

National Grid UK Pension Scheme

Responsible Investment Policy

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1 GLOSSARY OF TERMS

“ESG”	Environmental, Social and Governance
“GHG” or “Greenhouse gases”	Gases in the earth’s atmosphere that trap heat, including carbon dioxide, methane, nitrous oxide and water vapour
“IRM”	Integrated Risk Management
“IRMC”	Integrated Risk Management Committee
“LCP Executive”	Trustee Appointed Executive
“Net zero”	A position that achieves balance between the amount of greenhouse gases that are produced and the amount that are removed from the atmosphere.
“Net Zero portfolio alignment”	Metric to assess forward looking alignment to a Net Zero position.
“NGUKPS”	National Grid UK Pension Scheme
“RI”	Responsible Investment
“Scheme”	National Grid UK Pension Scheme (NGUKPS)
“Scope 1 emissions”	Emissions from sources that an organisation owns or controls directly
“Scope 2 emissions”	Emissions that a company causes indirectly when the energy it purchases and uses is produced
“Scope 3 emissions”	Emissions that are not produced by the company itself, and not the result of activities from assets owned or controlled by them, but by those that it’s indirectly responsible for, up and down its value chain
“Section”	a section of the Scheme.
“Stewardship”	The responsible oversight of capital that we invest in order to generate sustainable benefits for the economy, the environment and society.
“Sustainability”	Meeting the needs of the present without compromising the ability of future generations to meet their own needs.
“Trustee Board” or “Trustee Directors”	the Board of Trustees of NGUKPS
“WACI” or “Weighted average carbon intensity”	Weighted average carbon intensity or WACI is a metric that measures emissions of a company divided by revenue generated allowing the emissions of different size companies to be compared

2 RESPONSIBLE INVESTMENT POLICY

1. Introduction and Background

The National Grid UK Pension Scheme (NGUKPS) Trustee Directors defines Responsible Investment (RI) as a philosophy where Environmental, Social and Governance (ESG) factors are incorporated into its investment decisions. The Trustee Directors believes that the increasing materiality of ESG factors can give rise to reputational, operational and regulatory risks that can have a material impact on the quality and sustainability of long-run investment returns.

The Trustee Directors further believe that climate change represents a systemic and financially material risk to all asset classes that could have repercussions for the Scheme in terms of funding, covenant and member life expectancy. A transition to a low-carbon economy to combat climate change presents risks, but also offers opportunities with respect to the Scheme's investments.

As such, being able to identify, assess and manage ESG risks and opportunities, particularly those related to climate change, is key. To that end the Trustee Directors has defined a Responsible Investment Policy that sets out its high-level beliefs and requirements. This includes delegating the design and implementation of a set of processes (collectively a "framework"), to meet this policy, to the LCP Executive, which oversees the Scheme's Master Manager in its implementation of these processes.

The framework has been designed to allow the Trustee Directors beliefs in relation to RI to be put into practice and to meet the Trustee Directors' regulatory requirement with respect to climate change and RI.

2. Beliefs

The Trustee Directors has developed a set of investment beliefs, most recently reviewed in June 2023, including beliefs in relation to ESG / sustainability matters. The beliefs relating to ESG / sustainability are listed below and provide the foundation for the Responsible Investment Framework.

- **Our decisions should focus on financial outcomes, but we should be mindful of the sustainability impact of our investments and our wider responsibilities**
 - i. Good financial outcomes is the primary priority of the Scheme. Sustainability considerations embedded within investment decisions contribute to financial decisions but should not be the sole driver of them.
 - ii. We will ensure reporting of the Scheme's policies with respect to ESG integration and stewardship activities is transparent e.g. via a publicly available Responsible Investment Policy.
- **Long-term sustainability issues impact financial outcomes and create regulatory and reputational risks**
 - i. We will implement a 'best practice' approach in the spirit of regulatory requirements as opposed to a minimum compliance approach.
 - ii. We will make use of engagement, integration and impact investments within the portfolio but only where aligned to the financial objectives of the Scheme
- **Climate change is a systemic (perhaps existential) risk that merits specific attention**
 - i. Climate risk is a financial risk given its potential impact on assets, liabilities, members and the covenant.
 - ii. Climate change risk analysis and monitoring of potential impacts should occur on an ongoing basis in a similar manner to other risks.

- **Managers with the relevant skills are best placed to engage with companies and manage sustainability risks and their pricing, but we will monitor the resulting activity and outcomes**
 - i. With regards to the individual investments, ESG integration and stewardship will in general be delegated to the Master Manager, who will oversee the Scheme's external managers, but it is the Trustee Directors' responsibility to ensure that the Master Manager and the external managers have the requisite skills and resources to do this and monitor the outcomes.
 - ii. Further to the managers' engagement activities, unilateral or collaborative action with other investors will be considered where appropriate.

3. Governance

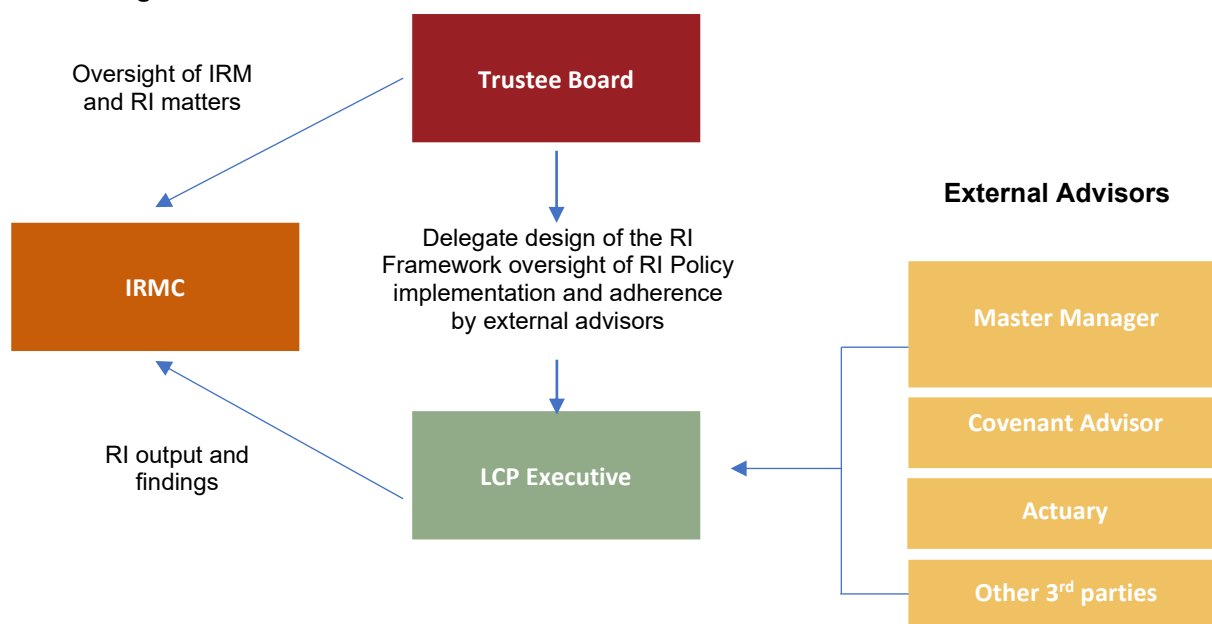
Key to the Trustee Directors approach to RI and ESG is an appropriate and effective governance structure, ensuring that RI and ESG considerations are embedded throughout the risk management of the Scheme. Ultimate responsibility for integration of RI considerations and in particular identifying, assessing and managing ESG / climate change risks and opportunities sits with the Trustee Directors. The design and implementation of the processes for doing this i.e. the RI Framework has been delegated to the LCP Executive and the Master Manager, but accountability remains with the Trustee Directors.

The Trustee Directors governance structure includes a strategic focussed Trustee Directors sub-committee being the Integrated Risk Management Committee (IRMC) whose role includes oversight of RI matters as part of their wider IRM oversight function. The IRMC meets quarterly with members of the LCP Executive also attending.

In addition to the LCP Executive's role in designing the processes underpinning the RI Policy, the Trustee Directors also requires the LCP Executive to

- Oversee the implementation of the RI framework by the Master Manager
- Coordinate the input of the Scheme's Covenant Advisor and Actuary, who also have important roles identifying and assessing the potential impact on covenant and longevity that ESG / climate change risks could have
- Coordinate any further third party input from, for example, the Scheme's Investment Advisor

Figure 2: Governance Structure



The Trustee Directors oversees the activities articulated in the RI framework and, as such, requires regular reporting and the opportunity to discuss the reports and RI related items at IRMC and Trustee Directors Board meetings:

4. Responsible Investment Framework

The framework has been designed to allow the Trustee Directors beliefs in relation to RI to be put into practice and to generate the required output to meet the Trustee Directors' regulatory requirements with respect to RI, including climate change.

The framework addresses a number of specific areas:

- a. Identification and assessment of sustainability risks and opportunities including determining relevant time horizon**
- b. Management of sustainability risks and opportunities**
- c. Active Ownership, collaboration and disclosure**

A Sustainability Action Plan has been created to address these, as discussed in item 5 of this policy. With the exception of determining relevant time horizons, which the LCP Executive works with the Trustee Directors to do, the implementation of underlying components of the framework has been delegated to the Master Manager with the LCP Executive and the Trustee Directors providing oversight.

5. Sustainability Action Plan

(a) Identifying and assessing sustainability risks and opportunities including determining relevant time horizons

Identification and assessment of risks and opportunities for subsequent management is something that is well anchored in the Trustee Directors investment beliefs. This also applies to sustainability risks.

Sustainability risks can manifest over any time horizon: from as quickly as the next day, in the case of ESG-related controversies, to many years, in the case of shifts in consumer preferences. With respect to climate related risks, physical risks are generally expected to be realised over longer time horizons than transitional risks.

In addition, climate change regulation dictates that the Trustee Directors must, on an on-going basis, identify climate-related risks and opportunities which it considers will have an effect over the short term, medium term and long term on the investment strategy and funding strategy (where relevant). Short-, medium- and long-term time horizons are defined in a way that the Trustee Directors determines to be appropriate, taking into account the liabilities and obligation to pay benefits. Further details on the Trustee Directors' approach to identifying climate-related risks and opportunities over various time horizons can be found within the Trustee Directors' climate reporting.

Identification

Identification of sustainability risks and opportunities (climate or otherwise) is the first step to be able to manage these risks and needs to be an ongoing process as over time new risks will emerge and portfolio exposures will change. Risks that have been identified will be assessed and through assessment of risks, we also anticipate new risks will be identified as separation of identification and assessment is not always straightforward and bottom-up analysis can reveal exposure to risks that might not be obvious at first sight.

Breaking down climate-related risks, in addition to broader E, S and G risks, in line with the recommendations of the TCFD, the Trustee Directors identifies two distinct categories of climate-related risk: transition risks, arising from a shift to a low carbon economy, and physical risks, arising from rising temperature and weather events. In addition, data quality has been identified as a risk given the expanding array of metrics and coverage of asset classes.

Once identified, the Trustee Directors' approach is for assessment of the risk to generally take place using one of two methods: scenario analysis, or by mapping the risk to various RI metrics. Scenario analysis lends itself particularly well to assessment over different time horizons. Assessment processes are described in more detail below, including the use of both top-down and bottom-up analysis.

Assessment – Top-Down Scenario Analysis

The Scheme regularly undertakes scenario analysis, as part of its climate change risk management. Scenario analysis is a useful tool to assess the impact on the funding of the Scheme, not only in a traditional financial risk management sense, but also to assess impact of climate-related risks. The scenarios are designed to cover a range of possible climate outcomes including warming of more than 3°C and less than 2°C. The scenario design process maps the expected impact (both in terms of magnitude and timing) of the scenario in question to a number of financial variables to which the Scheme's exposure can be assessed through time.

In addition, the impact on covenant and longevity is assessed in the scenarios to allow a full IRM picture to be built.

Further detail on the scenario analysis conducted can be found within the Scheme's climate disclosure reporting.

Assessment – Bottom-Up Metrics

The bottom-up analysis relies on a mapping of identified climate-related risk to representative metrics (i.e. carbon intensity as an indication of the impact of the price of carbon), allowing measurement of these metrics at holdings level and then aggregation to the mandate and Scheme level as a means of assessing risk.

The Trustee Directors' policy on selection of metrics to use is that they should be:

1. Understandable – aid understanding for the Trustee Directors and provide context in setting targets.
2. Verifiable – capable of supporting effective internal controls for the purposes of data verification and assurance.
3. Actionable – assist the Trustee Directors in reaching a conclusion.

4. Objective – free from bias and value judgement.
5. Trackable – metrics are consistent, providing clear progression against targets.

The climate-related metrics provide a lens to gauge historical, current and forward looking climate-related risks and opportunities. Some of the RI-related metrics that the Trustee Directors currently considers are scopes 1, 2 and 3 absolute greenhouse gas (GHG) emissions, weighted average carbon footprint (i.e WACI – defined as emissions/sales), net zero portfolio alignment and broader ESG scores sourced from various providers.

The Trustee Directors is aware that climate-related data / metrics and methodologies used for climate scenario analysis are expanding rapidly. Whilst not all holdings currently have data available, the Trustee Directors expects the LCP Executive to work with the Master Manager to expand coverage as data and methodologies for the more non-standard asset classes improve.

Broader ESG factor metrics are also used in the bottom-up metric assessment.

(b) Management of Sustainability Risks and Opportunities

Once identification and assessment of sustainability risks and opportunities has been achieved, those risks need to be managed. The Trustee Directors' policy is to manage sustainability risk through:

- (i) Strategic initiatives
- (ii) Exposure management through investment strategy and mandate design
- (iii) Manager monitoring, engagement and assessment

(i) Strategic initiatives

As a method of addressing climate change and reducing the risks associated with it, the Trustee Directors has committed to achieving a portfolio with net zero greenhouse gas emissions by no later than 2050 in line with the Paris Agreement on climate change. The Scheme has committed to the Paris Aligned Investment Initiative (PAII) to collaborate with other asset owners in pursuing this objective.

In addition to the ongoing work the external investment managers do in this area without Trustee Directors initiation, the Trustee Directors intends to deliver the objective through a number of levers including investment strategy, mandate design, active ownership, collaboration and disclosure.

Within the context of reaching the net zero objective, it is important to note that the Scheme is constrained to the extent they can incorporate climate awareness in asset allocation due to their stage of maturity and the large proportion of gilts held. The Scheme's achievement of the required temperature alignment is therefore largely dependent on the UK Government achieving its own climate-related objective of becoming net zero by 2050.

(ii) Exposure management through investment strategy and mandate design

Exposure management is used both to deliver the long-term net zero objective over time and to manage sustainability risks across multiple timeframes and can be done at both the investment strategy level and at the mandate level.

As previously noted, the Scheme is mature with de-risked investment strategy with large allocations to matching assets (gilts and hold to maturity investment grade credit) and limited allocation to return-seeking assets. As such, focus for both delivery of the long-term net zero objective and for near-term risk management is on the mandate level.

Within the context of exposure management, the Trustee Directors' policy is to fully divest from thermal coal companies, where thermal coal companies are defined as: (i) any company with revenues of 20% or more coming from thermal coal (generation or mining) or any company where 20% or more of their share of power production comes from thermal coal.

With regards to risk management, bottom-up metric assessment is currently used on a quarterly basis to assess, in particular, transition risk. The output of this analysis is used to challenge the external investment managers' risk management process e.g. why any holdings flagged as having high transition or physical risk are held. The exposure aggregated to mandate level can be used to determine if aggregate risk exposures are too high or if better alignment of mandate to strategic objectives is required possibly warranting a change in mandate guidelines, limits and / or targets.

(iii) Manager monitoring, engagement and assessment

The Trustee Directors' policy is for its investment managers to consider ESG-related implications as part of their investment processes and to engage with companies on the Trustee Directors' behalf to progress the RI and climate change agenda, ultimately contributing to the ambitions of the Paris Agreement.

RI and ESG considerations are therefore included in any manager selection exercise as part of the Trustee Directors' due diligence processes. The objective is to assess the extent to which ESG risks are integrated into the manager's philosophy and process. Even though expectations will vary according to asset class and investment style, ESG is an integral component of manager assessment. RI and ESG are integrated into external manager's Investment Management Agreements (IMA) or similar legal documentation where appropriate ESG objectives, ESG-related exclusions/restrictions, engagement plans and required ESG reporting are specified within such documentation.

The Trustee Directors' policy, which the Master Manager adheres to, is to evaluate the Scheme's investment managers in accordance based on the following criteria:

- Approach to ESG integration including:
 - **ESG commitment:** ESG resources should be robust and aligned with the investment process. Individuals responsible for ESG should have relevant experience and be skilled. There should be a variety of high-quality data sources and tools available to investment decision makers.
 - **ESG considerations:** There should be a strong awareness of the risk and return impact of ESG. Insights should be derived from primary research and be differentiated.
 - **ESG implementation:** ESG insights should be effectively and consistently translated into portfolio positioning. The manager should be able to clearly demonstrate how portfolio positioning reflects the management of relevant ESG risk and return drivers.
 - **Active ownership:** The Master Manager's policy is for the transparency, quality and duration of engagement with investee companies on ESG issues to be consistently superior to peers. Success measures should be clearly stated and appropriate. Where applicable, effort should be made to make informed use of proxies.
- Quality of ongoing risk management, reporting and responses to any challenges raised.

(c) Active Ownership, Collaboration and Disclosure

Active Ownership

The Trustee Directors views stewardship and engagement as essential pillars to the Scheme's approach to managing sustainability risks. Any items identified as part of the top-down and bottom-up assessment will inform the Scheme's active ownership approach. Engagement can include direct engagement with companies by managers or engagements via collaborative groups, such as the PAII. Proxy voting, where applicable, is also an important mechanism to influence company behaviour.

To guide the external investment managers' engagement, the Trustee Directors defines ESG themes on a regular basis (fundamental review every 3 years, annual appropriateness review) and engagements within these themes are reported on in the annual implementation statement.

The Trustee Directors believes that active ownership, in either equity or debt instruments, is the most appropriate channel to promote positive ESG practices. As all of the Scheme's assets are managed externally, the Trustee Directors delegates voting to these external investment managers and expects each to vote on their portfolio holdings in line with their internal voting policies and relevant recognised standards, such as the UK Stewardship Code. Any material exceptions are reported back to the LCP Executive.

Details on the Trustee Directors' key engagement priorities can be found in its statement of investment principles (SIP).

Collaboration & Policy Advocacy

In addition to the above, the Trustee Directors further believes that investor collaboration can help enable the achievement of its ambitions and aims to collaborate on initiatives that support the achievement of the Paris Agreement. The Trustee Directors supports industry-wide initiatives and will leverage on organisations such as the Institutional Investor Group on Climate Change (IIGCC), of which the Trustee Directors is a member, to enhance its RI practices.

Disclosure

Transparency and disclosure are key pillars of the Taskforce for Climate-related Financial Disclosures (TCFD), so the Trustee Directors, through its active ownership program, will encourage companies held by the Scheme to disclose in line with the TCFD requirements. The Trustee Directors also publishes an annual climate disclosure report, where it discloses its own approach to managing climate risks and opportunities. It also publishes an annual Implementation Statement, where it discloses the stewardship activities that have been undertaken on its behalf over each Scheme year.