WALTER SCOTT

BNY MELLON | INVESTMENT MANAGEMENT

CLIMATE CHANGE UPDATE

2022

CLIMATE CHANGE

We are due to publish our first entity level TCFD-aligned report in mid-2023. This document provides an overview of our approach to climate change and a summary of key activity in 2022.

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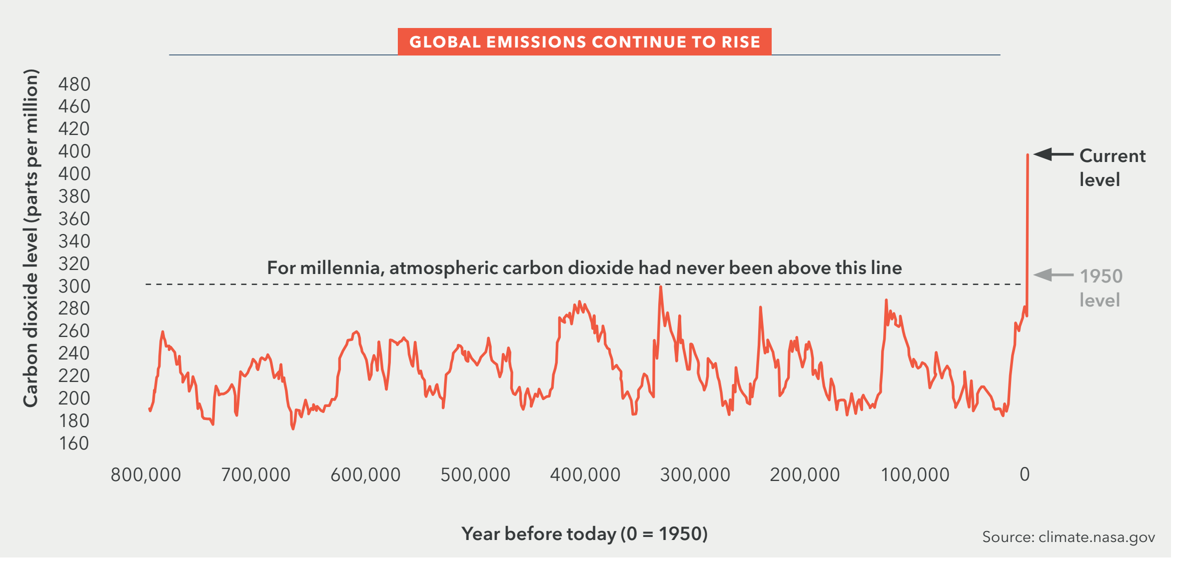
BACKGROUND

The Intergovernmental Panel on Climate Change (IPCC) has concluded that the climate challenge confronting humanity is increasingly stark, and that the world is now close to crossing a threshold where it will not be possible to achieve the 'stretch' goal of the 2015 Paris Agreement, namely limiting global warming to 1.5°C this century. Despite well-intentioned emissions commitments from governments and private sector organisations alike, global emissions are rising again after a very brief pandemic induced hiatus. Consequently, atmospheric carbon dioxide levels continue to increase, as the chart below from NASA shows.

What are the implications of this? The IPCC guidance is that we can expect to see an increasing incidence of the extreme weather events that have been experienced in many regions of the world over the last few years. A number of temperature records were broken in 2022, with the year proving to be the hottest on record in the UK and many other countries around the world. The state capital of wildfire-prone California, for example, recorded an all-time high temperature of 46.7°C (116°F) in September.

In addition to heat events, there has been a marked increase in other weather-related challenges, which is why it is important for investors to understand the full range of risks arising from climate change in addition to rising temperatures. Large parts of Pakistan were submerged in water in early 2022, and insurance companies have declared recent floods in Auckland, New Zealand as the worst climate-related event in the country's



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history. Disruption to polar weather patterns is resulting in more volatile winters in many regions – generally milder temperatures but with the risk of more frequent extreme cold events.

The second implication of persistently rising emissions and real-world physical impacts is that we can now reasonably expect to see more concerted intervention from governments, international agencies and consumers in many parts of the world in the years ahead. Most OECD governments are signed up to the concept of 'net zero', with the fractious international negotiations now focused on how fast we need to go and who pays for a just transition.

UNDERSTANDING TRANSITION RISK

Whether ultimately successful or not, transition efforts are already creating a range of different risks and opportunities for businesses. To give a very tangible example of such risks, take the automobile sector and the increasing number of countries that have set a date for the phaseout of the internal combustion engine. This regulatory intervention also creates as much opportunity as it does risk, giving the electric vehicle sector a collective 'supercharge'. Understanding our holdings' response to such transition risks and opportunities is a fundamental part of our ability to generate superior long-term investment performance.

There continues to be a spectrum of opinion on the science, causality and impact of climate change, and the importance (or otherwise) of taking concerted action to reduce emissions. However, transition risks arising from regulation and changing customer expectations are tangible, material and imminent. It is for this reason that we continue to believe that it is of material financial importance for all of our holdings to have the ability to successfully operate and grow within a Paris-aligned global economy.

The most significant transition risks clearly fall on the most carbon intensive companies in the economy. Climate Action 100+, the investor-led collaborative engagement network (of which we are a member) estimates that just 166 companies account for approximately 80 percent of corporate industrial greenhouse gas emissions globally. The purpose of the CA100+ initiative is to focus investor engagement efforts on these systemically important companies.

However, it is important to note that transition risks and opportunities are not just material to the largest emitters – every sector of the economy will be reshaped by the transition to a lower carbon economy. All companies are increasingly expected to understand their full 'value chain' carbon emissions and related environmental impacts, and to have a plan to significantly reduce these emissions within the next decade.

It is also important to note that not all physical and transition risks arising from climate change will be intuitively predictable, and certainly not without company specific nuance. A virtual reality software company with principal offices in a high-risk weather event area may be more susceptible to climate risk than a traditional carbon-intensive manufacturing business in a more stable region. With respect to regulatory transition risks at a company level, a high carbon-intensity business providing an essential but 'hard to abate' service may be less exposed to transition risks than the manufacturer of a less carbon-intensive but ultimately more discretionary consumer product. Governments are highly unlikely to phase out essential services where there is no credible alternative. Carbon emissions alone do not provide the full picture regarding the net 'social utility' of different kinds of businesses across the economy, and the corresponding transition risks relating to new regulations or shifting consumer sentiment.

Furthermore, there will be company specific 'second tier' transition risks that create commercial issues and opportunities for other potential holdings. To stay with the automotive sector example, a highly efficient, renewable energy powered company manufacturing specialist components for internal combustion engine vehicles may have relatively low carbon emissions but high transition risks. For these reasons, 'bottom up' fundamental analysis of investee companies is critical.

Therefore, our Research team undertake qualitative company level research on climate risks and opportunities as an integrated part of our investment research process, including:

- Ensuring that analysis of climate risk and opportunity is a core component of our Integrity, Sustainability and Governance research framework.
- Collection and monitoring of data on our holdings' existing carbon disclosure and climate-related commitments (tracking alignment with net zero, Science Based Target initiatives etc), and reporting on this to the Investment Management Committee on a periodic basis.
- Engagement with relevant holdings to understand their position on climate

and encourage management to be proactive with respect to the transition risks outlined above, adding companies to our tracked 'engagements for change' list where required.

- We are also currently undertaking further portfolio and holding transition risk analysis to enhance our understanding of climate risks and opportunities.
- In addition to the above work on climate change, other material environmental considerations are included in our investment analysis.

While our research is proprietary, we augment our understanding of climate risks with information and analysis from external sources, including third-party research and data providers, academics, and subject-matter experts.

Governance of climate risk

The Board of Walter Scott has delegated responsibility for our climate change strategy to the Managing Director in her role as chair of the Executive Management Committee. The climate change strategy is subject to periodic review and challenge by the Board of Directors.

Update on Portfolios

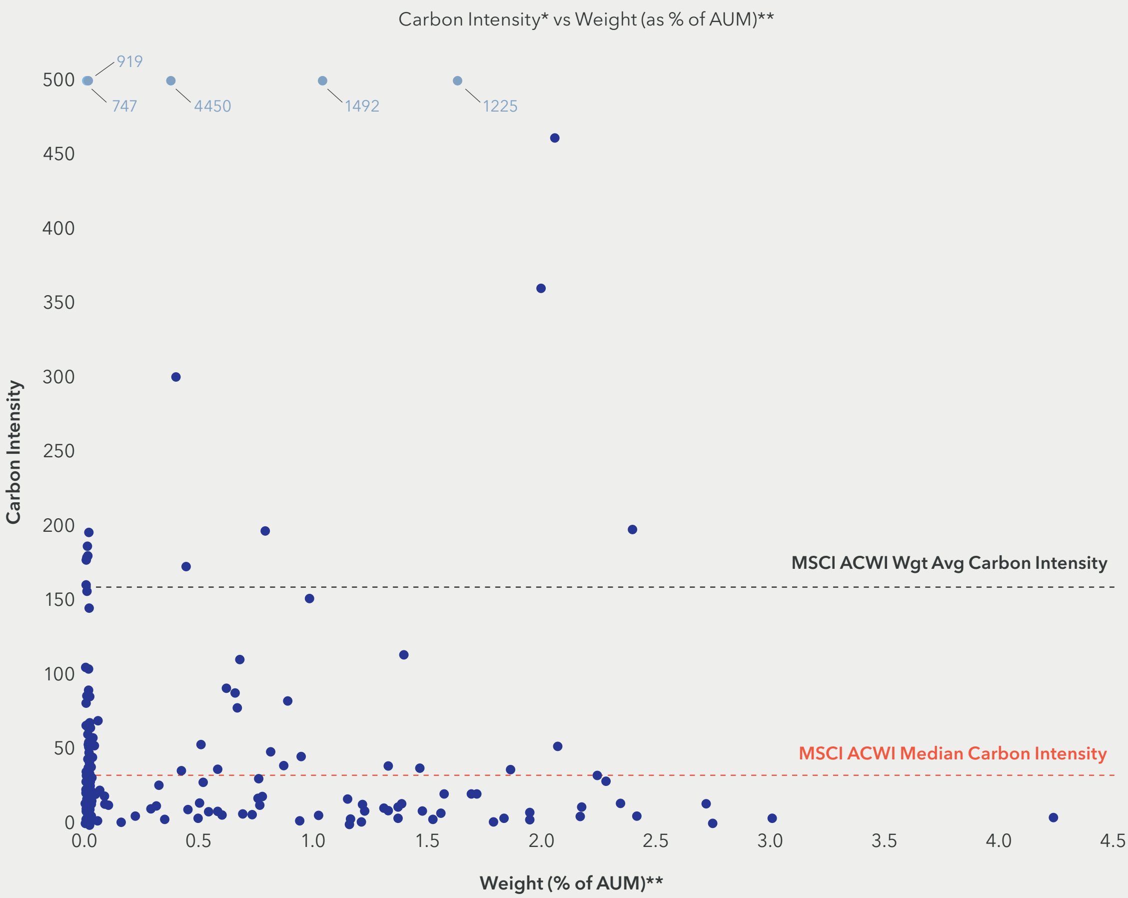
As noted above, a relatively small number of companies represent a large share of global corporate carbon emissions. The same is true of our portfolios. Details are provided in Table 1 on Walter Scott's top 20 holdings by weighted average carbon intensity.

TABLE 1 – TOP 20 WALTER SCOTT HOLDINGS BY CARBON INTENSITY RELATIVE TO ALL HOLDINGS

Company Name	Relationship Start Date	CDP climate responder	TCFD aligned	Net Zero or SBT commitment	Carbon Intensity (Scope 1&2 CO_2e / $m Rev)
CLP Holdings	1998	Yes	Yes	Yes	4450
Air Liquide	2012	Yes	Yes	Yes	1492
Linde	2010	Yes	Yes	Yes	1225
Guangdong Investment	2021	No	Yes	No	919
Sunny Friend	2019	No	No	No	747
Canadian National Rail	2020	Yes	Yes	Yes	462
Shin-Etsu	1995	Yes	Yes	No	360
Essential Utilities	2015	Yes	Yes	No	312
National Grid	2006	Yes	Yes	Yes	311
ODFL	2021	Yes	No	No	301
TSMC	2001	Yes	Yes	No	198
TotalEnergies	2001	Yes	Yes	Yes	197
Hansol Chemical	2021	No	No	No	187
SM Investments	2019	Yes	Yes	No	183
Brembo	2018	Yes	No	Yes	179
Nissan Chemical	2022	Yes	Yes	No	178
Hang Lung Properties	2013	Yes	Yes	Yes	173
United Urban	2008	No	Yes	No	161
CapitaLand India Trust	2019	No	Yes	Yes	157
AirTAC	2021	Yes	No	No	145

Source of Carbon Intensity data: MSCI. Based on all Walter Scott holdings as at 31 December 2022, emissions data run on 24 March 2023.

CHART 1 – WALTER SCOTT – COMPANIES



* Tonnes of Scope 1 and 2 CO_2 Equivalent Emissions per $m Revenue from last fiscal year available. Companies with emissions higher than 500t/$m are shown at the 500 mark and are highlighted.
** Approximate dollar invested proportionate weights of companies across all discretionary portfolios within Walter Scott.
NB. Holdings as at 31 December 2022. Emissions data run on 24 March 2023, sourced from MSCI.

Looking across our portfolios, there is limited exposure to more carbon-intensive industries, such as utilities and fossil fuels, where the transition risks outlined previously are more pronounced (see chart 1).

> *“The most significant transition risks clearly fall on the most carbon intensive companies in the economy.”*

Our portfolios typically have greater exposure to industries, such as healthcare and information technology, where transition risks, while still applicable, are likely to be less pronounced. A number of our holdings are also in a position to support the transition through the provision of their core products and services.

We expect all our investee companies to disclose emissions data to the CDP and report according to TCFD recommendations, in order to provide financially relevant climate information and data, although we recognise that in many markets there is still considerable work to be done to meet this standard.

Climate change and long-term performance

It is important to emphasise that our objective with the above monitoring and engagement work is about creating value for our clients over the long term.

Unaddressed climate change is a systemic risk to long-term performance for all companies, hence our analysis of all holdings. We want to ensure that our holdings could successfully operate and grow within a Paris-aligned global economy. We also focus on understanding whether holdings are exposed to additional transition or physical climate risks, and factor that into our analysis.

There can be a perception within ethical investment and beyond that it is somehow misguided or unethical to hold higher carbon-intensity companies. To challenge this view, we would reiterate that many of these companies provide the energy and infrastructure foundations of our current global economic system. They typically provide products and services that are highly valued by society, such as reliable electricity or consumer staples, and are therefore difficult to phase out entirely. These companies are also often key suppliers to the lower carbon-intensity healthcare and information technology companies that tend to dominate sustainable investment funds. Carbon intensity alone is just one factor relevant to policy makers seeking to determine the 'net social utility' of different sectors. Much more important for us as long-term investors is the overall 'direction of travel' – have management set appropriate decarbonisation targets, and would allocating capital to this transition benefit shareholders? We will be publishing our first comprehensive TCFD-aligned firmwide report in the summer of 2023, which will provide further information and analysis on the important topics above.

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