (GHG) emissions**. Not only is coal the most carbon-intensive of energy sources, it's the sector most likely to become obsolete, and we don't believe it can be aligned with the goals of the **Paris Agreement**.

Set a series of milestones or shorter-term climate-related targets – these will be continually reviewed in our dynamic approach to target setting.

Review outcomes and recalibrate targets regularly – to account for changes already implemented, the progress of other companies on their climate change journey, and improvements in data availability and methodologies. This allows flexibility to make changes if we need to while preserving the desired risk-and-return characteristics of the portfolio.

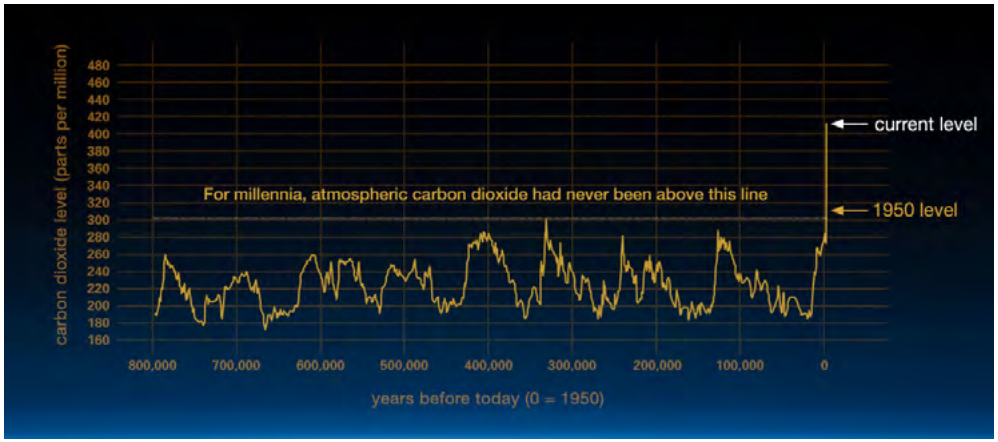
Engage and collaborate with the entities in which we invest – to transition to a sustainable, low-carbon economy. If, in the future, engagement is unsuccessful, we will, if appropriate, divest (for example, divesting from thermal coal, where we see no possible pathway to a sustainable future for the industry).

Monitor the asset managers running our investment mandates – we'll require asset managers to include climate-related implications in their investment processes and engage with companies on our behalf, in line with our overall principles and objectives. As our investment strategy is implemented by third parties, we'll ensure that appropriate risk management is also undertaken at the manager level.



Climate change – the defining issue of our time

Climate change is the defining issue of our time. It's not simply a theory or a threat that exists somewhere over the horizon. It's certain, based on a huge weight of evidence, that human activity is changing the Earth's climate. The world is already about 1°C above pre-industrial temperatures, according to the **Intergovernmental Panel on Climate Change**.[1]

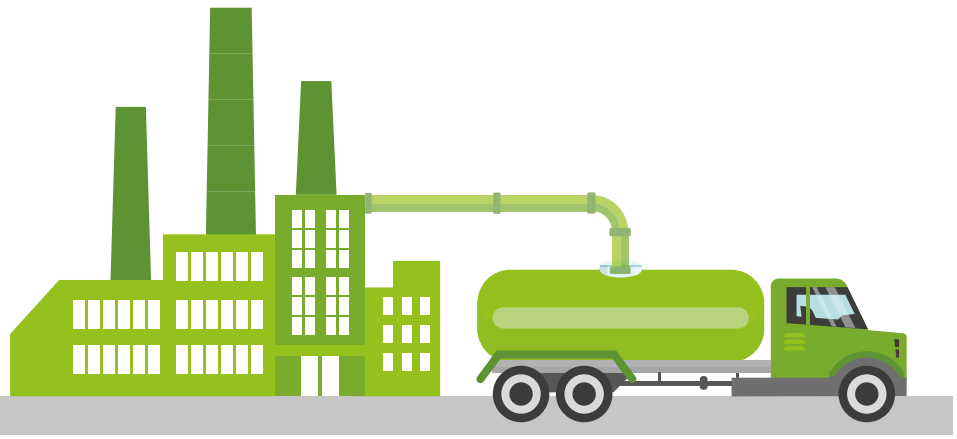


Source: https://climate.nasa.gov/climate_resources/24/graphic-the-relentless-rise-of-carbon-dioxide/

[1] https://www.ipcc.ch/site/assets/uploads/sites/2/2018/12/SR15_FAQ_Low_Res.pdf

Climate change is generating extreme weather conditions, flooding, droughts, and the melting of glaciers and polar icecaps; phenomena which are growing in both frequency and severity.

Concentrations of **GHGs** such as carbon dioxide (CO2) have increased over the past two centuries, both in terms of the rate of growth and absolute amounts. Atmospheric CO2 levels in 2019 were almost 410 parts per million – higher than at any point in at least the past 800,000 years.



Climate change – the defining issue of our time continued

The annual rate of increase in atmospheric CO2 over the past 60 years is about 100 times faster than previous natural increases.[2] This poses a threat to many natural environments, unable to adapt to such swift change. The Arctic has warmed faster than any other region over the past quarter of a century. In 2019, its average air temperatures were 1.9°C higher than those from 1981-2010.[3] The Arctic sea ice minimum in 2020 was measured at its second thinnest on record, and the continuing melting of polar glaciers may raise sea levels by almost 40cm by 2100 (according to Nasa[4]).

Climate change is a global threat to our environmental, social and economic futures, and society must act now. As an investor, we can't afford to be left behind. We believe that investing in a way which is consistent with the necessary transition to a low-carbon economy is likely to lead to the best financial outcomes for our Scheme and our members. That's why we're aiming to align our whole portfolio by 2050 with the **Paris Agreement's** more ambitious 1.5°C limit on warming.

The Paris Agreement aims to keep global temperature rises in this century to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase further to 1.5°C.

[2] https://www.climate.gov/news-features/understanding-climate/climate-change-atmospheric-carbon-dioxide#:~:text=The%20global%20average%20atmospheric%20carbon,least%20the%20past%20800%2C000%20years.&text=During%20these%20cycles%2C%20CO2%20was%20never%20higher%20than%20300%20ppm.

[3] https://www.nytimes.com/interactive/2020/04/19/climate/climate-crash-course-1.html

[4] https://climate.nasa.gov/

Climate change and large investors

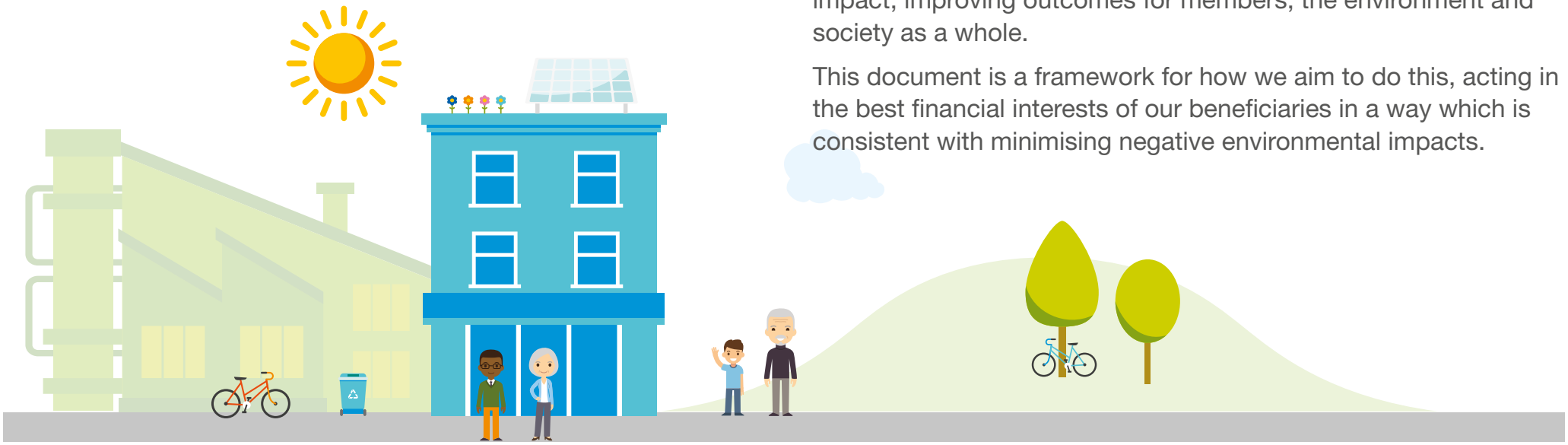
The world's top 100 asset owners represent about US$20trn in assets under management, and many of these are pension funds. Pension funds have a vested interest in addressing climate change and reducing the risk associated with it.

It's becoming increasingly apparent that the result of unchecked climate change will, over time, have negative financial repercussions for pension schemes such as ours.

The investment decisions of pension funds have material consequences not only for a scheme's finances but for the environment and the lives of its beneficiaries. All three are inextricably linked.

There's increasing awareness among investors that integrating climate change considerations can have a positive impact on financial returns as part of prudent risk management. We have a responsibility to factor this into our investment strategy and the way we construct our portfolio. But doing so will not only preserve the financial stability of the Scheme, it can also make a positive impact, improving outcomes for members, the environment and society as a whole.

This document is a framework for how we aim to do this, acting in the best financial interests of our beneficiaries in a way which is consistent with minimising negative environmental impacts.



Our beliefs and objectives

The risks – on our investments, and more broadly

Climate risk is unlike any other financial risk our Scheme faces. It has a multifaceted impact on all our members, as well as their descendants.

While our investment decisions focus mainly on delivering positive financial outcomes, we're mindful that the issues of financial outcomes and the broader results of climate change are heavily integrated.

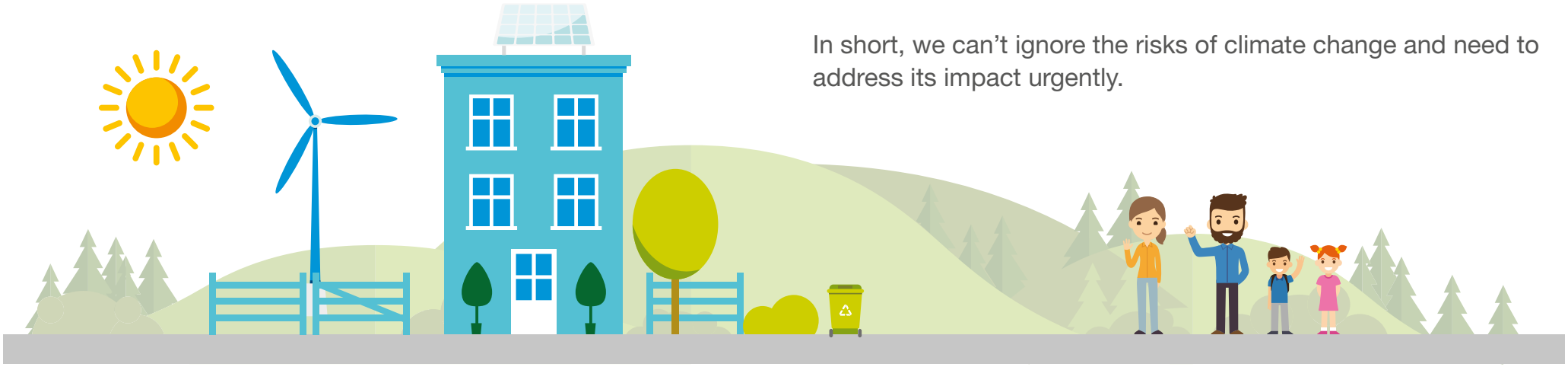
The financial impact of climate change spans pension schemes' funding levels and employer covenants. The wider repercussions on the economy include long-term interest rates and inflation.

The impact on humanity could affect members' life expectancy due to air quality and more extreme temperature swings.

Governments and regulators increasingly require investors such as pension funds to consider climate change. **The Pensions Regulator** considers climate change to be systematically significant, and schemes who don't factor it in will incur regulatory and reputational penalties.

Our primary concern is safeguarding the payment of benefits to members in retirement, and this goes hand in hand with preserving and protecting the world they'll retire into.

In short, we can't ignore the risks of climate change and need to address its impact urgently.



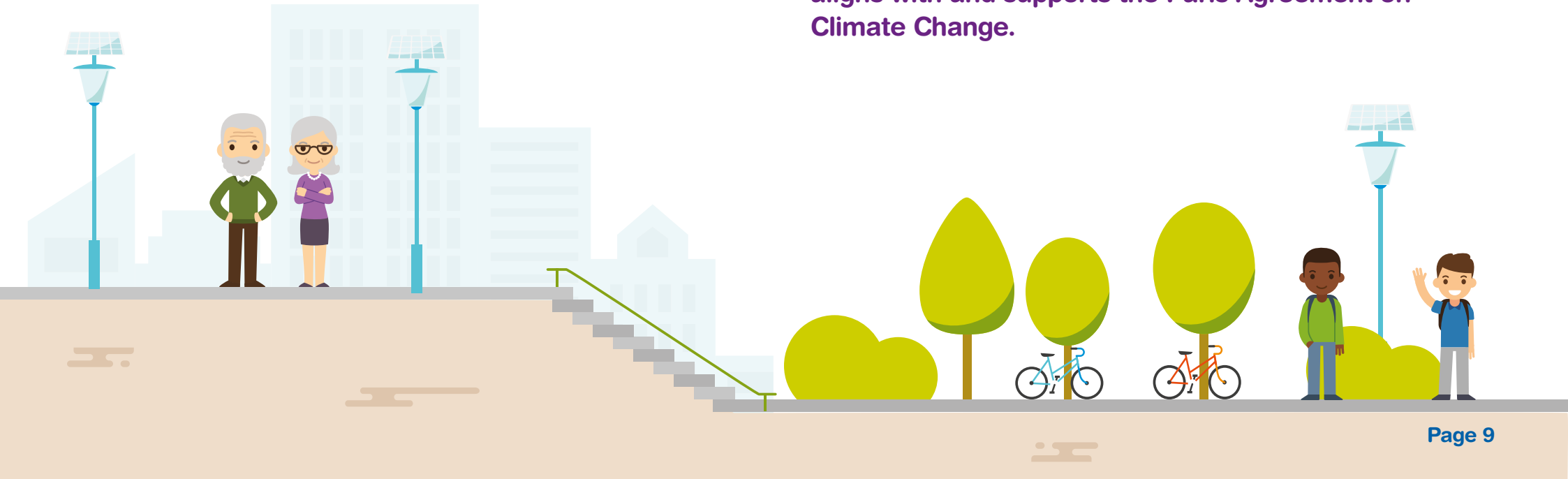
Mitigating the risks

While climate change presents a threat, it's not all negative for investors. Over the short-to-medium term, sustainability issues impact financial outcomes, but they also generate investment opportunities in building a sustainable future that will deliver for the Scheme in the long term.

In aligning our duty to act in the best interests of the members, climate-related risks and opportunities should be mitigated and exploited by investment decisions where appropriate. We're therefore fully integrating climate change considerations into our investment decision-making.

In practice, this means ensuring the funding level is resilient to climate-related risks across all time periods. We're doing this by incorporating climate-related thinking in our investment processes, across asset allocation where possible, manager selection and mandate specification (see **Our strategy**). This will include using financial 'tools' such as liability hedging and longevity insurance, alongside heightened awareness of covenant monitoring considerations and similar.

The Trustee seeks an investment strategy which aligns with and supports the Paris Agreement on Climate Change.



Mitigating the risks continued

Investor collaboration can play a significant role in achieving these goals, and we aim to join forces with other like-minded investors on initiatives that support these, in tandem with the more significant role that government policy, companies and broader society have to play.

Robustly engaging and collaborating with the entities in which we invest is generally the best way we can achieve the transition to a sustainable, low-carbon economy. One example of this is our support for the **Institutional Investors' Group on Climate Change (IIGCC)**, which aims to coordinate the actions of large investors to meet climate change targets in the UK.

Addressing climate change can only be done through broadly agreed measures and collaborative ways of working and by encouraging market participants to provide the required data, tools, and products to underpin investors' climate change investment-strategy implementation. In this way, industry-wide collaboration initiatives, such as the **Paris Aligned Investment Initiative (PAII)**, can bring large asset owners together around commonly agreed ways of working and increase their overall influence.

However, in some cases, engagement and collaboration with other investors may not be enough. When we think the risk (financial, reputational or regulatory) to certain companies, sectors or industries is disproportionally large for us as an investor or where engagement can no longer serve a useful purpose, we'll consider divestment and/or exclusion.

We're phasing out thermal coal-related investments by 2022, or earlier if possible.

Carbon emissions from existing and planned coal plants take up between half and two-thirds of the remaining 1.5°C **carbon budget**, with all known coal reserves fully capable of exhausting the remainder. We see no plausible path to sustainability for this industry.

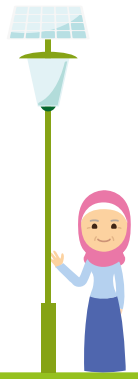
In practice, this means an increasing refocus of the portfolio on companies whose business models are better positioned to achieve the transition to a low-carbon economy.

Our strategy

Our strategy is based on three main pillars:

Investments

We'll incorporate climate change considerations in our investment processes and when implementing the investment strategy for each of the Scheme's Sections. This will be done across asset allocation, asset classes and mandate specification in a way that's consistent with the more audacious decarbonisation aims of the **Paris Agreement** constraining warming to 1.5°C, without compromising the Sections' main funding objectives and overall financial strategy.



Manager selection, monitoring and mandate specification

We consider climate change risks and opportunities alongside other relevant investment factors. We expect our investment managers to include climate-related implications in their investment processes and to engage with companies on our behalf to progress the climate change agenda, in line with our overall principles and objectives. Mandates will be tailored so that capital is directed to better climate-aligned assets and away from poorly climate-aligned assets, while maintaining other investment requirements such as appropriate diversification and risk/return characteristics.

Engagement & collaboration

We'll:

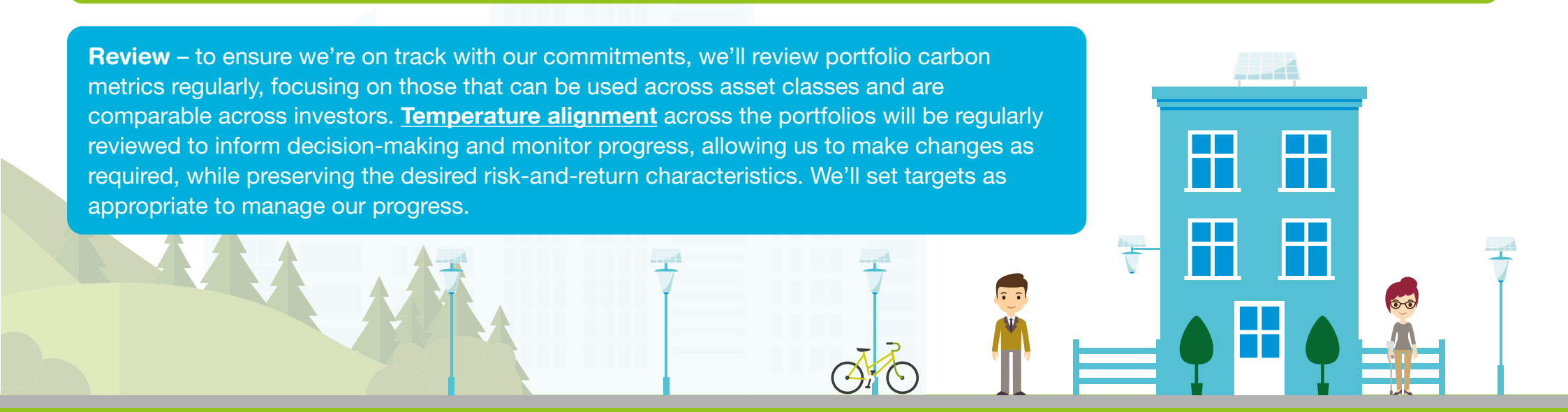
- Collaborate with like-minded organisations in pursuing a low-carbon economy and collectively manage climate-related risk in financial markets.
- Focus on engagement and assist, encourage and require portfolios' companies to embark on decarbonisation pathways of a scale and pace consistent with the objective. As these companies start transitioning towards low-carbon business models, the portfolio will decarbonise along with them. We support the investor-led initiative **Climate Action 100+.** We'll also influence and apply pressure on insurers we enter into buy-in transactions with so that they align their portfolio of assets with the ambitions of the Paris Agreement, consistent with the Trustee's beliefs. Finally, we'll hold the UK Government to account for the achievement of its long-term (and legally binding) target of ending its contribution to global warming by 2050.
- Encourage market participants to provide the required data, tools and products to underpin the implementation of investors' climate-change investment strategy.

Measuring our progress

Progress – will be reviewed on an annual basis to ensure our strategy is kept fit for purpose in light of evolving climate change policies and regulations, technology, and best practices for companies and investors.

Transparency – we'll communicate with key stakeholders, the membership base and externally, as and when appropriate. For example, we'll be incorporating the recommendations of the **Taskforce on Climate-related Financial Disclosures (TCFD)** into our practice and will produce a TCFD report for 2021. This is a set of eleven clear, comparable and consistent recommended disclosures regarding climate change. Through such consistent transparency, we'll be well-placed to assess the impact of climate change on the Scheme, enabling the best outcomes for our members.

Review – to ensure we're on track with our commitments, we'll review portfolio carbon metrics regularly, focusing on those that can be used across asset classes and are comparable across investors. **Temperature alignment** across the portfolios will be regularly reviewed to inform decision-making and monitor progress, allowing us to make changes as required, while preserving the desired risk-and-return characteristics. We'll set targets as appropriate to manage our progress.



Glossary

Carbon budgets

Global warming is fundamentally linked to the absolute concentration of greenhouse gases in the atmosphere. To stabilise global temperature at any level versus pre-industrial levels, there's a finite amount of emissions that can be released before net emissions need to reach zero. For CO2 emissions, this can be referred to as a 'carbon budget'. Carbon budgets continue to be a popular approach to frame the challenge of keeping global warming to 'acceptable' levels. The IPCC Special Report on Global Warming of 1.5°C (2018) is the most recent authority on 'total' carbon budgets – meaning the total amount of emissions that can be released and hence contribute to warming across all sectors of the economy (which can be categorised as energy sector emissions plus land use, land-use change, forestry and industrial sector emissions).

Climate Action 100+ (CA100+)

CA100+ is an investor initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. These companies include 100 'systemically important emitters', accounting for two-thirds of annual global industrial emissions, alongside more than 60 others that are crucial to driving the clean energy transition.

Climateaction100.org

Greenhouse gases (GHGs)

Four GHGs are linked to global warming: carbon dioxide (CO2), methane, nitrous oxide and fluorinated gases. CO2 makes up more than three-quarters of global GHGs.

Scope 1, 2 and 3

Companies' GHG emissions are divided into three groups, or 'scopes':

- Scope 1: direct emissions from the reporting company's owned or controlled sources
- Scope 2: indirect emissions from purchased electricity, steam energy, heating and cooling that have been consumed by the reporting company
- Scope 3: all other indirect emissions that occur in the reporting company's value chain.

ghgprotocol.org

Institutional Investors' Group on Climate Change (IIGCC)

The European membership body for institutional investor collaboration on climate change. It aims to mobilise capital for the low-carbon transition and to ensure resilience to the impacts of a changing climate by collaborating with business, policy makers and fellow investors.

iigcc.org

Continued on next page

Glossary continued

Intergovernmental Panel on Climate Change (IPCC)
Created in 1988 by the World Meteorological Organization and the United Nations Environment Programme, the objective of the IPCC is to provide governments at all levels with scientific information that they can use to develop climate policies.

ipcc.ch

Paris Agreement on Climate Change
The Paris Agreement is the first-ever universal, legally binding, global climate change agreement, adopted in December 2015. It set out a global framework to avoid dangerous climate change by limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C. It also aims to strengthen countries' ability to deal with the impacts of climate change and support them in their efforts.

Paris Aligned Investment Initiative
Set up by the IIGCC, the initiative looks at how investors can align their portfolios to the goals of the Paris Agreement. It seeks to: develop relevant working definitions of concepts, terms and pathways; assess methods and approaches relevant to measuring alignment and transitioning different asset classes; and test the implications of such alignment using real-world portfolios.

Principles for Responsible Investment
This is a United Nations-supported international network of investors working together to implement its six principles.

unpri.org

Temperature alignment
Temperature alignment analysis is a methodology that aims to enable all industry participants to utilise a common, intuitive and consistent metric and enable investors to assess the status and ambition of companies and governments when building Paris-aligned portfolios. It's expressed in degrees and indicates in which path a particular company or portfolio is, based on their business plans in relation to climate change, and the level of carbon emissions associated with that.

Task Force on Climate-Related Financial Disclosures (TCFD)
Established in 2015, the TCFD has the goal of developing a set of voluntary climate-related financial-risk disclosures which can be adopted by companies so that those companies can inform investors and other members of the public about the risks they face in relation to climate change.

fsb-tcfd.org