Pension Protection Fund

Responsible Investment Report 2020/21

About the PPF

Protecting people's futures

Our purpose is to protect the future of millions of people throughout the UK who belong to Defined Benefit (DB) pension schemes. When these schemes fail, we're ready to help.

We do this by paying our members, by charging a levy and by investing sustainably.

Our work has a real impact on people's lives, so whatever we do, we strive to do it well, with integrity and with their future in mind.

When an employer becomes insolvent and its pension scheme cannot afford to pay its promised pensions, we compensate scheme members for the pensions they have lost. We take over responsibility for payments once we have assessed that a scheme cannot afford to buy benefits from an insurance company which are equal to, or more than, the PPF would pay.

Currently around 288,000 people are members of the PPF. Before the PPF, these people could have faced significant financial uncertainty and hardship. We protect almost 10 million members of more than 5,000 DB pension schemes.

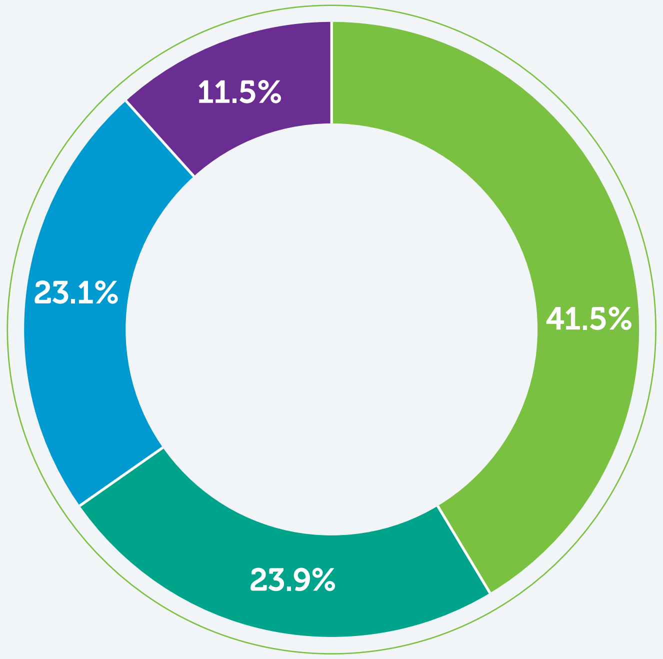
How we are funded

We raise the money we need to pay PPF benefits and the cost of running the PPF in four ways:

Split of funding sources

- Assets from pension schemes transferred to us
- The return we make on our investments
- The levy we charge on eligible pension schemes
- Recovered assets we secure from insolvent employers

We have £38 billion in our investment portfolio (31 March 2021) which is continually growing, and is currently managed both internally and externally.



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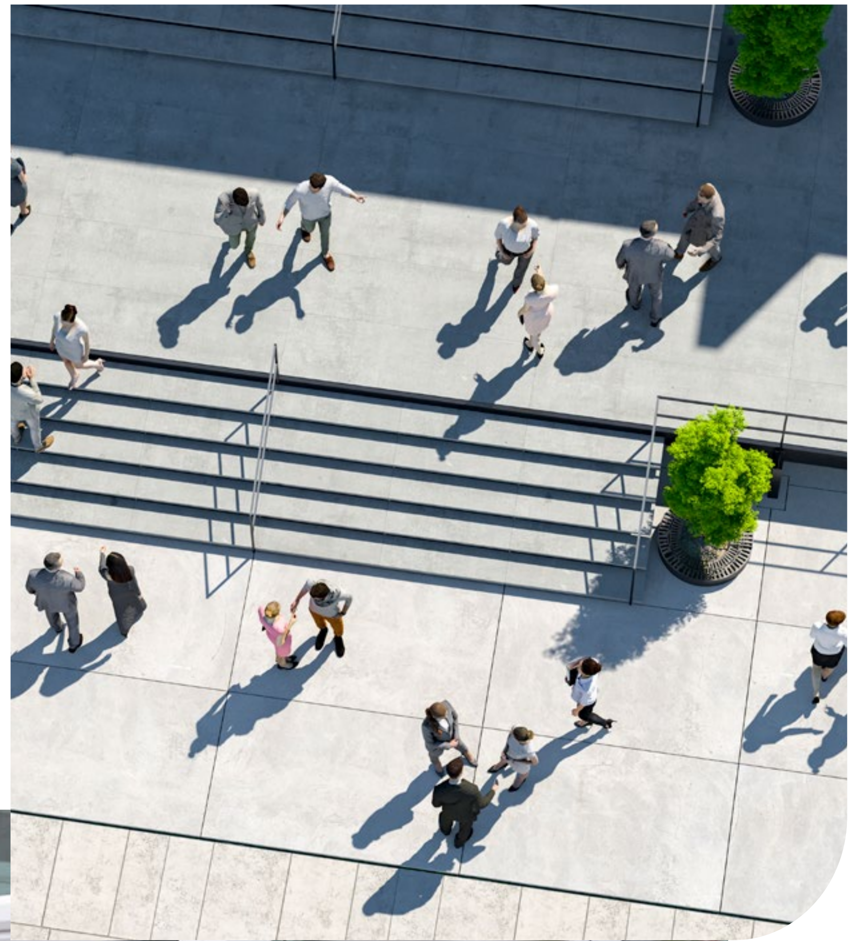


Key achievements

We were delighted to be awarded A+ scores in eight modules and A scores in the remaining two modules, for the 2020 Principles for Responsible Investment (PRI) Reporting Assessment.

Purpose and governance

- Created a new stewardship policy under the oversight of the Investment Committee and Board
- Updated our SIP, adding ESG risks to the risk register and further detail on our stewardship principles and monitoring external managers
- Retendered for stewardship services, expanding the scope into more asset classes
- Enhanced our regular reports to our governing committees on ESG activities
- Mandated compulsory inclusion of our ESG integration, stewardship and reporting clauses within our legal agreements with managers

Delivering clearer governance and oversight on behalf of our members

For Purpose and governance section **see page 8**.

ESG integration

- 99 per cent of external assets now managed by fund managers that have a firm-wide ESG policy
- 92 per cent of our external assets now managed by PRI signatories, following extensive encouragement with our managers
- Achieved 100 per cent of our Liquids managers reporting against our mandated ESG and carbon reporting templates
- Integrated diversity metrics in our annual manager monitoring questionnaires
- Finalised a new climate-aware equity benchmark to meet our investment strategy while reducing our exposure to climate risks by at least 50 per cent[1]

Delivering lowered ESG risk across the portfolio on behalf of our members

For ESG integration section **see page 12**.

Engagement

- Achieved tangible engagement milestones, prioritised by our most exposed holdings or our key themes of climate change, human rights and diversity and inclusion
- Collaborated with key stakeholders in the market, such as the Institutional Investors Group on Climate Change (IIGCC), Climate Action 100+ and the PRI
- Notable progress made by our managers in emerging markets, sovereign debt and infrastructure asset classes
- Contributed to dialogue with the UK Debt Management Office (DMO), led by the Impact Investing Institute (III) on the UK Green+ Gilt proposal
- Collaborated with PRI signatories on encouraging FTSE companies to comply with disclosure on the UK Modern Slavery Act

Pushing for clear progress from our issuers on behalf of our members

For Engagement section **see page 16**.

Voting

- Committed to voting every share, where feasible, and worked in close collaboration with our stewardship provider to improve processes
- Upheld a voting watchlist of key companies for which we pay additional attention to voting recommendations
- Expanded reporting from all managers with voting rights on their voting activities, beyond just our equities managers
- Established split-voting mechanisms for two pooled fund mandates, allowing us to override inconsistent voting instructions
- Voted on 34 shareholder resolutions related to climate issues during the year

Making sure our voice is heard on behalf of our members

For Voting section **see page 25**.

1 When compared to FTSE All-World Index carbon emissions and reserves intensity metric

Messages from our Chair, CEO and CIO

Kate Jones, Chair of the Board

> We've come a long way since becoming a PRI signatory in 2007, but the challenges of climate risks are more real than ever. It's vital to keep a prudent steer on our investments for the benefit of members and stakeholders, and to use our influence for the greater good.

Kate Jones
Chair of the Board

The last year proves that environmental, social and governance (ESG) related risks, which can manifest well into the future, can also be material to investments today. Sound social practices for companies and workforce welfare proved to be an essential pillar for any company in the times of the COVID-19 crisis.

Transitioning away from fossil fuels is also a critical step for the future of the world. The realities of physical climate risks are becoming ever more apparent as we see the impacts of climate change on a global scale – such as the devastation caused by recent wildfires, floods and hurricanes. The rise in the importance of limiting warming to 1.5°C – and the role investors should play in this transition – are clear.

Since becoming a PRI signatory in 2007, we have come a long way, yet now more than ever, it is vital to keep a prudent steer on our investments for our members and stakeholders. Responsible investment (RI) is a specific area of focus highlighted in our 2019–22 Strategic Plan. As we move into the final period of this plan, we look to accelerate our work in this area.

We are committed to setting an example of best practice implementation. In the past year, we welcomed and contributed to the Department for Work and Pensions (DWP) consultations on reporting on climate risks and considering social factors. We are actively considering how the investment industry can best support UK legislation requiring the Government to achieve net zero emissions by 2050.

We strive to use our influence with the asset management community and work tirelessly with our fund managers to ensure we are well positioned for the transition.

One example of this is the introduction of new ESG and climate reporting that we require from our managers.

Gathering evidence of the stewardship activities that our managers have undertaken on our behalf has been challenging. I'm particularly pleased with how we developed our new ESG reporting templates to address this.

We recognise that stewardship is an important lever to bring long-lasting change. This year we published our stewardship policy, which sets out our priorities and expectations in the area. We also welcome the development of more standardised voting reporting and guidelines (including around conflicts of interest) from the Pensions and Lifetime Savings Association (PLSA).

Diversity and inclusion is another major area of importance to our organisation that is also increasingly gaining focus in the investment industry as a whole. We work actively within our own business to set new standards, and monitor our managers to ensure that the organisations managing our assets and the companies we invest in reflect the societies in which they operate.

The Board, and our Investment Committee, actively oversee how we are managing RI considerations. Over the year, we continued to be engaged with the ESG developments and informed of our progress on activities taking place throughout the investment portfolio. This is our second RI report and we are delighted to share our most recent activities and achievements in stewardship practices and other RI developments during the year.

> The role of institutional asset owners like the PPF is crucial as the world adapts to the climate crisis and a post-pandemic world. We are committed to rising to this challenge and pleased to share the positive action we've taken this year.
>
> We're actively setting new standards in our work with our external managers and engaging with important initiatives around climate change, diversity and fair working conditions.
>
> By acting as active, responsible stewards, we can fulfil our mission of protecting people's futures while having a real impact on the world around us.

Oliver Morley
Chief Executive Officer

Oliver Morley, Chief Executive Officer

Chief Investment Officer’s foreword

Barry Kenneth, Chief Investment Officer

"We want to keep raising the bar, not only for ourselves but also for those we choose to work with."

Barry Kenneth
Chief Investment Officer

Our investment strategy is focused on delivering sustainable long-term returns, and RI is a core component of this. Through the three key priorities of our RI strategy – climate change, stewardship and reporting – we seek to reflect the importance of these issues in the broader context of the investment world.

This year we are publishing our first detailed Task Force on Climate-related Financial Disclosures (TCFD) report alongside this RI report. We’ll also continue to include a summary of our climate disclosures in our Annual Report and Accounts.

During the year, we chose to amend our Statement of Investment Principles (SIP) to address the evolving expectations of asset owners around RI and stewardship. Our newly approved stewardship policy builds on these principles and further details our commitment to engaging with our external managers and working collaboratively with industry partners.

We also progressed the implementation of our climate strategy, by developing a new climate-aware version of our equity benchmark. We finalised this with our index provider, FTSE Russell, in March 2021. Our expectation is that it will considerably reduce the climate risk profile of our equity portfolio, while still delivering the fundamental characteristics we seek.

We greatly value the power of collective engagement to address systemic risks. One example is our continued membership and involvement in the work of the IIGCC. This includes supporting the ongoing Climate Action 100+ initiative as well as participating in working groups developing the Paris Aligned Investment Initiative (PAII) and investor expectations on physical risks.

Transparency is key to enabling us to perform our oversight duties, so we now require our external managers to complete comprehensive reporting templates to improve our understanding of ESG and climate risks in our portfolios. This has not been a simple task. It required many months of engaging with and educating our managers to design relevant templates for their strategy.

In the past year, we’ve also worked hard with our service providers to update our portfolio management systems with the ever-expanding ESG and carbon data and analytics available. These combined efforts have improved our ability to monitor, report on and ultimately manage these risks and opportunities.

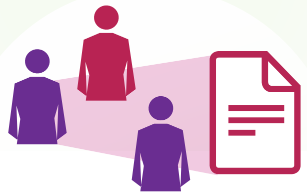
We’ll continue to mandate more fund-specific ESG reporting from our managers. It is still challenging to gather this information, especially in less traditional strategies, but we actively support our managers’ development. We hope this will also benefit other asset owner clients. We have seen great progress from our Liquids managers in the past year and are now rolling out the templates to cover our Alternatives portfolios in the coming year, starting with Real Estate. The quickly evolving regulatory landscape in relation to ESG matters continues to drive reporting practices forward and we remain committed to evolving our strategy and risk processes to stay ahead of the market dynamics.

Barry Kenneth
Chief Investment Officer

Progress at a glance 2020/21

Stewardship

Published stewardship policy to align with global standards



Updated Statement of Investment Principles (SIP) to further cover ESG issues

Expanded stewardship services to cover our in-house managed assets and oversight of pooled fund assets

Climate change

Developed our assessments and scenario analysis of climate-related risks and opportunities

Introduced new climate-aware equity benchmark

Full portfolio climate alignment analysis under way

Reporting

Number of managers as PRI signatories grown significantly by 25 per cent

Awarded PRI assessment scores of A+ in 8 modules and A in remaining 2 modules

Setting best practice reporting standards on ESG and climate risks from our managers

Next steps

Results and action points from climate alignment assessment

Further development of stewardship practices and voting guidelines

Focus on net zero scenarios and engagement with issuers and external managers

Purpose and governance

What we stand for

Our purpose is to make sure we can continue to pay current and future members their full benefits for life. We believe this goes hand-in-hand with responsible investing for two main reasons:

- Good corporate governance and management of ESG risks is an indicator of how well an organisation manages risk as a whole
- Exercising our ownership rights is not only a key part of being a responsible owner but also helps safeguard sustainable returns in the long term

Read our RI strategy to learn more about our beliefs, aims and objectives.

Our values

Our ICARE values define how we conduct business across the organisation. They are integrated into every employee's performance development review and objectives. Whenever we make investment decisions, we also apply these values. The table alongside shows how we translate these five values into performing our duty as a responsible investor.

Our values

Integrity: Doing the right thing	We consider all material ESG risks when we assess investment opportunities
Collaboration: Working as one	We work collaboratively with peer organisations and partners
Accountability: Owning our actions and their outcomes	We enact our shareholder rights and push our fund managers to deliver best practice on ESG risk management and transparency
Respect: Valuing every voice	We encourage our fund managers and other stakeholders to deepen Diversity and Inclusion practices
Excellence: Being our best	We're never complacent – we strive to grow our RI practices and set new standards

Our approach to RI and stewardship

Our RI framework puts our core beliefs into practice:

RI Framework

- Governance & accountability
- Strategic direction & policy
- Risk management
- Metrics & transparency

Priorities

- Climate Change
- Stewardship
  - Engaging with fund managers
  - Engaging with issuers
  - Voting of shares
  - Collaborative engagement & public policy
- Reporting

Our purpose is to ensure we continue to pay members their full benefits and this goes hand-in-hand with responsible investing.

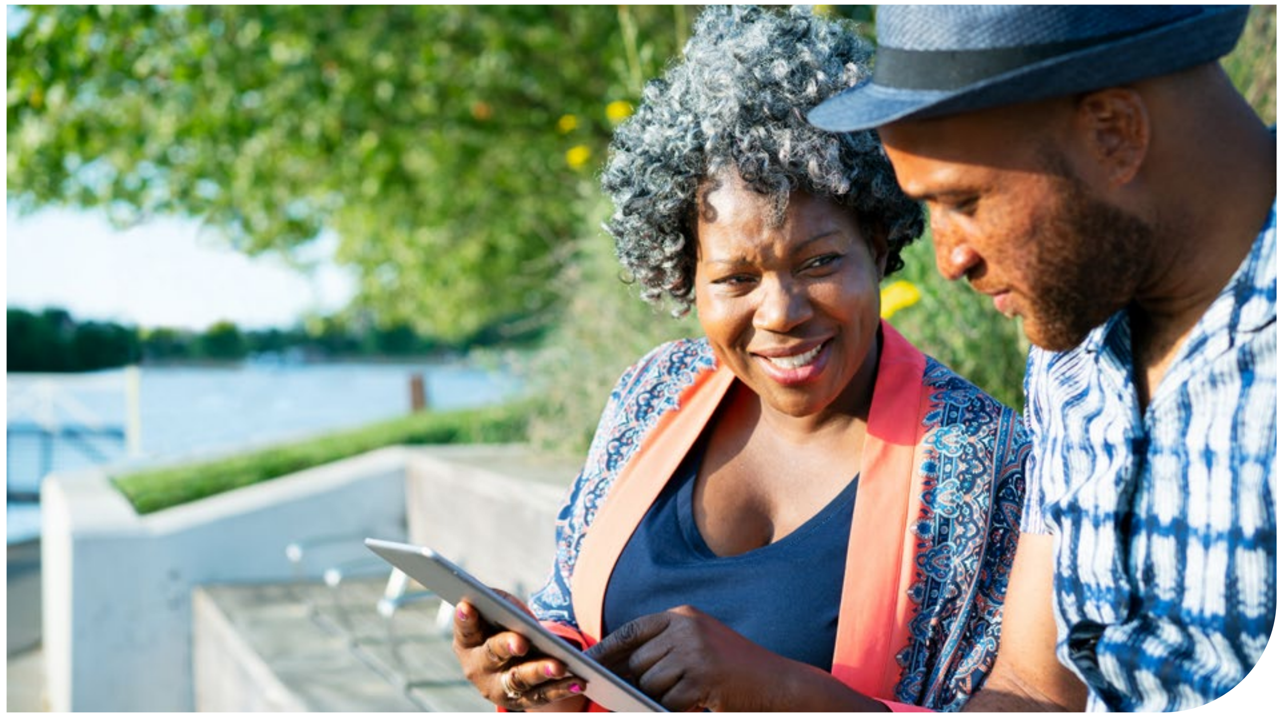
Purpose and governance continued

Governance overview and update

RI governance and stewardship of our investments:

PPF Board	Highest governing body with oversight of RI and stewardship activities (including climate-related).
Investment Committee	Responsibility for developing and maintaining the Fund's RI and stewardship principles and policies (including climate-related).
Investment Team	Led by the CIO. Responsibility for ensuring adherence to the RI framework, stewardship principles and associated policies across all asset classes, both internally and externally managed.
ESG Team	The ESG Team, as part of the Investment Team, provides support and expertise, oversees appropriate implementation of the RI framework, engages with portfolio managers and monitors investments for ESG risks and opportunities. Engages with external asset managers and stewardship service providers.
Asset managers and stewardship service provider (EOS at Federated Hermes)	Follows the PPF's RI framework and stewardship policy, undertakes ESG integration and engagement, then reports transparently and accordingly.

Our Investment Committee reviewed our SIP, climate change policy and exclusion policy during the year.



Updating key policies

Taking action

The Board has committed that the Investment Committee will review our SIP and RI policies annually, to ensure they stay relevant and ambitious. During the year, the Investment Committee reviewed our SIP, our climate change policy and our exclusion policy. The Committee also approved our new stewardship policy. All policies are available on our website.

New SIP

As part of this year's annual review and our drive to deliver best practice, we chose to update our SIP in line with the DWP's amended occupational pension schemes regulations.

Within the new SIP we provided further detail on our principles around stewardship and monitoring external managers. We also included ESG and climate-related risks as a specific part of our risk register, which is regularly monitored by the Investment Committee.

New stewardship policy

We developed a new stewardship policy during the year and it was approved by the Investment Committee and Board in March 2021.

This policy outlines our approach to stewardship – including how we engage with our managers and underlying issuers on RI issues – as part of managing the Fund, in line with the SIP.

It has been developed to allow us to address the requirements of the Financial Reporting Council (FRC) UK Stewardship Code 2020 and the European Union Shareholder Rights Directive II (SRD II).

Review of climate change policy

In 2019, we finalised a specific climate change policy for our investments, which outlines our approach to climate-related risks and opportunities. The Investment Committee reviewed this policy in 2020/21 as part of its annual review cycle.

Review of exclusion policy

Our exclusion policy applies to all funds and relevant asset classes. It covers controversial weapons, recreational cannabis and sovereign issuers with a UN imposed arms embargo.

The list is updated on a quarterly basis, as determined by an independent external data provider.

Purpose and governance continued

How we manage conflicts of interest

We have taken all reasonable steps to prevent potential or actual conflicts of interest that could impact our members or stakeholders. In this section of the report, we've detailed the wide range of controls we've implemented to put the best interests of members and our business first.

PPF Conflicts of Interest and Code of Conduct policies

Our formal Conflicts of Interest and Code of Conduct policies set out principles and procedures for identifying, assessing and managing conflicts. These policies are reviewed at least annually by the Compliance and Ethics (C&E) team and approved by the Executive Committee (ExCo).

- **Register of conflicts and outside business interests**
  The C&E team maintains a register of employees' conflicts and outside business interests, which they review at least once a year. We also share Board members' outside interests on our website.
- **Ongoing training**
  All employees receive training on conflicts of interest when they start and as part of ongoing development. They also sign to say they've read, understood and followed these policies every year.
- **Gifts and Hospitality policy**
  Our Gifts and Hospitality policy requires all employees to request sign-off from their line manager and the C&E team before accepting gifts or hospitality over the value of £25.

The C&E team maintains a register of all gifts and hospitality that have been accepted and declined, with regular reviews to make sure these are within acceptable levels.

We also publish Board member expenses quarterly on our site.

- **Personal accounts**
  Our Personal Account Dealing policy requires all transactions to be approved by line managers and the C&E team. If there's a conflict between the employee, member or PPF interests, we may create a list of restricted investments that our employees can't invest in.

Our Conflicts of Interest and Code of Conduct policies are reviewed annually.

- **Senior manager fitness and proprietary checks**
  We have implemented a version of the FCA's Senior Managers and Certification Regime. As part of this regime, the C&E team meet annually with senior managers to discuss their roles and responsibilities. This includes assessing any potential conflicts and forms part of the annual assessment of their fitness and proprietary to carry on their role.

  Other checks, as part of this fitness and propriety assessment, include performance review along with credit and background checks on a rolling three-year basis with self-assessments carried out every year.
- **Rigorous procurement processes**
  When procuring new suppliers, we are subject to the Public Contracts Regulations 2015. Our dedicated Commercial Services team makes sure new contracts follow the correct procurement process and are awarded fairly, based on objective criteria.

  The Commercial Services team also maintains an ongoing assurance programme for all our suppliers.

Outsourced external management

Our fund managers are assessed by a dedicated Operational Due Diligence (ODD) team who complete checks, which include reviewing Conflicts of Interest policies and monitoring them on an ongoing basis. We clearly reference our expectations in this area across all agreements and side letters. Where there's potential for any conflicts of interest, we expect our external agents to identify and manage these under Principle 3 of the FRC's UK Stewardship Code 2020, putting the best interests of clients and beneficiaries first.

Taking action:
We have experienced a varying level of disclosure from our fund managers on how they are assessing and managing stewardship-related conflicts of interest. In an effort to ensure continuous improvement, we are looking to address this in the coming year by asking our managers to report more specifically on their stewardship-related conflicts.

Outsourced stewardship provider

Our external stewardship provider, EOS, considers conflicts when undertaking voting and engagement on our behalf, as part of its Stewardship conflicts of interest policy. Under this policy, staff report any potential conflicts to the compliance team to be assessed and, when necessary, the register is updated. The conflicts of interest register is reviewed by senior management on a regular basis.

EOS has the right expertise, policies, research and resources to carry out day-to-day stewardship activities on our behalf. Therefore, if conflicts of interest were to arise (for example, with the sponsoring entity of a scheme we are protecting) we would adopt an arm's length approach and avoid overriding its decisions. However, we review voting proposals ahead of AGMs and reserve the right to amend any votes.

Purpose and governance continued

Oversight and reporting

New internal RI reports

We provide monthly updates on the management of our climate-related and other ESG risks to the CIO and the Head of Investment Strategy. We also highlight portfolio-relevant information or events as they arise in our daily investment meetings.

Taking action:
This year the ESG team developed a new quarterly RI update report for the Investment Committee. The report reviews our RI policies, processes and policy review schedule. It provides updates on stewardship, manager appointments and monitoring, and key quantitative metrics such as ESG scores and carbon intensity by asset class.

Oversight of stewardship services

We have chosen to outsource stewardship activities for our active segregated listed equities, to ensure that our shares are voted cost-efficiently and our portfolio companies are engaged with, where ESG concerns arise.

Taking action:
We regularly review our outsourced stewardship services and retendered for this in October 2020, taking the opportunity to expand our requirements around voting and engagement. We wanted to improve and expand coverage to our in-house managed assets in fixed income and cash, as well as drive greater insight on the engagement services for our pooled assets. Following a due diligence process, we reappointed EOS at Federated Hermes.

EOS provides voting recommendations to us for our segregated equities, in line with its published corporate governance principles. However, we are always in control of the vote and have the ability to exercise our voting rights in segregated holdings in line with our own policy and principles.

EOS carries out engagements and exercises votes in line with the Hermes Responsible Ownership Principles. These have been devised to contribute to better management of companies and the sustainability of investments over the long term. EOS is also a signatory to the Best Practice Principles for Providers of Shareholder Voting Research.

Taking action:
We monitor EOS' activities through regular contact, and more formal quarterly client meetings. We participate in its semi-annual client advisory council meetings and have fed back to the firm extensively on the development of its new client portal over the last year. Our participation in these meetings enables us to influence EOS' approach, the issues of focus and the targets of our engagement, so that the service remains beneficial for our members.

We hosted our first Member Forum in 2020, presenting a unique opportunity to find out exactly what our members think.

ESG oversight of managers

We continuously review all existing and potential managers' policies, as well as their ESG integration processes and reporting to ensure they meet our evolving minimum standards. We also keep a close eye on the portfolios of our managers through our own systems, and consider whether they are in line with our expectations of the mandate agreement. This analysis helps inform our ESG review, as discussed on page 14.

Our ODD function assists with monitoring our managers' ESG risks and stewardship policies. They also review policies in key areas such as ethics, business continuity, disaster recovery and money laundering.

We will not appoint or allocate more capital to managers that fall short of our standards.

For example, when we identified that an infrastructure investment manager didn't have a Gifts and Hospitality policy, we made this a requirement of its appointment.

Keeping our members updated

More broadly, we actively seek our members' and stakeholders' views and feedback by a number of methods, including quantitative surveys, consultations, focus groups, one-to-one interviews and our Member Forum. We know that stakeholders expect us to invest responsibly and we believe we have a duty to set the highest standards of practices.

Taking action:
We're committed to regular reporting and transparency so that our members and stakeholders can be aware of our progress and activities in all areas, including stewardship. We regularly update our website with timely published voting and engagement statistics and responses to consultations. We're publishing our second annual RI report, we provide RI disclosure in our Annual Report and Accounts and we've published a dedicated TCFD report. Our Head of ESG frequently speaks at industry conferences and events.

ESG integration

Our approach to ESG integration

In line with our RI strategy, and detailed in our first RI report, we embed material ESG considerations right across our investments and our work with external managers, from selection through to ongoing monitoring and reporting.

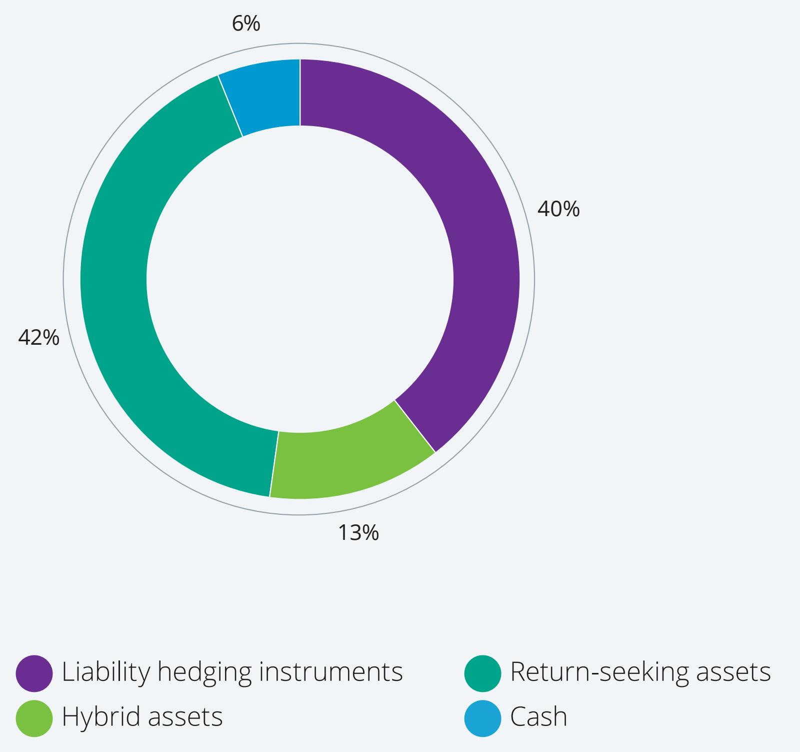
We also engage with our underlying issuers and use our voting powers to advocate for ESG principles.

As outlined in our full stewardship policy, we strive to extend our activities across our entire portfolio.

We amend our approach depending upon the asset class or strategy, how directly we're invested in it and the level of control we've been granted. We insist on a high level of responsible conduct from our underlying issuers, and seek to avoid investing in issuers that contravene international conventions or norms for controversial activities that are ratified into UK law, for example the production of specific controversial weapons.

We implement this through a small exclusion list, which is applied across our Fund to the extent possible. The Fund's targeted strategic asset allocation is as follows:

PPF strategic asset allocation (31 March 2021)



Setting new standards for stewardship

ESG best practice is still developing, so we work extensively with our external managers and incentivise them to develop their processes in line with our RI principles, for example by setting time-bound commitments in legal documents.

Owing to our size, we have the opportunity to encourage improvements in ESG integration around the globe. We see this as an area where we can influence and help set new standards for the industry, particularly in private markets which have less developed stewardship practices.

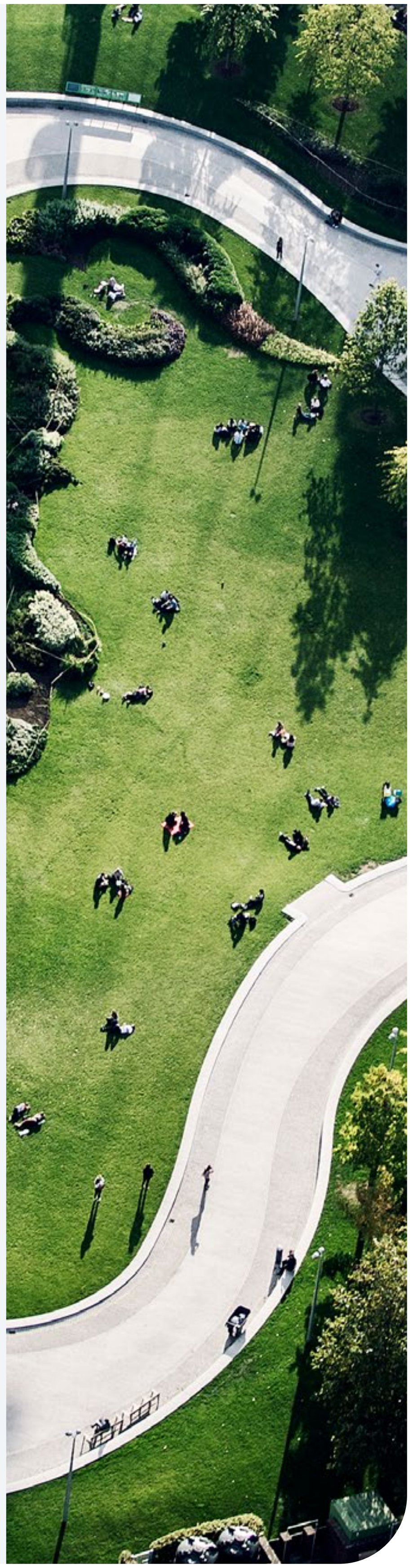
Listed equities historically have most established stewardship practices, but – as shown in our strategic asset allocation chart – they make up a smaller part of our investments. In asset classes where good stewardship isn't fully established yet, we consider the best and most efficient approaches. Our regular review meetings with our fund managers often include education around these methods and emerging developments.

Diversity and inclusion is a topic that we're focusing more on at the organisational level of our fund managers. Over the last two years, we have been including questions relating to this in our tender documents, which form part of the overall ESG assessment.

Summary of our ESG integration approach

The following table summarises our approach to ESG integration and stewardship across each asset class.

	Asset class	Integration and stewardship approach
Direct (Managed in-house)	Liability Driven Investment (LDI)	• We engage with borrowers, primarily during reissuance or refinancing. Less influence in sovereign debt, although we engage on issues like LIBOR, Retail Price Index (RPI) and inaugural UK green gilts issuance
	UK Public Credit and Strategic cash	• We engage with borrowers, more so around reissuance or refinancing • External stewardship provider also covers these portfolios for engagement services
	UK Private credit	• We engage with borrowers, more so around reissuance or refinancing
Indirect (Externally managed)	Listed Equities	• Managers can exert influence on companies through voting and engaging with company management. Approaches will differ depending on whether managers follow active, systematic or passive strategies • We reflect any concerns from our assessments in our voting and engagement approach. We also use intelligence from engagements to inform our assessment • External manager monitoring
	Listed Credit: corporate, sovereign, emerging markets (EM)	• Managers can engage with borrowers, more so around reissuance or refinancing – less influence in sovereign debt
	Absolute Return	• External manager monitoring • Managers can engage, but with limited influence in strategies with shorter holding periods
	Real Estate	• Managers with full control of assets can engage with tenants and local community • Continuous engagement on climate resilience
	Private Equity and Infrastructure	• Managers can have direct engagement with companies or assets in primary funds, or with operating companies in infrastructure, especially if they have Board seats
	Private Credit	• Managers can have ongoing dialogue with borrowers, but limited control over management
	Secondaries and Fund of Funds	• External manager/General Partner monitoring



ESG integration continued

Monitoring our agents

Although underlying stewardship with our issuers is largely carried out by our external fund managers and stewardship provider, we carry out a holistic oversight of our external agents across the Investment team, ESG team and ODD team.

We continually monitor our agents' practices in order to enhance the quality and quantity of their stewardship activities and ensure consistency with our own investment beliefs, policies and guidelines.

Generally speaking, we expect our fund managers to focus on the next link in the investment chain and have greater expectations for our fund managers managing strategies with longer holding periods.

Our RI requirements

We've implemented minimum RI requirements that all our external managers must meet, to ensure we are all aligned. These are specific to each asset class but all managers must agree to:

- Follow an external standard, preferably the PRI
- Regularly report on ESG and climate-related matters
- Apply our exclusion policy
- Share evidence of integrating material ESG factors within their investment analysis, decision-making and stewardship practices on an ongoing basis

By setting down these expectations in legal documents, they form part of the overall investment management agreement (IMA).

Amending our historical agreements

We've spent considerable time over the last two years working with our legal team to amend historical paperwork across all our external mandates, where possible. This has largely been driven by our wish to have better reporting from our managers.

It has been particularly challenging in the alternative asset classes where most vehicles are closed funds and our position of leverage is lower. However, whenever new fundings are coming up with an existing manager, we've encouraged them to amend the old fund documents as well if they wish to be considered.

Taking action:
We report our progress on this to our Investment Committee quarterly and have been able to demonstrate an ongoing reduction in the percentage of assets in this category that do not have updated terms reflecting our expectations.

The ESG review

The ESG review is an essential part of selecting and appointing managers that align with our principles.

RI criteria and ESG considerations as part of our investment process

Phase	Request for proposal/ identification	Selection/ due diligence	Appointment	Post funding
ESG requirement	Evidence of firm-level and strategy-level ESG policy; PRI support; and capabilities or resources for ESG integration	Ensure ESG processes are in place, appropriate industry guidelines are followed and reporting is available	Binding ESG and climate risk clauses inclusion in legal documentation (e.g. IMAs, side letters)	Ongoing monitoring and engagement with external managers; regular fund-level ESG, carbon and stewardship reporting; commitment to continuous improvement

Taking action:
In the past year we have withheld investment – from both new and existing managers – when we haven't seen sufficient progress on ESG integration or they've been unwilling to meet our minimum requirements.

A key consideration within a recent passive equity RFP was that the fund managers had appropriate stewardship processes and capabilities in place and could provide the reporting to us that we need.

Case study

Raising the bar

We've worked hard to engage with our managers and keep their processes up to market standards. In 2020/21, 11 of our managers became signatories to the PRI, five of which are large US-based private markets managers.

As a result, 92 per cent of our external assets are managed by PRI signatories (up from 80 per cent), while 99 per cent of our external assets are with managers that have a firm-wide ESG policy. It's especially good to see progress in private markets as this is an area where we have spent a lot of time engaging with our managers over the last year.

92% of our external assets are managed by PRI signatories

99% of our external assets are with managers that have a firm-wide ESG policy

ESG integration continued

Monitoring our managers

We continuously monitor our managers' progress through regular reports on stewardship activities, ESG-related risks and climate-related information. When we raise issues with specific managers, we report this to the Investment Committee.

Our fund managers are also assessed by the ODD team, who we work with to ensure that ESG considerations are part of the appointment and reviews of fund managers. We screen for reputational risks and are now implementing diversity and inclusion metrics in the annual ODD questionnaire. This will allow us to capture the information we need to help drive diversity in the investment industry.

Implementing diversity and inclusion metrics in the annual ODD questionnaire will allow us to capture the information we need to help drive diversity in the investment industry.

Driving transparency across our portfolio

We expect our external managers to influence issuers, regardless of asset class, and update us on their actions. This includes engagement and taking part in collaborative initiatives, and being transparent about voting where we have ballots.

We regularly carry out in-depth reviews of their activities to assess how they're engaging on our behalf and particularly scrutinise votes on our key themes of climate change, diversity and inclusion, Board governance and executive remuneration.

However, more can be done, so we're continuing to drive transparency across our portfolio.

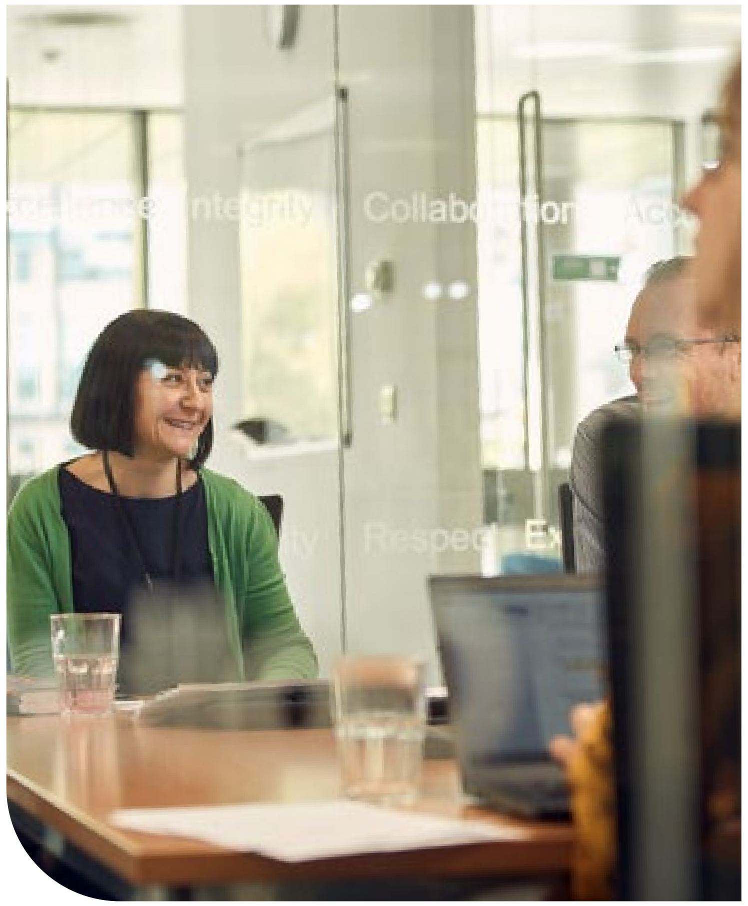
Taking action:
This year we worked extensively with our Liquids managers to develop dedicated reporting templates that will give us insight into essential ESG, climate and stewardship data across our Liquids portfolios. This will allow our dialogue with the managers to be more targeted, and enable us to report our own stewardship progress.

Our Liquids managers are now preparing to share additional metrics in early 2022, particularly in the area of more advanced TCFD climate analysis. We're also rolling out the reporting process to our Alternatives fund managers and we aspire to have appropriate templates in place across the book by 2022.

We believe that this engagement with our fund managers has increased their awareness of potential ESG risks, particularly climate-related. We also believe that it has already led to a significant impact on the risk profile of our managers.

We're pleased to report that 100 per cent of our managers of publicly traded assets are reporting under this new framework now, so we have oversight over:

- ESG policy compliance during the quarter, including identifying and managing material ESG risks
- Stewardship activities during the quarter, including engagement and voting
- ESG portfolio profile
- TCFD climate assessment of the portfolio



Improving portfolio management systems

Over the past year, we've also worked closely with our service providers to get easier access to ESG and stewardship data across our systems.

Taking action:
We've created specific templates in our portfolio management system so that we can quickly run self-serve reports and regularly assess a portfolio for ESG risks ahead of a manager review meeting. As it's still difficult to get exactly what we need, especially in private markets, we're continuing discussions with software providers to find ways to enhance their platforms so we can monitor developments across more of our Fund.

Our Liquids managers are now preparing to share additional metrics in early 2022, particularly in the area of more advanced TCFD climate analysis.

Engagement

How the Fund is managed

We manage around half of our assets in-house, through a team of portfolio managers across LDI hedging strategies, hybrid assets and strategic cash. The remaining 50 per cent is managed by external fund managers across a range of vehicles, including segregated accounts, pooled funds, closed-end funds, co-investments and passive instruments.

We prioritise engagements in themes of greatest importance to us, in sync with our own RI strategy.

Our approach to engagement

Engagement is a driving force behind our RI strategy and we'll always exhaust it before considering divestment. However, there's a real need to boost transparency around engagement, especially in asset classes such as sovereign debt and private assets, which could have the greatest potential for impact. Over the past year, we've worked hard to improve this and support our managers to engage with the entities in their portfolios.

We prioritise engagements in themes of greatest importance to us, in sync with our own RI strategy. As part of this we work closely with our stewardship provider to define focus areas and provide feedback on them. More detail on our engagement approach was provided in last year's RI report.

Our engagement approach for the assets we manage

Engagement in LDI assets

Our objective is to improve the efficiency and functioning of markets through collaboration on important issues with stakeholders and policymakers. As a large participant in the Gilt market, we regularly engage with the DMO and HM Treasury. This involves taking part in annual consultations, forums and investor roundtables.

Taking action:
This year we provided support and insight on developing the UK's green gilt issuance.

As a participant in derivatives markets, we already have an established oversight process for our bank counterparties. However, over the coming year we'll be exploring how to further embed ESG considerations and engagement practices of counterparties to strengthen our ongoing assessments of and reduce counterparty risks related to ESG issues.

Case study

Green gilts

In October 2020, we supported the Green+ Gilt Proposal developed by the III, Green Finance Institute and Grantham Research Institute.

Green gilts are a sovereign bond with an aim to attract private sector capital into the green recovery and social renewal. Following the Chancellor's announcement, in the Spring 2021 Budget, of at least £15 billion in green gilts issuance, the III was appointed as Secretariat of the new Stakeholder Discussion Forum on green finance, set up by HM Treasury and the DMO.

While our participation in any such issuance will be based on it meeting our investment requirements, as active stewards it's important to express our opinion. We therefore took part in a closed-door working group organised by the III to develop potential metrics and measurement frameworks for environmental and social co-benefits reporting.

As part of this, we highlighted the importance of ensuring diversity is considered in the just transition to a low carbon world, as some technology and infrastructure industries are still very heavily male-dominated. We welcome the development of the UK Government Green Financing Framework, although we believe the right requirements must be put in place to report on the use of proceeds and impact.

Engagement continued

Engagement in hybrid and strategic cash assets

We take a nuanced approach within our hybrid assets, depending on whether they are private or public.

Our private assets are typically held for the long term and often have very little secondary market liquidity. This makes due diligence – including ESG assessments and issuer engagement – critical at the pre-investment stage.

Taking action:
Over the last year, we have declined a number of deals due to extreme governance concerns with an issuer or uncertainty about future earnings from particular industries over the long term.

Our public hybrid assets and strategic cash books have reasonable ESG and carbon data coverage within our portfolio management systems. We can use these to monitor the portfolio regularly, along with assessments from open-source initiatives. For example, being an investor member of Climate Action 100+ has helped us understand the transition plans of European energy corporates when reviewing their debt instruments for inclusion into our portfolio.

EOS identified 74 engagement objectives or issues to engage on across 35 companies in the portfolios last year.

12 out of 19 companies with specific objectives saw progress on those objectives during the year.

Taking action:
Over the year, we also brought our UK Public credit and cash assets under the remit of the engagement services from our external stewardship provider, EOS, as part of the expanded contract.

Enel SpA

An example was Enel, a Climate Action 100+ company, where EOS set a specific objective to encourage the company to acknowledge the need for phasing out coal power generation. This objective progressed to the next milestone in December 2020 when the company confirmed it had developed a phase-out plan, and was confirmed as completed in January 2021, when the company updated its coal phase-out timeline, committing to a coal-fired power asset closure schedule by 2027 instead of 2030.

12 out of 19 companies with specific objectives in our internally managed fixed income holdings saw identifiable progress during the year.

Case study

Monmouthshire social housing deal

In 2021 we directly invested in refinancing debt for the Monmouthshire Housing Association (MHA) loan portfolio. The MHA was established in 2008 to provide and manage affordable homes for people who need them. It also helps make sure that homes meet and are maintained to the Welsh Housing Quality Standard.

The MHA manages and maintains around 3,600 homes and 270 leasehold properties, garages and land around and within its estates. It's committed to managing its housing stock in alignment with environmental standards and has published a comprehensive environmental policy.

The Welsh Government's decarbonisation target by 2030 presents a challenging opportunity to the real estate sector in meeting these targets. Therefore, the MHA has been developing a comprehensive business plan that outlines potential costs around energy efficiency measures and capital expenditure for achieving carbon savings. We are monitoring closely the progress of the MHA in setting and achieving carbon reductions alongside providing affordable social housing.

Engagement continued

Our engagement approach for externally managed assets

As detailed on page 11, we extensively review all existing and potential managers' RI policies, ESG integration processes and stewardship practices so we're confident they're meeting our standards.

We also instruct EOS – our stewardship provider – to engage and vote across our segregated equity mandates. EOS carries out engagements on our fixed-income holdings and reviews the activities of our managers of pooled funds as well.

Equities

Engagement in segregated equities

Our first RI report and our stewardship policy provide more detail on our approach to engaging with issuers in our segregated equities.

During the year, EOS reviewed its engagement themes for the 2021–23 period, as shown in this graphic. EOS currently focuses on four priority sectors: **human and labour rights, human capital management, Board effectiveness and climate change.**

Taking action:
We also constantly communicate with EOS, providing feedback and input to its engagement roadmaps when needed. Engagement themes for 2021–23 will drive progress in key areas, especially climate change and labour rights.

Source: 2020 PPF Annual Voting & Engagement report, EOS at Federation Hermes

Engagement continued

EOS carries out engagement through a four-step process. As shown below, it begins with raising a concern which it follows up diligently until it achieves a measurable outcome. The process can span a few quarters.

Engagement milestone process of our external provider

1. Our concern is raised with the company at the appropriate level.
2. The company acknowledges the issue as a serious investor concern, worthy of a response.
3. The company develops a credible strategy to achieve the objective, or stretching targets are set to address the concern.
4. The company implements a strategy or measures to address the concern.

Progress

Engagement in pooled vehicles

Due to current operational barriers in extracting shareholder rights, we must generally accept that our managers will carry out stewardship activities for pooled equity investments. In most cases, fund managers engage and vote on our behalf concerning investee companies in these funds. However, our new quarterly reports from our managers give us oversight of engagements, votes and outcomes.

Fixed income

Engagement carried out by debtholders has a way to go, partly due to limited influence in some areas – however, it is developing and becoming increasingly important. We believe we can reach better outcomes in these asset classes through long-term relationships and by encouraging managers to keep pursuing their stewardship agenda.

Engagement across sovereign debt and emerging markets

Sovereign debt is a fundamental asset class for every asset owner and a pillar of a well-functioning economy. Engagement in emerging markets is crucial where dialogue with governments takes a concerted effort over time. Investors' voices are also vital for pressing topics such as the transition to a low carbon economy and deforestation.

We welcome the evolution of tools and data sets that deepen the ability of investors to measure climate-related and other ESG risks in relation to sovereign bonds. We encourage our managers to contribute knowledge and resources to drive progress forward.

Case study

The IPDD – engaging on deforestation

Several of our credit managers are part of the Investors Policy Dialogue on Deforestation (IPDD) initiative – a global investor-led engagement under the Tropical Forest Alliance. The initiative aims to halt deforestation and mitigate investment risks in vulnerable geographies, focusing on Brazil and Indonesia. To combat deforestation, the IPDD engages with key individuals and government agencies to hold them accountable, head off unwelcome legislation and push for supply chain transparency.

In Brazil, the initiative has already made considerable progress through active dialogue with local and municipal governments.

However, investors noted that recent policies appear to be moving the country further away from deforestation goals. They urged the president to engage with other stakeholders to find constructive solutions to the threat of illegal deforestation.

In Indonesia, the work is in earlier stages – laying out the scene that there's a lot of investor demand to drive progress on deforestation and responsible land management. We receive regular updates from managers who are members of the initiative and continuously encourage further dialogue at local and state government level.

Engagement continued

Engagement in investment grade credit

It's encouraging to see how engagement practices have evolved within investment grade credit. We're pleased that all of our managers in this asset class now report their stewardship progress to us regularly. We see engagement with debt issuers as having a longer-term focus, given their need to reissue debt on an ongoing basis, and one that is well suited to our investment profile.

Green bonds are an ever-growing share of this asset class and we expect our managers to consider these as potential investments if the financials or credit risk fits with their investment case. However, transparency and assurance on the use of proceeds as well as continuous oversight are key to the integrity and success of the green bond market. We seek to invest in green bonds that have at least a second opinion issued by a credible independent body, as well as ensure that any relevant evidence is provided on the green profile.

Taking action:
EOS, our stewardship provider, is also increasingly engaging with issuers from a debt perspective on our behalf. During the year, EOS engaged with a non-equity issuing Dutch financial institution held in our long-term strategic cash portfolio to encourage the integration of climate change into the bank's strategy. The company since published its first TCFD report and has started to focus its climate strategy on the more exposed mortgage and agribusiness areas of its loan portfolios.

Case study

Promoting employee health and reducing plastic pollution

One of our managers is a bond holder for a major UK retailer. It engaged actively with the company throughout the past year, focusing on crucial social aspects due to the pandemic as well as plastic pollution.

The company demonstrated reasonable resilience and responsiveness in upholding expectations on employee health and benefits over a challenging year. It kept vulnerable staff and workers in self-isolation at home with full paid leave at the outset of the pandemic to minimise health risks.

The retailer also continues to target more sustainable packaging by establishing a closed loop for plastics. It has worked with suppliers to remove hard-to-recycle materials, with industry-leading innovation to create recyclable products, which help prolong the shelf life of goods and reduce food waste.

Our listed infrastructure manager recently presented its analysis on climate scenarios to our investment team.

Engagement in private debt

We have been working with our managers in this more challenging asset class to increase their engagement processes. We encourage them to provide us with information on progress and demonstrate the added value of more stringent sustainability practices.

After constant pressure, we're pleased to report that nearly 90 per cent of our alternative credit assets are with managers who are now PRI signatories. This means they will need to meet the PRI's minimum requirements, including TCFD reporting, but also gain access to education and networks for promoting best practice. We have set this out as a clear preference under our minimum requirements for all managers.

Engagement in infrastructure

We are pleased to note that engagement efforts for this asset class have made excellent progress, particularly around climate risks in listed infrastructure assets.

Through our investments, we aim to support the development of climate-resilient infrastructure that also adds social value.

Our listed infrastructure manager has played a key role in integrating scenario analysis on climate-related risks in its investment approach. It recently presented this to our investment team through an informal training session.

Engagement in private equity

Given the diverse nature of private equity (PE) strategies, we take a nuanced approach to engagement within this asset class. Here, more than anywhere else, we look to our managers to focus on the next link in the investment chain.

Our interactions with general partners (GPs) and expectations of how they engage with portfolio companies will differ from those we have with our secondary managers, and how they engage with underlying GPs. In terms of control, we have greater expectations around stewardship where GPs hold Board seats or controlling stakes in companies.

During the year, one of our UK-based GPs became a PRI signatory, meaning that 100 per cent of our core PE managers are PRI signatories. On the secondary side, many of our managers are rapidly expanding their own monitoring of their sponsors' ESG practices, with increasing focus on TCFD reporting. We are planning to roll out our ESG reporting templates to our PE managers shortly.

Case study

Building net zero carbon schools in Wales

We are keen to develop social infrastructure that goes beyond housing. Through one of our infrastructure managers, we invested in the Welsh Education Partnership (WEPCo).

WEPCo will create schools and other community-based facilities in Wales, from planning to financing, right through to maintenance. The public-private partnership will create more than 30 new schools and colleges across the nation, with an operation that will last 25 years.

It's part of the Welsh 21st Century Schools Programme to meet the growing demand for education in the country.

The facilities will be energy efficient, built and maintained to high standards under a 'PassivHaus' net zero approach.

Engagement continued

We have increased our investment in forestry and farmland by 20 per cent over the year.

Engagement in forestry

Forestry can help mitigate CO_2 emissions by storing carbon. This makes sustainable forestry assets one of a few viable nature-based solutions in the journey towards a net zero carbon world. Well-managed forests can also increase biodiversity and are more resilient to the effects of climate change.

We make sure that we invest in, or only have exposure to, responsibly managed forests and farmland.

Year on year, the share of timberland in the process of certification has slightly increased, which is due to the fact that new assets have been acquired within growing funds. Our managers commit to converting all new assets to certified forests as part of their post-acquisition, where possible, and it is something we actively track.

Taking action:
Over the year, we have increased our investment in forestry by 20 per cent and we continually review the proportion of our timberland assets that are FSC and/or PEFC certified. We receive regular reporting from our managers and are starting to consider the whole forestry commodities value chain.

Certification of timberland (PPF's share)	2019 proportion %	2020 proportion %
Certified timberland in accordance with the FSC and/or PEFC	98.21%	93.09%
Timberland in the process of certification in accordance with the FSC and/or PEFC	0.17%	5.83%
Land that is sustainably managed in accordance with the FSC and/or PEFC, but that cannot be certified	0.23%	0.01%
Other	1.40%	0.27%

Collaborating to address and mitigate market-wide risks

As part of our efforts to maximise the collective voice of the industry, we are members of key initiatives and engagements around a number of themes that are important to us. However, there are many initiatives, so we prioritise supporting workstreams in the markets where we're active or rapidly developing new rules for better functioning markets to reduce systemic risks.

For example, on climate change, we actively participate in the programmes run by the IIGCC and have contributed to key projects focused on net zero frameworks and physical risks.

We also work closely with policymakers and market stakeholders, such as the PLSA, UK DMO and the DWP.

Transition Pathway Initiative
Diversity Project
CDP
ilpa Institutional Limited Partners Association
CFA Institute
IIGCC
A proud supporter of: Climate Action 100+
UKSIF UK Sustainable Investment and Finance Association
BVCA British Private Equity & Venture Capital Association
Occupational Pensions Stewardship Council
PRI
TCFD Task Force on Climate-Related Financial Disclosures
Transparency Task Force

Engagement continued

Key activities in public policy engagement over the year

Regulatory standards and guidance around ESG issues are rapidly evolving and we follow these developments closely.

We engage with key entities globally on public policy that promotes and enables smooth market functioning. We carry out this engagement directly or through other groups such as our stewardship provider, the PRI and the IIGCC.

Taking action:

Directly

DWP consultation: Taking action on climate risk – we responded to this as we believe introducing standardised climate metrics is a crucial step to being able to measure climate alignment across strategies.

DWP consultation: Consideration of social risks and opportunities – we responded to this as we already consider social factors where material, for example diversity and inclusion.

HM Treasury consultation: Reform of the RPI methodology – we submitted a direct response to the consultation during the year, expressing our views around potential impacts to the PPF and other DB schemes. Although our liabilities are indexed by reference to the Consumer Price Index (CPI), the absence of a liquid CPI market means we largely use the RPI-linked Gilt and RPI derivative markets to hedge our liabilities against inflation risk. The effectiveness of this strategy is important to our long-term viability and to limit calls on our levy payers.

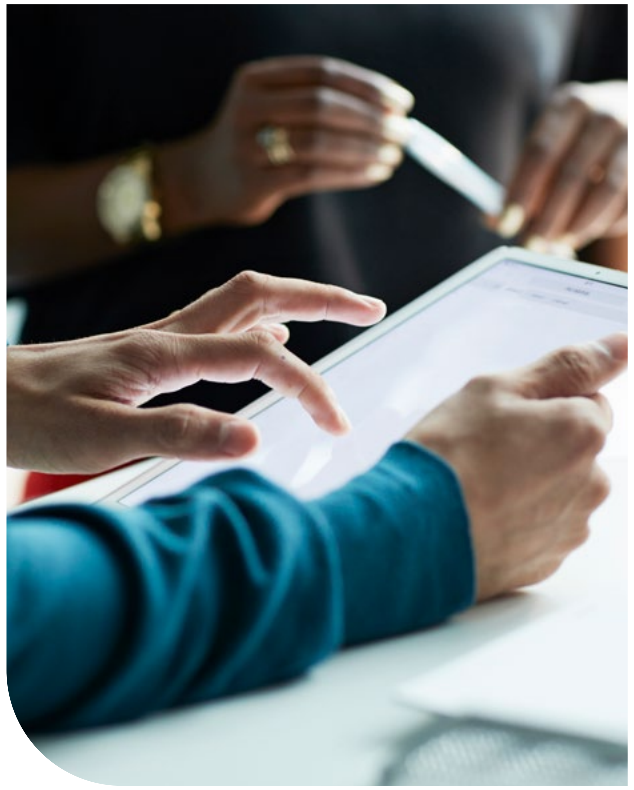
Through EOS

In the past year we've been glad to see the results of engagement on Japan's Corporate Governance Code revision. This included development around Japan's sustainability disclosure and progress on the National Action Plan on Business and Human Rights. In the UK, we provided input to the FRC on future corporate reporting and the Asset Management Taskforce for stewardship.

We also engaged with the UK's Home Office review of the Modern Slavery Act information portal, under development, that would allow the public to search for companies' modern slavery statements.

Through the IIGCC

As active members of the IIGCC, we often join collaborative initiatives on public policy. In the past year we signed the Global Investor Statement, now supported by 587 investors managing $46 trillion, urging all governments to raise their climate ambition and implement robust policies by COP26 in November 2021.



Other collaborations with industry

- We've been a signatory to the PRI since 2007; our Head of ESG currently sits on the PRI's Infrastructure Advisory Committee and we're members of its Collaboration platform
- As an investor member of the IIGCC, we recently joined its Net Zero Stewardship Working Group. We also participate in its collective responses to consultations, such as with the TCFD on its forward-looking metrics proposal
- We encourage greater climate disclosure through supporting initiatives such as the CDP and the TCFD
- We are supportive of the revised UK Stewardship Code and its increased drive towards greater transparency on stewardship activities and progress
- Although we're committed to voting all our shares, implementing policies – particularly in relation to pooled funds – is challenging, and improving shareholder voting is an important issue

Taking action:
Taking guidance from the newly formed Taskforce on Pension Scheme Voting Implementation, we've successfully agreed with two of our public equity managers to apply a split-voting approach and the option to override votes with our decision.

- The EU's Sustainable Finance Disclosure Regulation (SFDR) is a positive move towards transparency and standardisation, which should benefit asset owners such as ourselves. A growing number of our managers are aligning their reporting with this regulation, for funds classified under articles 8 and/or 9. The coverage of assets committed varies, however with time we expect a larger share of mandates to adopt some ESG guidelines.

Net Zero Stewardship

As a member of the IIGCC's Net Zero Stewardship Working Group, we're helping create practical approaches to help asset owners to engage around carbon emissions. There are two main workstreams:

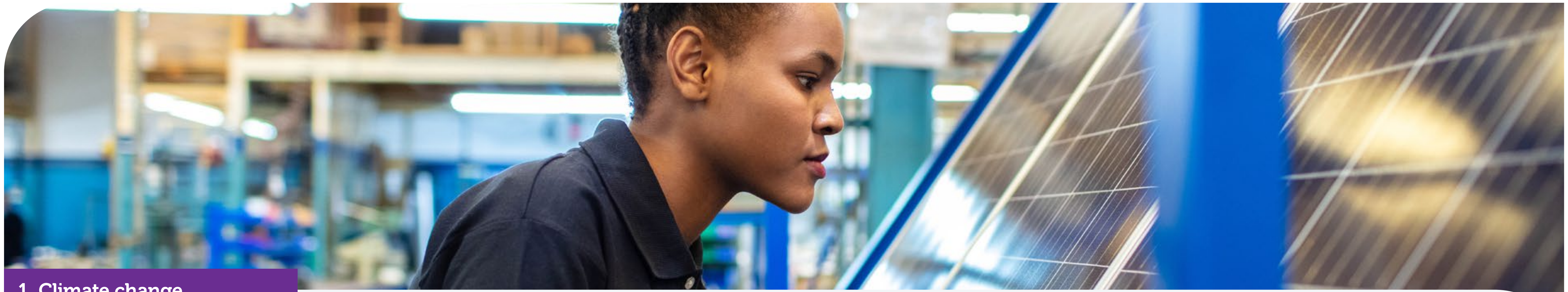
- Developing the resources and infrastructure that investors need to engage and exercise voting rights with priority companies
- Creating a framework that can hone engagement targeted to net zero. We also monitor the efforts of proxy voting providers to include clients' needs, particularly around climate risk management

Engagement continued

Our engagement progress and outcomes

We've focused on three themes in particular for engagement during the last year:

This year, we participated in the IIGCC workstream on setting investor expectations on physical risks.



1. Climate change

Climate change is a key pillar of our RI strategy and an ever-increasing priority that can affect the profile of our investments over the short, medium and long term.

Through our stewardship activities, especially those with our managers, we seek to drive the progress on climate adaptation and move towards a net zero future.

We have provided full detail on our work around climate in a dedicated TCFD report that shows how we assess and manage climate-related risks and opportunities across our investment portfolio.

Over the past year, we've dramatically improved our oversight by expanding our ability to produce TCFD-related metrics and analysis across our portfolio management systems.

As a result, we have ESG data available through our portfolio system for 70 per cent of the Fund's net asset value. Within this coverage, we also have carbon emissions data for approximately 30 per cent of the total, reflecting the difficulty in assigning sovereign carbon emissions.

To drive further visibility, we've chosen to focus on each asset class in turn and in a way that works best for each.

This year, we also participated in IIGCC workstreams on physical risk and welcomed its 'Investor Expectations on Physical Risks and Opportunities' guide.

This gives practical guidance on governance, assessing physical risk and opportunity, developing a resilience strategy and tracking metrics. With a focus on our portfolio, we are in the process of augmenting physical risk data to measure exposure across the board.

We also engage with companies such as Rio Tinto, POSCO and McDonalds – identified by Climate Action 100+ as large corporate greenhouse gas emitters – urging them to take necessary action on climate change.

We have started to examine the alignment potential of our investments, covering our equity, fixed income, real estate and internally managed LDI strategies. The results of the analysis will further inform our stewardship activities and actions that we need to take to drive our issuers to align with the Paris Agreement.

Taking action:
Over the coming year, we'll be assessing our entire portfolio through a climate lens. This will give us an independent, objective benchmark and tangible steps for moving forward.

Climate Action 100+ focus

One of the companies held across a few of our portfolios is the multinational retailer corporation Walmart. The company is part of the Climate Action 100+ list and has been engaged on various topics across ESG themes, such as climate change, Board effectiveness and natural resource stewardship.

As a result of continuous engagement, Walmart assessed the risk of potential conflicts between the company's position on climate change and support of the Paris Agreement and any activities of industry associations it is a member of.

The company also acknowledged the need to enhance next iterations of TCFD risk assessments to include consideration of impacts, such as demographic changes and population movement.

Walmart disclosed the Board's process for overseeing human capital management, including the option to designate an independent director who has employee engagement responsibilities. It also recognises the importance of actively increasing Board diversity and has committed to implementing changes to rules in director recruitment, ensuring minorities representation.

Net Zero Asset Managers initiative

15 of our managers have become signatories to the Net Zero Asset Managers initiative so far, including two managers in infrastructure, one in forestry and one in emerging markets.

While some managers will implement this across parts of their portfolio to start with, it's positive to see them set targets and we're looking forward to finding out how they implement the commitments and track progress.

Engagement continued

2. Diversity and inclusion

Diversity and inclusion is an area of growing importance to the investment industry and a key priority for us as an organisation. We're continually developing our internal initiatives and are active members of the Diversity Project.

Taking action:

This year, we went further than publishing a gender pay gap report, and published our first diversity pay gap report as a demonstration of our commitment. We also set targets for ethnicity representation at all levels of the organisation.

Along with reviewing diversity efforts at our issuers, we now collect diversity data as part of selecting our managers. We feel it is important to see our managers reflecting this in their own organisations too.

Case study

Driving leadership diversity at Nintendo

EOS and one of our pooled fund managers have been engaging with Nintendo on Board diversity for several years, emphasising the need to improve gender diversity and independence, improve disclosure and increase discussion of diversity on Board agendas.

Although we continue to engage with Nintendo, we have seen positive progress as a result of these engagements. The company has recently appointed its first female Board member, established a nomination advisory committee and expanded the number of independent directors on the Board.

Nintendo also improved its disclosures by producing its annual report in English and included information on cross-holdings, an important aspect of potential interdependence at Japanese companies. We also asked for increased workforce flexibility in the form of maternity leave.

Nintendo has also committed to increasing its female workforce from 20 per cent to 25 per cent and strengthening its talent management programme to establish a pipeline of senior female executives.

3. Human and labour rights

As a responsible asset owner and employer, we focus on the importance of a fair and equitable workplace. We recognise the responsibility of all companies to respect human rights and provide decent work conditions and a living wage to employees. The COVID-19 pandemic further highlighted the urgency of establishing the necessary protocols, which we continue to review across issuers.

We have hit key milestones when working with a broad set of stakeholders, for example, with the progress seen through the PRI's Collaboration Platform where we focused on Modern Slavery Act compliance within FTSE 350 companies over the year.

Taking action:

FTSE Modern Slavery compliance

This year, we participated in a successful coalition to ensure UK FTSE 350 companies comply with the UK Modern Slavery Act. The PRI coordinated the initiative, one of the largest to date, and brought together 97 investors with assets of £7.8 trillion to actively engage on the issue during the AGM season.

62 companies either didn't have Board signoff on their modern slavery annual statements or hadn't published them.

Following the coalition's engagement, most companies have responded positively, and 56 of them are now compliant.

We were also pleased to see the Home Office's update of statutory guidance under the Modern Slavery Act 2015 this year.

We are keen to see the scope of the initiative progress beyond an engagement focused solely on compliance, to driving improved quality of reporting as well.

Driving disclosure at ConocoPhillips

Following the Deepwater Horizon oil spill disaster, EOS began engaging with crude oil producer ConocoPhillips in 2010. It met and corresponded with several directors, setting objectives around health and safety, disaster response risk management, oil sands risk and climate disclosure.

The company has completed many of these objectives, convincing EOS that it is an industry leader in health and safety and disaster recovery, with excellent oil sand production practices.

We have also seen progress in its climate reporting, as it now reports on three 2°C scenarios. It has also set out a climate change action plan. EOS continues to encourage the company to improve its disclosure, governance, lobbying activity and factoring climate into executive pay.

Voting

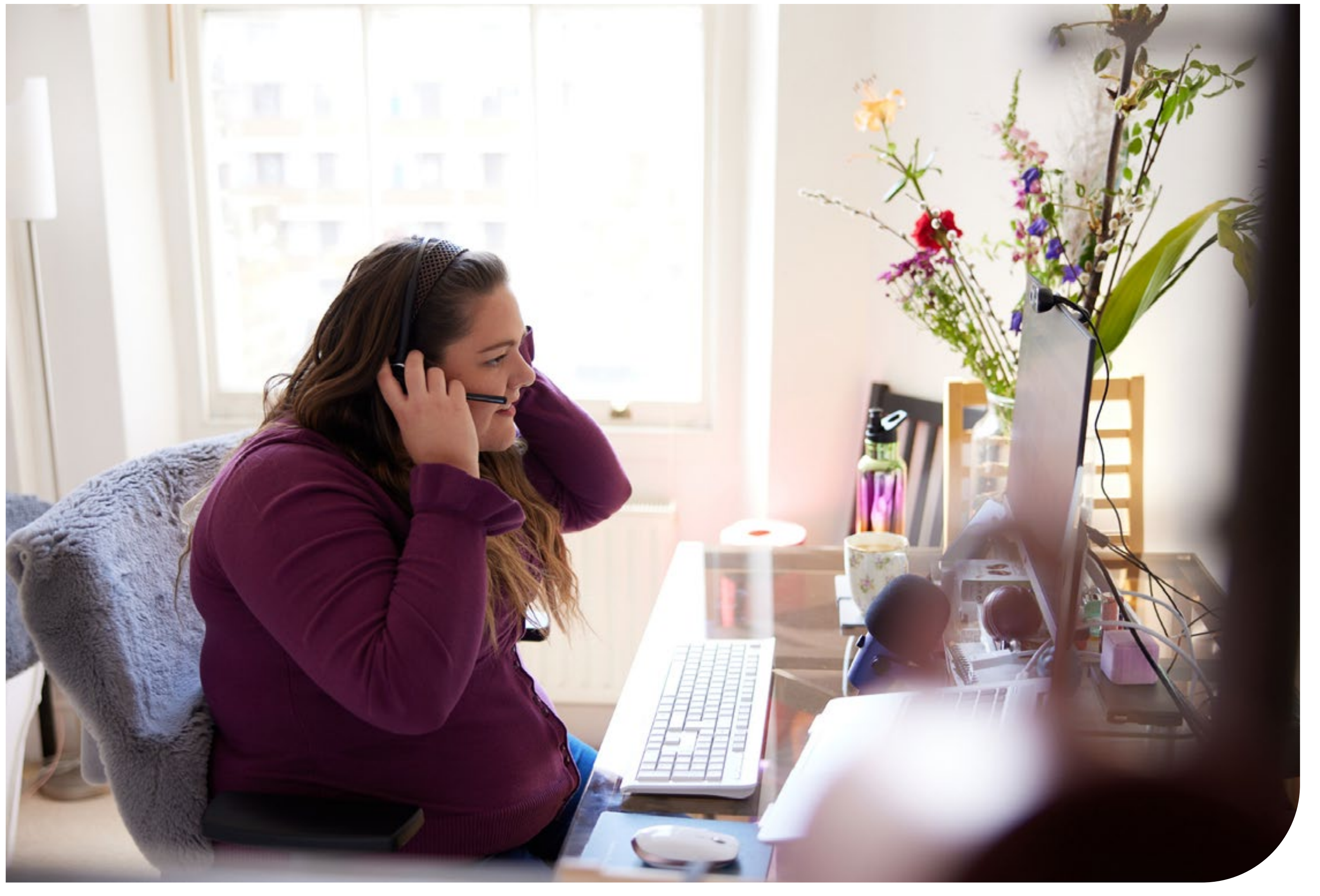
Our first RI report and our stewardship policy provide detail on our approach to voting in our segregated equities.

How we escalate important issues

Where an engagement is not progressing at a sufficient pace privately with the company, there are a range of potential escalation strategies that we can employ, including collaborating with other investors or campaign groups, issuing a public statement or filing a shareholder resolution.

Voting against Board recommendations is an important tool we can use as part of a thoughtful escalation when necessary. However, we would always look to engage with the company at Board or management level to discuss this in advance.

We closely follow the AGMs of companies targeted by Climate Action 100+ and discuss with our managers if there is an important vote to be cast on our behalf. We are also reviewing the new trend of formal shareholder votes on companies' climate transition plans. However, we recognise the dilemma that the majority of shareholders aren't likely to have reviewed the robustness of these plans in thorough detail. This could lead to them just ending up supporting management rather than encouraging a company to be as ambitious as possible.



Taking action:
For example, we use the Transition Pathway Initiative's (TPI) assessments of companies to help guide our climate-related votes executed via EOS. The TPI provides a useful framework for setting stretching but achievable engagement objectives on climate change. EOS has had a formal climate change voting policy that uses the TPI management quality scoring system since 2019. Over the last year, the voting policies for certain regions – including the UK – now consider opposing the chair or other directors at companies falling below a Level 4 management score, up from the previous Level 3 threshold.

Our voting policies for certain regions now consider opposing the chair or directors at companies with a low TPI score.

Our guidelines for voting

We commit to voting every share we hold, except when it's cost-prohibitive or not possible due to operational reasons.

While EOS votes on our behalf, we will review votes across key topics in advance. These key topics are aligned with the voting guidelines issued by the PLSA and include:

- Board leadership and company purpose
- Division of responsibilities, e.g. separation of chair and chief executive
- Composition and diversity of Boards and executive committee
- Audit, risk and internal control
- Remuneration
- Climate change and sustainability
- Capital structure and allocation
- Company strategy, vision and business model

Where we feel engagement has not been fruitful, we may vote against management on certain resolutions, such as reports and accounts or electing individual Board members responsible for poor environmental or social performance.

Taking action:
We're developing specific voting guidelines for the next AGM season to make sure we vote in line with our key priorities. We will also be reviewing our policy around stocklending and recalling stocks out on loan for voting purposes.

Our criteria for significant votes

Along with the guidance of the PLSA around significant votes, we also use our own criteria to flag material votes that we need to scrutinise more carefully.

Taking action:
We've created a watchlist where we get particular coverage and have an agreed timescale for action to proactively execute votes for significant and material positions in our portfolio.

Our watchlist includes:

- Companies where we have over 1 per cent ownership of equity
- Companies that we hold directly, which we escalate to our CIO for decision
- Companies with specific issues, e.g. practices that are non-compliant with the UN Global Compact
- Votes related to a specific initiative that we're involved in, such as our holdings on the Climate Action 100+ list and related shareholder resolutions

Voting continued

How we voted

Voting for segregated equities

On a quarterly basis our voting and engagement reports are uploaded on our website. In the table to the right, we present our segregated equities voting statistics for the period April 2020 to March 2021, cast on our behalf by EOS.

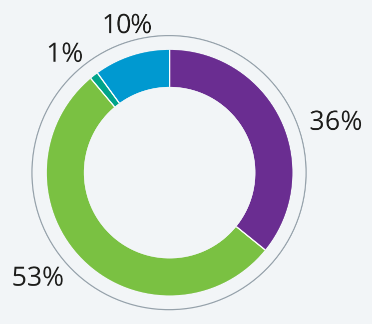
Voting against management is broadly seen as an escalation action towards company management.

The table on the far right presents a split of our votes cast per topic of the shareholder resolutions filed. In some cases, the shareholder resolutions are withdrawn prior to the meeting or when sufficient progress through engagement has been achieved with the specific company, precluding a vote against a resolution.

Taking action:
We voted on a total of 6,897 resolutions, the vast majority of which (over 95 per cent) were proposed by management.

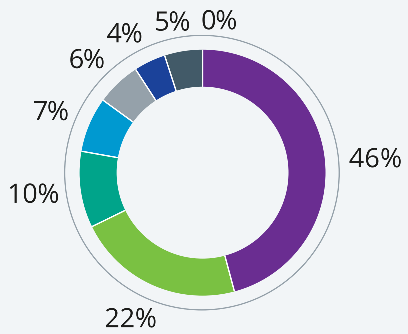
Voting statistics April 2020 – March 2021	Response
How many meetings were we eligible to vote at?	**591**
How many resolutions were we eligible to vote on?	**6,897**
What % of resolutions did we vote on for which we were eligible?	**100%**
Of the resolutions on which we voted, what % did we vote with management?	**88%**
Of the resolutions on which we voted, what % did we vote against management?	**11%**
Of the resolutions on which we voted, what % did we abstain from voting?	**1%**
In what % of meetings, for which we did vote, did we vote at least once against management?	**59%**

Voting by number of meetings



- Meetings in favour
- Meetings against (or against and abstain)
- Meetings abstained
- Meetings with management by exception

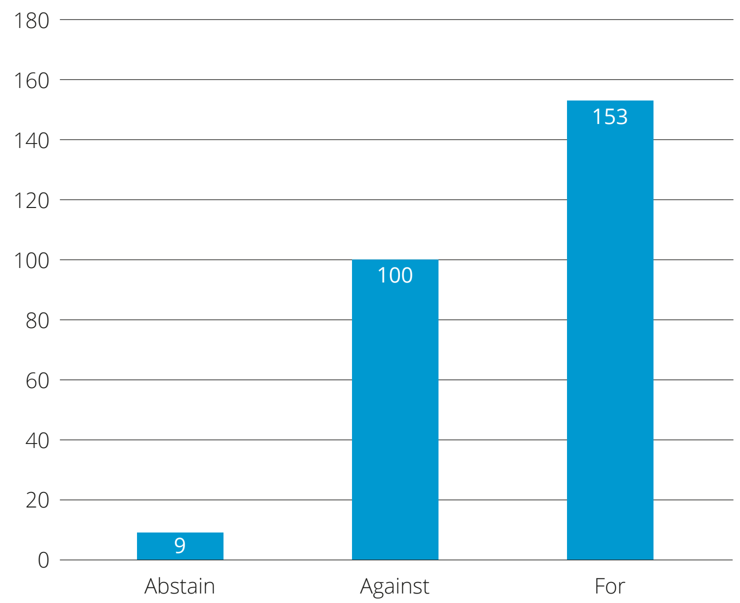
Voting against management or abstaining by issue



- Board structure
- Remuneration
- Shareholder resolution
- Capital structure & dividends
- Amend articles
- Audit & accounts
- Other
- Investment/ M&A

Shareholder resolutions

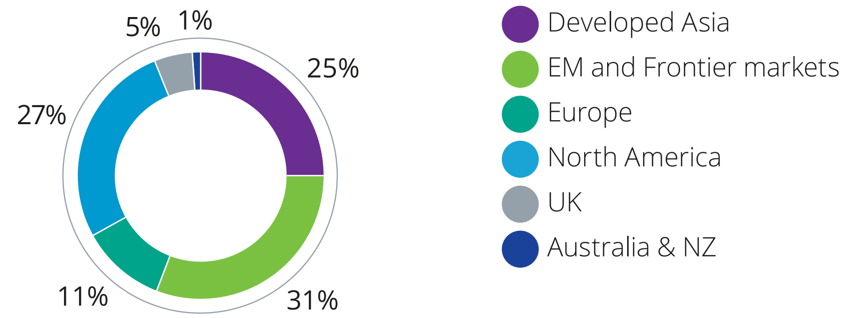
April 2020 – March 2021	Abstain	Against	For	Grand total
Compensation		8	6	14
Corporate Governance	2	1	13	16
Governance/ Directors' related	7	37	61	105
Climate & Environment		21	13	34
Other		5	22	27
Routine Business		28	29	57
Social equity & Human Rights			4	4
Social Proposal			5	5
Grand total	**9**	**100**	**153**	**262**



In terms of regions and where we cast our votes, the most active region in terms of resolutions were Emerging Markets and North America, followed by Asia.

Voting continued

Votes on shareholder resolutions per region



Climate-related voting

While we strongly encourage climate-related stewardship across our investment portfolios and asset classes, we direct our own voting within our segregated equities.

Taking action:
In the past year, as shown in the table on the previous page, we voted on a total of 34 shareholder resolutions specifically related to climate and environmental issues within 16 companies.

We voted in favour for inclusion of the Paris Agreement 1.5°C Target in Articles of Association of the Finnish power producer Fortnum, a Climate Action 100+ target company. We also voted in favour of corporate disclosure on addressing stranded carbon asset risks with the American natural gas company Cheniere Energy.

Within our externally managed accounts, some of the significant climate votes cast were at the annual AGMs of fossil fuel majors such as BP, Eni, Vale and BASF.

The most active markets were Emerging Markets, North America and Developed Asia.

Voting in pooled vehicles

We are in the process of setting up a process for using our stewardship provider's platform to monitor statistics on votes cast on our behalf through pooled mandates. We will then be able to raise any practices or voting actions that don't align with our expectations in our discussions with pooled managers.

While our views do generally align with our managers', we're keen to exercise a consistent voice on key topics.

Where we've been able to, we've taken advantage of a split voting set-up to allow us to vote on or 'override' our shares in a pooled fund. We have put this in place for two of our global equity mandates this year.

For mandates where this isn't possible, we carry out ex-post assessments of voting activities for our portfolio across our key topics or most material issues. When they're allowed to share information, we find out how our managers intend to vote on high-profile issues ahead of AGMs. However, we acknowledge the challenges with pre-declaring votes, and would welcome any action to address this in future.

Taking action:
Over the past year, we voted in 5,555 meetings on more than 76,000 resolutions across six pooled mandates with applicable ballots. We supported more than 50 per cent of all shareholder resolutions in two mandates and 41 per cent in a third pooled fund.

Within our passive equity strategy, we voted on 2,049 shareholder resolutions, 199 of which were related to climate and environmental issues, while 34 were related to social equity and human rights. In 18 per cent of cases we voted against management.

Making voting more transparent

We would welcome further regulatory guidance around voting rules and transparency in pooled funds. We have encountered significant challenges and barriers to overcome around voting, particularly with pooled accounts.

For example, our managers use different proxy voting providers and reporting formats. Not all managers will pre-declare their voting intentions. This makes it hard to position our votes ahead of meetings and creates the risk of misaligned voting for the same company. Greater transparency would prevent potential discrepancies.

An additional barrier to all of our ballots being voted is created if a fund manager sets a materiality threshold for when to cast votes. This is often based on the share of ownership for a position. For non market-cap weighted strategies, this can result in a high number of positions being considered out of scope, which is in conflict with our policy to vote all shares where possible.

Looking forward

By keeping active stewardship at the heart of everything we do, we will continue to advocate for improved management and outcomes related to the climate, diversity and inclusion, and better working conditions.

Our immediate actions for the next financial year include measuring our assets through a climate assessment of the entire portfolio. More specifically, we'll continue developing our TCFD disclosure and improve our analysis of physical climate-related risks. We will also explore further potential opportunities for sustainable investment in asset classes such as forestry and infrastructure.

While we are keen to keep evolving, we have worked hard to set a baseline for understanding material ESG and climate-related risks. We're now at the stage in our journey where we're able to manage and act on these risks. We will continue to develop our stewardship practices in a way that we believe will reduce the risks that our investments are exposed to. This will include implementing bespoke voting policies for our key themes.

When it comes to working with our external managers, we will also seek to achieve continued improvements in transparency and reporting across our pooled funds and segregated mandates.

At an industry level, we will actively support stewardship practices and collaboration with peers to drive long-lasting change in our focus areas.

"Climate change will remain a priority for us. We're looking forward to seeing the results of our portfolio alignment project across our entire portfolio."

Barry Kenneth
Chief Investment Officer

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Appendix

Appendix 1

The information in this report is intended to meet the reporting expectations against the FRC Stewardship Code's 12 principles. The table to the right describes how the report relates to the Code.

#	UK Stewardship Code principle	Report section	Page reference
1	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	Messages from our Chair, CEO and CIO; Purpose and governance	5–6, 8
2	Signatories' governance, resources and incentives support stewardship	Purpose and governance	9
3	Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first	Purpose and governance	10
4	Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system	Engagement	21
5	Signatories review their policies, assure their processes and assess the effectiveness of their activities	Purpose and governance, ESG integration, Engagement	9, 11, 14, 17–19
6	Signatories take account of client and beneficiary needs, and communicate the activities and outcomes of their stewardship and investment to them	Key achievements, ESG integration	4, 11
7	Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change to fulfil their responsibilities	ESG integration	12–13
8	Signatories monitor and hold to account managers and/or service providers	ESG integration, Engagement	14–15, 18–21
9	Signatories engage with issuers to maintain or enhance the value of assets	Engagement	16–21, 23–24
10	Signatories, where necessary, participate in collaborative engagement to influence issuers	Engagement	16–17, 19, 21–24
11	Signatories, where necessary, escalate stewardship activities to influence issuers	Voting	25–26
12	Signatories actively exercise their rights and responsibilities	Voting	25–27

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