Parliamentary Contributory Pension Fund (PCPF)
UK Stewardship Report

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Foreword

Despite the challenges faced by many UK pension schemes throughout the year, as many asset classes struggled in relation to uncertainties over inflation and interest rate levels, the PCPF's position remains strong. As a Board of Trustees, we have maintained our commitment to responsible investment and focus on good scheme governance. Our Responsible Investment policy continued to be a primary consideration throughout the year as we looked for opportunities arising from a greater understanding of Environmental, Social and Governance (ESG) factors.

We remain committed to responsible investment, responding to climate change risks to our assets as well as considering what opportunities may arise as the investment industry seeks to find solutions for net zero commitments. As part of this work, we completed the equity transition in April 2021, adopting a sustainable and low carbon approach to our passive equity assets in line with the Fund's Climate Risk policy. Changes made to the equity portfolio have reduced the Fund's total carbon emissions by c.77%. The Fund continues to perform well from a climate risk perspective and the current total carbon intensity across the equity and bond-based investments is c.40% lower than the composite benchmark.

Previously, the Trustees had agreed to invest 10% of Fund assets in renewable energy infrastructure. These investments continued to ramp up over the year as suitable projects were sourced by the underlying investment managers. We also continued to explore other impact investment opportunities where appropriate. In September, we agreed to restructure the property portfolio and to invest 5% of the Fund in a property impact investment which will have an environmental or social target to meet, alongside a financial return. We remain open to considering alternative responsible investment opportunities and will look to receive further training on these assets in the future.

We exercise our responsibility to continue to monitor the voting and engagement activities of our equity managers, and we do this on a quarterly basis, at our investment focused Trustee meetings. We also held two Manager Days this year. Over the course of these sessions, we met with all investment managers in person and challenged them on topics such as voting practices, ESG integration, and carbon footprint intensity. The Trustees ensure that at least one formal training session annually is directly focused on responsible investment. This year the Trustees received training on property impact investment, ESG integration in global private finance, and other topical areas such as biodiversity, modern slavery, and artificial intelligence through a responsible investment lens.

As asset owners, we have welcomed the introduction of the Financial Reporting Council's new UK Stewardship Code and see this as an opportunity to improve the transparency of our stewardship of the Fund and improve standards over time. We are proud to have been included as signatories to the Code since the new Code's inception, and hope this report provides an update on the work we have done over the year to integrate stewardship into our investment strategies.

Sir Brian H Donohoe
Chairman of the Trustees of the PCPF

Introduction

1. The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting. The 2012 UK Stewardship Code, published by the FRC, called for greater collective action among shareholders and outlined 7 Principles for good stewardship practice. The revised UK Stewardship Code (the Code) took effect on 1 January 2020, and set out 12 Principles for asset owners. The Code sets a new higher standard for stewardship reporting for those investing on behalf of UK savers and pensioners. It defines stewardship as the responsible allocation, management, and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

2. Under the revised Code, signatories are required to submit an annual report on stewardship activities and outcomes. This stewardship report works through each of the 12 Principles of the revised code in turn. It firstly sets out the FRC's definition of the principle, before going on to demonstrate how the Parliamentary Contributory Pension Fund ('the Fund', or 'PCPF') has sought to apply each of these 12 Principles during the period from 1 January 2023 to 31 December 2023.

1. Purpose, strategy, and culture

Principle 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.

3. The Parliamentary Contributory Pension Fund ('the Fund', or 'PCPF') is a statutory scheme that is made up of the MPs' Pension Scheme which provides benefits for Members of Parliament (MPs) and certain office holders, and the Ministers' Pension Scheme which provides benefits for paid Government Ministers and holders of a Qualifying Office. The benefit structure of the MPs' Pension Scheme is determined by the Independent Parliamentary Standards Authority (IPSA) and the benefit structure of the Ministers' Pension Scheme is determined by the Minister for the Civil Service (MCS). It is important to note that Members of Parliament, office holders and Ministers are not employees. The payroll for MPs and office holders is handled by IPSA. The payroll for Ministers is handled by Government departments.

4. Given the purpose of the PCPF, the Trustees believe that it is paramount that the Fund's strategy reflects clearly stated objectives, beliefs, and robust responsible investment policy that will stand up to scrutiny from various sources. The long-term vision and overriding objective of the Fund is to ensure that its assets are invested in a manner which meets the need to pay benefits to members as they fall due. The Fund's investment strategy is guided by a set of investment beliefs, as documented in the Fund's Statement of Investment Principles (SIP), which is published on the PCPF website.[1] The SIP was last reviewed in January 2024, along with the Fund's Responsible Investment Policy and Climate Risk Policy.

5. Below is a summary of the Fund's key investment beliefs, which create a framework for the Trustees' decision-making:

Belief	Further information
Clear and well-defined objectives are essential to achieve future success.	The Trustees are aware that there is a need to generate a sufficient level of return from the Fund's assets, while at the same time having a clear understanding of the potential risks and ensuring there is sufficient liquidity available to pay members' benefits as they fall due.
Although manager and stock selection are important, strategic asset allocation is a key determinant of risk and return, and should be prioritised when making investment decisions.	The Trustees understand that having the appropriate strategy in place is a key driver of the Fund's future success. As a result, priority is given to more strategic investment matters.
Long term investing provides opportunities for enhancing returns.	The Trustees believe that investors with long term time horizons are able to better withstand periods of price volatility. As a long-term investor, the Fund may choose to gain additional compensation (a return premium) by investing in assets that are illiquid or may be subject to higher levels of volatility.

[1] PCPF website in this report refers to https://www.mypcpfpension.co.uk/investments/.

The strength of employer covenant allows the Fund to take a long-term view of investment strategy.	The Trustees believe that the strength of employer covenant (the UK Government) means that the Fund can take advantage of the benefits associated with a long-term investment horizon, as set out above.
Equities are expected to generate superior long-term returns.	The Trustees believe that, over the longer term, equities are expected to outperform other liquid assets, in particular government bonds. The Trustees are therefore comfortable that the Fund maintains a significant target allocation to equities.
Alternative asset class investments provide diversification.	The Trustees believe that diversification across asset classes can help reduce the volatility of the Fund's overall asset value and improve its risk-return characteristics. The Trustees believe that investing across a range of asset classes (including but not restricted to equities, corporate bonds, infrastructure, and property) will provide the Fund with diversification benefits.
Fees and costs matter.	The Trustees recognise that fees and costs reduce the Fund's investment returns. The Trustees monitor the fees and costs of its investment arrangements to ensure the Fund is getting value for money and to minimise, as far as possible, any cost leakages from its investment process. The Trustees have undertaken industry benchmarking of the Fund's investment management fees and the Fund's overall costs and will continue to review this on a regular basis.
Passive management has a role to play in the Fund's structure.	The Trustees recognise that passive management allows the Fund to access certain asset classes (e.g. equities and bonds) on a low cost basis and, have over time increased the proportion of assets managed on a passive index tracking basis within the Fund.
Active management can add value but is not guaranteed.	The Trustees recognise that certain asset classes can only be accessed via active management. The Trustees also recognise that active managers may be able to generate higher returns for the Fund (net of fees), or similar returns but at lower volatility, than equivalent passive exposure. By carefully selecting and monitoring active managers, the Trustees seek to minimise the additional risk from active management. The Trustees will monitor active managers to ensure their mandates remain appropriate for the Fund.

Environmental, social, and corporate governance ('ESG') issues will have a material impact on the long-term performance of its investments.	The Trustees recognise that ESG issues will impact the Fund's returns, and the Trustees aim to be aware of, and monitor, financially material ESG-related risks and issues through the Fund's investment managers.

6. Responsible investment is at the centre of the Fund's investment philosophy. The Trustees recognise that their duty is to act in the best financial interests of the Fund's beneficiaries and they believe that ESG risks can have a material impact on the long-term performance of the Fund's investments. The Trustees have developed a stand-alone Responsible Investment Policy which continues to be a primary consideration when forming their forward-looking business plan. The policy is explained further in this report under Principle 7.

7. The Trustees formalised a Climate Risk Policy in November 2020 which outlines their approach to addressing climate related risks within the Fund. The Trustees acknowledge that climate related risks may negatively impact the Fund and are particularly relevant for investors with long-term time horizons. The policy set out the Trustees' ambition for all PCPF investments to be compatible with net zero emissions by no later than 2050. This objective will be re-examined at regular intervals.

Trustee Board values

In line with their investment beliefs and funding objectives, the Trustees agreed the following statement of their culture and values:

"As a Trustee Board we are responsible for ensuring that the Fund's assets are invested in a manner sufficient to meet our overriding objective, which is to pay member benefits as they fall due, we aim to do this by maintaining a funding level of as least 100%.

Our Board is an open, transparent and inclusive body, which actively promotes the principles of equality, diversity and inclusion. Diversity amongst Board members is highly valued, and we recognise that when the board is comprised of individuals with a complementary range of experience and individual skills, this helps to improve our decision making and leads to better outcomes for our members.

Responsible investment is at the forefront of our investment philosophy. We believe that investing in sustainable, well governed companies and practicing active stewardship will have a positive impact on returns in the longer term. We also value engagement, recognising that we can positively influence the behaviour and practices of our investment managers with regard to stewardship through ongoing and forceful engagement, even where assets are invested through pooled funds. This is supported by our Responsible Investment policy."

8. While the Trustees maintain overall responsibility for the management of the Fund, in practice they have appointed Officials from the Finance, Portfolio and Performance Team within House of Commons to provide a full secretariat and administrative service. Day to day management of the Fund is delegated to Secretariat officials.

9. The Secretariat staff are House of Commons (or 'House') employees and are therefore required to behave in line with House values. These values describe what House staff want their culture to be and help reflect how they work together to deliver a shared strategy and the vision 'Together, we make

Parliament happen'. Essential priorities that underpin the House strategy include supporting our people to thrive and achieving value for money.

10. There are four values: Inclusive, Courageous, Trusted, and Collaborative. Each value is described by three supporting behaviour statements to expand on what they mean for how staff behave at the House of Commons.

Inclusive • We value everyone equally • We respect each other • We all have a voice	Trusted • We trust each other to do a good job • We are impartial • We build confidence in Parliament through our integrity
Courageous • We try new things • We own our actions and decisions • We learn from our mistakes	Collaborative • We share our knowledge and experience • We work towards a shared vision • We know we work better in partnership

11. All the above factors combined influence how the PCPF operates and feed into its business plan, which guides important decision-making such as choosing asset managers, setting stewardship expectations, and monitoring delegated activities (see Principles 7 and 8).

12. Below is a selection of activities that demonstrate how the focus on responsible investment is reflected in various aspects of the Fund's operation:

- Opportunities arising from a greater understanding of ESG factors (e.g., renewable energy infrastructure and property impact investment) are considered when setting investment structure.
- Responsible investment considerations are explicitly made for new mandates, including voting and engagement policies.
- Managers demonstrating weaker practices over sustained periods will not be considered for future appointments, and their appointment will be reviewed.
- Analysis of the Fund's carbon exposure and intensity will be carried out annually.
- The Annual Review includes an update on the Fund's stewardship and governance activities, including voting and engagement.

13. One example of integrating investment beliefs with investment decision-making is the steps taken by the Trustees to incorporate impact investment within the Fund's strategic asset allocation over the years.

14. The Trustees have acted on opportunities arising from a greater understanding of ESG factors in recent years and have committed a total of 10% of Fund assets to renewable energy infrastructure mandates. Half of this allocation is committed to a Global Renewable Infrastructure strategy managed by BlackRock,

with the first investment made in August 2020. The strategy specialises in building the infrastructure required to generate renewable energy, such as Solar and Wind farms. The remaining half is committed to a strategy with an explicitly stated objective to achieve a positive environmental or social impact, alongside generating a financial return. Foresight Energy Infrastructure Partners (FEIP) were selected to manage this mandate. FEIP targets renewable energy generation and also places a significant focus on supporting infrastructure and technology. The first investment to FEIP was made in August 2021. Both mandates are now more than 50% funded and are expected to have drawn at least 90% of the capital committed by the end of 2024.

15. In September 2023, the Trustees reviewed the Fund's property portfolio and agreed to re-position towards areas of property offering greater potential for return and an opportunity to add a positive environmental and/or social impact. A 5% allocation to impact property has been agreed, with a manager selection exercise scheduled in 2024. It is expected that further impact investment opportunities will be considered in the future.

16. To assess how effective the PCPF has been in serving the best interests of the beneficiaries, the Trustees regularly monitor investment outcome and measure success against the Fund objectives to:

- invest predominantly in long term growth assets reflecting the investment time horizon of the Fund
- achieve a rate of return over the long term that is at least equivalent to the assumed level of investment return used when calculating the long-term cost of the benefits
- maintain a funding level of at least 100% over the medium to longer term
- ensure that the Fund's assets provide sufficient liquidity to meet benefit payments as they fall due, and minimise the risk of forced selling
- manage the investments as efficiently and effectively as possible, including from an environmental, social and corporate governance (ESG) perspective. Fees and costs should be reviewed annually and challenged if not as expected to ensure all fees and costs remain reasonable and competitive.
- have due regard to the risk of incurring large and sustained deficits in the future with resulting increases in contribution levels and reducing these risks where possible

17. The Fund's triennial actuarial valuation, as at 1 April 2023, was conducted through 2023 and the final results were reviewed by the Trustees at their May 2024 meeting. The funding level was estimated by Government Actuary's Department (GAD) to have increased to 122%, compared to a funding level of 104% as at 1 April 2020. An investment strategy review will be carried out in 2024.

18. In November 2023, The Trustees discussed results from the latest annual carbon footprint exercise. The PCPF's equity and bond holdings have a Weighted Average Carbon Intensity (WACI) of 85.3 tCO_2/\$m Sales relative to an equivalent figure of 143.1 for the combined benchmark. The Trustees were content that based on numerous climate risk metrics, their managers are on the whole exposed to lower levels of climate risk than their market benchmarks. Where individual holdings appeared to contribute to the Fund's carbon intensity disproportionally, the Trustees and their advisers engaged with their investment managers during various meetings to understand the rationale and challenge them where appropriate.

19. The Trustees are satisfied that the Fund has been effective in serving the best interests of its beneficiaries and that the Fund's Responsible Investment Policy has been treated as a primary consideration throughout all relevant decision-making processes.

2. Governance, resources, and incentives

Principle 2 - Signatories' governance, resources and incentives support stewardship.

Governance structure

20. The Parliamentary Contributory Pension Fund (PCPF) is a funded, public service, trust based pension scheme, governed by a statutory framework under schedule 6 to the Constitutional Reform and Governance Act 2010 (CRaG). The rules of the Fund are set out in the following schemes made pursuant to that Act:

- an administration scheme, made by the Independent Parliamentary Standards Authority (IPSA),
- the MPs' Pension Scheme made by IPSA, setting out the benefits payable to and in respect of members of the House of Commons and certain officeholders, and
- the Ministers' Pension Scheme made by the Minister for the Civil Service (MCS), setting out the benefits payable to and in respect of Ministers and prescribed officeholders.

21. The provisions of CRaG prescribe various matters relating to the structure of the Trustee Board (such as the number and composition of Trustees), requirements for member-nominated Trustees and the Trustees' powers and procedures. In particular, it prescribes that the Trustee Board is made up of the following:

- 1 person appointed by IPSA, referred to as the "IPSA Trustee",
- 1 person appointed by the MCS, referred to as the "MCS Trustee", and
- 8 member-nominated Trustees.

22. Collectively, the ten Trustees of the Fund have a range of legal duties for the Fund as well as maintaining overall responsibility for the management of the Fund. It is the Trustees' fiduciary duty to oversee all aspects of the Fund to ensure that the Fund's assets are invested in a manner which meets their overriding objective to pay benefits to members as they fall due. The Trustee Board maintain oversight of, and overall accountability for, the Fund's effective stewardship, and they are supported operationally by the Secretariat team, led by Gurpreet Bassi, Head of Members' Pensions, who also acts as Secretary to the Trustees.

23. The Trustee Board regularly meet for ordinary and investment focused meetings to scrutinise how the Fund operates and address any emerging concerns. Since 2021 the Trustees have increased the number of investment focused meetings to four per year to further strengthen the focus on robust governance and active stewardship. The Trustees agreed to the Fund's Responsible Investment Policy in 2019, which is reviewed annually and was last updated in January 2024. It sets out the Trustees' policy for incorporating responsible investment (including climate risk) considerations within the investment process. The policy also details the processes for reviewing the Fund's stewardship and investment policies (see Principle 5).

24. The Trustees recognise the importance of ongoing education on a broad range of investment matters, including responsible investment. Arrangements are in place to assess and address the ongoing training requirements of Trustees, to ensure that they keep up to date with new and current issues affecting the Fund's operations. Regular and relevant Trustee training sessions are arranged both during and outside of Trustee meetings. As part of their annual business planning, the Trustees ensure that at least one

formal training session is directly focused on responsible investment. Training is sought from the Trustees' investment advisers, investment managers, legal advisers, external specialists and other engaged pension funds to provide exposure to a range of opinions and approaches to effective governance. The Trustees held a Responsible Investment Training Day in December 2023. The training included sessions on property impact investment, ESG (Environmental, Social and Governance) integration in global private finance, and other topical areas such as biodiversity, modern slavery, and artificial intelligence through a responsible investment lens.

25. The Trustees maintain a 'balance of powers' document which sets out their responsibilities relating to the administration and governance of the Fund. The roles and responsibilities the Trustees have delegated to the Secretariat are set out in the Secretariat terms of reference.

26. The Secretariat report to the Managing Director of Finance, Portfolio and Performance (FPP). The FPP Team was created to support the House of Commons to be efficient, professional, and fit for purpose and is responsible for financial strategy and corporate business planning with a focus on providing Parliament value for money. Working in FPP is a natural fit for Members' Pensions and has increased in-House financial support and advice that is available to the Trustees.

27. The three-year PCPF Business Plan for 2023-26 was approved by the Trustees in July 2023. The focus of the Business Plan included delivery of the PCPF's response to McCloud[2], preparing to connect to Pensions Dashboards, reviewing the member engagement strategy, and planning and delivery around the General Election. The team also takes account of the wider FPP Business Plan, one of its key objectives being 'attracting, developing and retaining talent, investing in people and strengthening an inclusive team culture'. During the reporting period, Trustees monitored regular reports provided by the Secretariat at Trustee meetings, on progress made in each area, including Secretariat performance.

Resourcing/Incentives of stewardship activities

28. The Trustees appoint professional external advisers to provide high-quality tailored investment and legal advice and services. Currently Hymans Robertson act as the Fund's investment consultant and Sackers its legal adviser. Hymans Robertson were re-appointed in 2021 through a tender conducted under the LGPS (Local Government Pension Scheme) framework. Their expert advice guides the Trustees' decision-making and covers a wide range of areas relating to pension schemes, including stewardship activities. Over the past year the advisers have been instrumental in supporting the Trustees with their expertise on key areas of stewardship such as:

- Reviewing the Fund's protection asset portfolio and property portfolio and recommending changes in line with the Trustees' investment objectives;
- Supporting the Trustees in conducting a manager selection exercise to appoint an investment manager for a maturing buy and maintain credit mandate;

[2] After reforming public service pension schemes in 2014 and 2015, the Government introduced transitional protections for older members. However, in December 2018, the Court of Appeal ruled that younger members of the judicial and firefighters' pension schemes had been unlawfully discriminated against because the protections did not apply to them. This ruling is called the 'McCloud judgment'. As a result of the ruling, changes are being made to remove the age discrimination. These changes are known as the 'McCloud remedy'. While not directly impacted by the McCloud judgement or remedy, IPSA have responded to the McCloud judgement by making similar changes to the MPs' pension scheme rules.

- Reviewing contractual terms and agreements in relation to the new investment into the Insight buy and maintain credit mandate;
- Guiding the Trustees in meeting their climate change commitments as set out in the Climate Risk Policy and providing analysis on the Fund's carbon footprint profile;
- Guiding the Trustees in review of investment policies;
- Discussing investment managers' quarterly voting and engagement reports with Trustees;
- Monitoring managers' adherence to Trustees' investment and stewardship policies;
- Raising the Trustees' and Secretariat's responsible investment concerns with managers and reporting back to the Trustees;
- Educating Trustees on recent responsible investment trends and drivers, ESG reporting/disclosure guidelines, and impact investing etc.

29. The Trustees require administrative support from the Secretariat team to ensure that the Fund is managed properly. Efficient operation of a pension scheme enables the Trustees to focus on the important issues, leaving sufficient time at meetings for key decision-making. As well as business as usual activity, there has been an increasing focus on strengthening scheme governance and enhancing active stewardship.

30. Over the past few years, the level of engagement with and external interest in the Fund and the Trustees' investments has increased, and this has had resourcing implications within the Secretariat team. Since May 2020, an Investment and Governance Specialist has been appointed to bring a level of investment expertise and renewed focus on investment stewardship. A Pension Secretariat Specialist dedicated to the PCPF was also added to the team in 2022 to support ongoing projects and an increased focus on administrative and Fund governance. These additional resources have proved to be valuable to both the Trustees and the wider Secretariat team. By increasing Secretariat support the Trustees have ensured that external advisers and suppliers are used in an efficient and appropriate manner, and that all parties are challenged if necessary.

31. The PCPF Trustee Board is made up of ten Trustees, eight are member-nominated Trustees, one appointed by IPSA, and one by the MCS. As of the end of the reporting period, four Trustees were serving MPs. All Trustees bring with them a complementary breadth of knowledge and experience.

32. The House of Commons has a dedicated Inclusion and Diversity team that works with parliamentary stakeholders to provide a positive, inclusive working environment where people are valued for the skills and experience that they bring to work. This means making Parliament more accessible, diverse, free from discrimination and meeting the requirements of the Equality Act 2010.

33. The House of Commons is committed to delivering its diversity and inclusion priorities as an organisation. The Inclusion and Diversity Strategy 2023 to 2027 sets out the key commitments over the next four years. It was developed through consultation with key stakeholders and one of the strongest messages from the consultation was the need to improve certain areas. The strategy focuses on three key areas:

- decreasing the ethnicity pay gap;
- improving accessibility;
- fostering inclusive environments.

34. Colleagues from across the House were invited to make pledges linked to the key themes of the new Diversity Strategy to action within their relevant spheres. In June 2023, the Members' Pensions team pledged to strengthen the focus on digital accessibility across PCPF communications, particularly in relation to the PCPF website, myPCPFpension.co.uk. This work is expected to continue through 2024 and beyond and will help improve the accessibility of PCPF communications for both PCPF members and the general public.

35. The Members' Pensions team have a diverse workforce and good female representation at management level. Gurpreet Bassi, Head of Members' Pensions and Pension Scheme Secretary, is APMI qualified (Associate of the Pensions Management Institute). The team promote Continuing Professional Development (CPD) as part of ongoing personal development. The Secretariat team are members of industry-wide organisations such as the Pensions and Lifetime Savings Association (PLSA) and Pensions Management Institute (PMI), and are encouraged and supported by the management to participate in various industry forums, investment conferences, and e-learning to keep abreast of developments in areas such as stewardship and Environmental, Social and Governance (ESG). New learning and development opportunities, including LinkedIn Learning and the Civil Service Learning Portal, were introduced in December 2023 and there is a strong focus on learning and development opportunities within the Finance, Portfolio and Performance team.

36. The team adopted the Coach and Focus approach launched by House of Commons in 2020 for performance and development and ongoing support and training on Coach and Focus is available through the Learning & Development portal. Team managers look to nurture and retain talents through regular dialogues that are focused, unbiased, non-judgemental, committed and supportive.

37. In April 2023, a member of the team was nominated for the Star Award, a staff recognition scheme, for going above and beyond in their role.

<u>Effectiveness of governance, resources, and incentives</u>

38. The Fund's stewardship processes and commitments are reviewed regularly. For instance, previously the Trustees increased the number of investment focused meetings from three to four meetings each year, to ensure increased focus on investment stewardship.

39. Overall, the Fund's governance structure has been effective in supporting active stewardship, with enhancements being made to certain areas such as resourcing. As the PCPF is a taxpayer funded, public service Pension Scheme, the Trustees are careful in scrutinising their resourcing requirements. Resourcing papers are prepared and brought to ordinary Trustee meetings as and when business needs arise. The decision to increase the resourcing of investment stewardship and appoint a PCPF Investment and Governance Specialist has provided additional support on investment matters, with a focus on ESG issues. Whilst the PCPF, as a taxpayer funded pension scheme, does not directly sponsor reward programmes, the workforce are incentivised by staff recognition schemes through the House of Commons in various areas including investment stewardship.

40. To continue to improve the Fund's governance framework, the Trustees aim to review services currently provided by their external advisers, including those in relation to stewardship, and examine whether certain activities are better carried out in-house. This will reduce external dependency, improve cost efficiency, and ensure that external advisers could be challenged where necessary.

3. Conflict of interest

Principle 3 - Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

41. The basic principle in relation to conflicts of interest is found in the High Court case of Re Thompson's Settlement [1986] where the Court held that: "…a man must not put himself in a position where duty and [personal] interest conflict or where his duty to one conflicts with his duty to another *unless expressly authorised"*.

42. The Fund encourages its investment managers to have effective policies that address potential conflicts of interest in relation to stewardship.

43. In respect of conflicts of interest within the Fund, The Trustees recognise that they need to be able to identify conflicts of interest, including those in relation to stewardship, and have procedures in place to manage and monitor them appropriately. The Trustees reviewed and updated Parliamentary Contributory Pension Fund (PCPF) Trustees' Policy and Procedure for Managing Conflicts of Interest, with effect from March 2023, to manage potential or actual conflicts of interest that they may have in carrying out their functions in relation to the Fund. The policy is to be reviewed every three years and may be revised from time to time.

44. New Trustees are appointed under procedures that require them to disclose any conflicts of interest. New Trustees are also provided with a Trustee induction training pack which contains a copy of the Conflicts of Interest policy, as well as other information about the Fund and their new role as a Trustee.

<u>Background to the policy</u>

45. In preparing the Conflicts of Interest policy, the Trustees are mindful of the importance of effective and efficient pension scheme governance and in particular of recent developments in the context of managing conflicts of interest, including:

- guidance issued by the Pensions Regulator - though the Fund is not regulated by it,
- the requirements under the Public Service Pensions Act 2013 on certain other public service pension schemes to ensure that their pension board members do not have a conflict of interest - the Fund is not subject to the governance provisions of that legislation and the circumstances of the Fund differ in many respects from those other schemes, and
- the principles set out in the UK Stewardship Code issued by the Financial Reporting Council

46. Although no new material conflicts of interest were declared by the Trustees during the reporting period, they have identified the below indicative examples of other roles and responsibilities, which may give rise to a potential conflict in relation to investment stewardship:

- a Trustee may have roles or responsibilities from employment, private business or personal interests (outside of their membership of the Houses of Parliament),
- a Trustee may have a financial interest in an existing or potential Fund investment or fund manager,
- a Trustee may have views regarding the Fund's investments based on their personal beliefs.

47. In respect of other roles and responsibilities, individual Trustees may have obligations to declare and manage conflicts of interest. For example, Trustees who are members of the House of Commons must comply with the Code of Conduct approved by the House which includes requirements for members to declare interests and to register certain financial interests (and that register is publicly available).

48. Where a Trustee is an active political campaigner, they may have a predetermined interest in the outcome of Trustee deliberations. If that is the case, they should consider whether there is a conflict of interest, and if there is make a declaration in line with the policy.

49. The Trustees understand that they are fiduciaries and as such have a duty to safeguard the interests of the Fund's beneficiaries. However, this does not preclude any of them from having other roles or responsibilities which may result in a potential or actual conflict of interest with their role as Trustees.

50. Although these do not apply to the Fund, the Trustees have endorsed the Pensions Regulator's guiding principles in relation to Trustees' own conflicts of interest, which can be summarised as requiring Trustees to:

- understand the importance of conflicts of interest, particularly the need to exercise independent judgement and to be perceived to be doing so,
- identify conflicts (potential and actual), including maintaining a record of each Trustees' relevant interests,
- implement procedures to evaluate, manage and avoid conflicts in a way that ensures decisions are not compromised by conflicted Trustees; encourage a culture of openness where conflicts are disclosed and appropriately managed rather than ignored, and
- agree and document a policy (or procedures) for identifying, managing, and monitoring conflicts.

<u>Conflicts of Interest policy and procedures</u>

51. The Trustees have agreed that they must:

- acknowledge any potential conflict of interest they may have,
- be open with each other on any conflicts of interest they may have,
- adopt practical solutions, and
- plan ahead and agree on how they will manage any conflicts of interest which arise.

52. With these objectives in mind, the Trustees have adopted the following procedure:

- at the commencement of meetings of the Trustees (or any sub-committees they establish), each Trustee is required to declare to the meeting any potential or actual conflict of interest that they may have in respect of the business of the meeting, and
- a record of Trustees' declared interests will be made in the relevant meeting minutes.

53. It is the responsibility of:

- each Trustee individually to consider whether, in carrying out any of their functions as Trustees, they may have a potential conflict of interest, and

- the Fund Secretary, in consultation with the Fund's Secretariat, to seek to identify any potential conflicts of interest, particularly when preparing the agenda for Trustees' meetings.

54. In each case the person responsible must, where practical, advise the Chair of any potential conflict issues relevant to the business of the meeting (limiting detail if necessary, to avoid placing the Chair in a similar position of potential conflict) prior to any relevant meeting. If it is not practical to advise the Chair in advance, the person responsible must state the potential conflict issue clearly at the outset of the meeting itself. Where the Chair is advised of a potential conflict and the relevant person responsible does not state it at the relevant meeting, the Chair must disclose its existence to the Trustees.

55. It is for the Chair to decide on the action (if any) required to manage a potential conflict of interest and to advise the Trustees of any actions taken. In taking that decision, they may have regard to such factors as they consider relevant, including (but not limited to) the perception of Fund members or other Fund stakeholders.

56. Where a conflict is identified outside of a Trustees' meeting, the Chair will consult with the Fund Secretary or the Fund's Secretariat prior to making a decision. Where the conflict is identified at a Trustees' meeting, the Chair will consult with the other Trustees prior to making a decision. In either case, the Chair may additionally consult with any of the Trustees, the Fund Secretary, the Fund's Secretariat, or any appointed professional advisers as they see fit.

Managing a conflict of interest

57. Steps that may be taken to manage a conflict might include (but are not limited to): a decision being delegated to a sub-committee of the Trustees which does not include the conflicted Trustee; or the conflicted Trustee being required:

    - to leave the meeting during, or refrain from contributing to, the discussion on the conflicted matter,
    - to withdraw from voting on the conflicted matter, and/or
    - to draw to the attention of the other Trustees that they hold information that may be confidential to another party that is relevant to the discussion or decision (without being required to disclose that information where the Trustee owes a duty of confidentiality in respect of that information or to that other party).

58. Where steps are taken to manage a conflict of interest, the existence of the conflict and the action taken will be recorded in the relevant meeting minutes.

Investment stewardship

59. The Trustees recognise that with an increased focus on responsible investment matters, there is a potentially greater scope for individual Trustee views regarding some aspects of the Fund's investments to conflict with Trustee fiduciary duties when setting the Fund's investment strategy and reviewing investment options.

60. Trustees should note that where there is a financial interest, they must declare a conflict of interest. However, Trustees may have an 'interest' other than financial gain which may need to be declared as a potential conflict of interest.

61. Procurement of investment related services is an important area where potential conflicts of interest may arise. The PCPF follows the Public Contracts Regulations 2015 which require contracting authorities to take appropriate measures to prevent, identify and remedy conflicts of interest arising in the conduct of

procurement procedures so as to avoid any distortion of competition and to ensure equal treatment of all economic operators. Prior to any involvement in the procurement process, the PCPF tender evaluation panel are asked to declare whether they have any direct or indirect, financial, economic or personal interest that would give rise to any Actual Conflict of Interest or Perceived Conflict of Interest that might compromise or be perceived to compromise their impartiality and independence in the procurement process. The procurement team will then consider the position and take any necessary measures to ensure compliance.

62. A similar process applies when the Trustees assess new investment opportunities. During the reporting period, the Trustees completed a manager selection exercise to appoint an investment manager for a maturing buy and maintain credit mandate. The Trustees followed the standard procedure and no actual or perceived conflict of interest has been declared in this instance.

4. Promoting well-functioning markets

Principle 4 - Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

63. The Trustees recognise that as asset owners they have the important duty of working with others to promote a well-functioning financial market, and address risks of a market-wide and systemic nature.

64. The Secretariat maintain the Parliamentary Contributory Pension Fund (PCPF) Risk Register to help identify key risks the Fund is faced with, monitor their likelihood and impact, and document mitigations to be put in place. This includes market-wide and systemic risks. The Risk Register is reviewed and updated regularly and taken to every Trustee meeting for discussion. Throughout the reporting period, the risk of 'failure of Fund assets to provide expected returns due to impact of climate change or other significant market uncertainties' remained a top scoring risk on the Register. This reflects an ongoing focus on addressing climate change and additional market-wide risks identified during the year.

65. Important changes have been made to the Fund's investments this year to mitigate systemic and market-wide risks. For instance, the Trustees made a decision to restructure the Fund's property portfolio and protection asset portfolio, in order to address the risks around failure of assets to provide expected returns or enough income to pay liabilities as they fall due.

<u>UK commercial property sector</u>

66. UK Property, as measured by the MSCI UK Monthly Property Index, returned -15.4% over the year to 31 August 2023. Capital values saw a sharp decline over the year, particularly in the office and retail sectors, which are down close to 23% and 15% respectively year-on-year.

67. The Fund has a 10% core UK property allocation and therefore suffered some of these losses. However, performance stabilised in the third quarter of 2023 and the Fund's performance was ahead of the wider property benchmark over the full period.

68. Given the challenges faced by this sector, in September the Trustees carried out a review of the Fund's property portfolio to reassess its long-term suitability. The Trustees noted that the UK commercial property landscape is changing, with a shift in demand towards alternative sectors. Furthermore, Energy Performance Certificate (EPC) rating conditions are expected to increase capital expenditure. EPC ratings are used to assess the energy efficiency of buildings in the UK. The Government introduced the Minimum Energy Efficiency Standards in April 2018, which requires non-domestic properties to have an EPC rating of C or above by 2027, and B or above by 2030.

69. These targets are ambitious and have put pressure on property owners. Many funds still have significant amount of work to do to meet the minimum standards, however, this dynamic also creates opportunities to purchase high-quality properties at depressed prices. For instance, some property impact investment strategies explore ways to acquire properties with low EPC ratings at discounted prices and employ a specialist team to renovate and improve the energy efficiency of the properties. A clear environmental objective can be achieved besides the financial objective, through enhancing and/or accelerating energy efficiency, contributing to overall sustainability, and reducing energy consumption.

70. As a result of the review, the Trustees concluded that high quality core UK property continues to provide diversification, strong income potential, and long-term inflation linked returns and therefore has a place in the Fund's long-term strategy. However, the Fund's current portfolio could be repositioned to mitigate the market-wide risk and better capture new opportunities. The Trustees agreed to redeem the holdings in

BlackRock UK Property and Schroders UK Real Estate and increase the allocation to the UBS Triton fund to 5%. These changes were agreed to best position the portfolio from a forward-looking perspective. The Trustees also agreed to invest 5% of Fund assets in a property impact investment. They received training on opportunistic/impact property investing in December 2023 and will carry out a manager selection exercise in 2024.

<u>ESG risks including climate change and biodiversity</u>

71. The Trustees acknowledge that there are a broad range of ESG risks which operate over different timeframes and with differing potential degrees of impact on the Fund.

72. Climate change presents a systemic and material risk to the ecological, social, and financial stability of every economy and country in the world and is increasingly having a real impact on both Trustees and sponsors of defined benefit schemes. It is also particularly relevant for investors with long-term time horizons. While climate change poses a key financial risk over the lifetime of schemes, it also provides opportunities for investors to positively impact the world that savers will retire into.

73. In November 2020, the Trustee Board formalised a Climate Risk Policy, which outlines their approach to addressing climate related risks within the Fund. The policy sets out the Trustees' longer-term ambition for 100% of the Fund's assets to be compatible with net zero-emissions by 2050 or earlier, in line with the Paris Agreement.

74. Recognising their current investment arrangements and governance budget, the Trustees' primary focus over the near term will be on climate-related risk exposure within their equity and real asset holdings, which account for c.70% of the Fund's assets. Having completed the equity transition in April 2021, switching from equity funds tracking traditional market indices to a combination of sustainable and lower carbon approaches, the Fund has achieved significant reduction in its carbon emissions intensity. In summary, the change has reduced the Fund's Weighted Average Carbon Intensity (WACI) by c.51% and the total carbon emissions by c.77%.

75. In November 2023, the latest annual carbon footprinting exercise showed that the Fund's equity and bond holdings have a WACI of 85.3 tCO_2/\$m Sales relative to an equivalent figure of 143.1 for the combined benchmark. The Trustees were content that based on numerous climate risk metrics, their managers are on the whole exposed to lower levels of climate risk than their market benchmarks. Where individual holdings appeared to contribute to the Fund's carbon intensity disproportionally, the Trustees and their advisers engaged with their managers to understand the rationale for this during manager meetings held separately.

76. The Trustees have committed a total of 10% of Fund assets to renewable energy infrastructure, including 5% to the BlackRock Renewable Power Infrastructure Fund and another 5% to Foresight Energy Infrastructure Fund. During the reporting period, these investments grew steadily as fund managers continued to call capital to fund new projects. Further impact investment opportunities will also be examined as the Trustees look to restructure the property portfolio.

77. The Trustees recognise that one important tool to tackle the climate risk challenge and promote well-functioning markets is by engaging with investment managers and monitoring their voting and engagement approach. The Trustees strongly emphasise the importance of engagement on climate-related risks through dialogue with their investment managers. In particular, the Trustees encourage their managers to support engagement with investee companies on climate-related issues, and promote an increase in the disclosure on climate-related risks by companies to investors.

78. The Trustees expect their managers to engage with investee companies (see Principle 9-11) and exercise voting rights (see Principle 12) on their behalf, in line with the Fund's stewardship policy and climate risk objectives. As climate change is considered an Environmental, Social and Governance (ESG) issue of importance by the Trustees, as well as a market-wide and systemic risk, the Trustees encourage their managers to work with other stakeholders and participate in collaborative engagements where appropriate to advance industry initiatives and influence issuers.

79. The Trustees believe that collaboration with other asset owners can be an effective method for engaging with investment managers and raising awareness of climate-related issues on a wider scale basis. In conjunction with other stakeholders, the PCPF has been playing its role in bringing pressure on companies, investors, and policymakers to tackle climate change. Whilst it is hard to point to specific changes that are attributable to the PCPF alone, there is evidence that collective efforts have resulted in changes. For instance, the Fund's asset managers have reported an increasing number of instances where shareholders worked in tandem to successfully put pressure on fossil fuel companies to move towards more sustainable energy resources and to improve their reporting of climate change impact.

80. The Fund's investments in renewable energy infrastructure have also had tangible outcomes in addressing climate change. Foresight's infrastructure investments, for example, support the energy transition and global decarbonisation agenda, which requires significant investment in low carbon generation, along with supporting flexibility assets and grid infrastructure. From financing the UK's largest solar farm, to providing flexibility services in moments of blackout and investing in some of the largest onshore wind turbines in the Nordics, Foresight is working to create a sustainable legacy of clean power.

81. As an asset owner of modest size, the PCPF might not have the resources available to larger pension schemes to meaningfully contribute to industry initiatives and collaborations. However, the Trustees collaborate with their peers and other organisations to understand the developing trends and regulatory changes in managing climate risk. For instance, the Trustees have heard from Institutional Investors Group on Climate Change (IIGCC) and explored their framework that was developed to help guide asset owners in net-zero planning and implementation. In July 2022, the Trustees invited the Head of Responsible Investment at USS (Universities Superannuation Scheme), for a roundtable discussion on the challenges faced by pension schemes in climate related reporting and meeting the net zero target.

82. The Trustees understand that for society to achieve a net zero carbon future by 2050 or earlier, systemic change and collaboration in the investment community will be crucial. They are aware that many of their investment managers are signatories to, or active participants of, relevant industry initiatives such as ShareAction, Carbon Disclosure Project, and Climate Action 100+. The Trustees are keen to explore what role they may play in the future by interacting with other stakeholders, such as investors, issuers, policymakers, and not-for-profits.

83. Biodiversity loss is also a systemic risk that can have a direct financial impact for companies and investors. Biodiversity is the variety and variability of life on Earth, measured at the genetic, species and ecosystem levels across the land, ocean, freshwater and atmospheric realms. Biodiversity is declining faster than at any time in human history. There has been a c.70% decline in the populations of mammals, birds, fish, reptiles and amphibians since 1970. Over 25% of global species is likely to be threatened with extinction over the near term.

84. The Trustees received training on biodiversity as part of their responsible investment workshop in December. They noted that the economy vitally depends on nature, as $44 trillion (over 50%) of global GDP is directly reliant on natural capital. Biodiversity is key for medicinal resources and 50% of pharmaceutical compounds are derived from plants and animals. Agriculture is directly affected by biodiversity loss. Genetic biodiversity also helps guard our food supply against disease. An estimated $20

billion a year is spent worldwide on pesticides and the annual value of natural pollination has been estimated to be worth over $250 billon. Healthy ecosystems underpin trillion-dollar industries such as agriculture, pharmaceuticals, tourism, and forestry.

85. The Trustees recognise that addressing biodiversity loss is a natural extension of Net Zero and efforts to reduce carbon emissions. Oceans and forests each capture around a quarter of global greenhouse gas emissions arising from human activities. Conversely, climate change is a key threat to both terrestrial and marine biodiversity.

86. The Trustees agreed to incorporate biodiversity loss as a major systemic risk during their review of the Fund's Responsible Investment Policy in January 2024. They also intend to review the Taskforce for Nature-related Financial Disclosures (TNFD) reporting requirements and monitor the progress of wider industry adoption in 2024. The TNFD provides a framework to help organisations address environmental risks and opportunities, aiming to encourage improved reporting of nature related financial information.

<u>Mansion House speech</u>

87. On 10 July 2023, the Chancellor delivered his annual Mansion House speech, providing a comprehensive review of the current economic landscape and outlining a number of reforms and initiatives. The speech focused largely on the UK pension industry. Some of the areas of the Government's focus for UK pension funds include:

- Encouraging UK institutional investors (such as pension funds) to invest in UK high-growth companies.
- Ensuring the gilt market is strong and diversified to help encourage investment by pension funds.
- Improving the culture of investment decision making and improving the understanding of pension trustees' fiduciary duty across all pension schemes.
- Aiming to double the existing Local Government Pension Scheme allocations in private equity to 10%.

88. The Trustees examined the speech from a defined benefit perspective and its potential implications for the Fund at their November meeting. While any changes to regulation and the specific impact on the Fund will only become clear after the consultations have concluded, the Trustees believe that the Fund is relatively well placed considering the main areas discussed in the speech. For instance, the majority of Fund assets (c.70%) are already invested in asset classes which may be viewed as 'productive' such as listed equity, infrastructure, and property. In addition, the Trustees already have a level of expertise which allows them to invest in illiquid and more alternative asset classes.

89. The Trustees take their fiduciary duties incredibly seriously and this prime consideration remains at the heart of all investment decisions taken. They continue to work with their investment consultants and legal advisers to balance fiduciary duties with the commitment to responsible investing and managing climate risk. Whilst the pension industry is still considering how to respond to the objectives set out in the Chancellor's speech, the Trustees agreed that they are broadly in support of the initiatives outlined in the speech. When new investment opportunities become available, they would be assessed in the spirit of the Mansion House proposals. In doing so, the Trustees believe the Fund will play its part in contributing to a well-functioning pension industry as well as the long-term growth of the economy.

5. Review and assurance

Principle 5 - Signatories review their policies, assure their processes and assess the effectiveness of their activities.

90. The Trustees are responsible for reviewing the effectiveness of internal controls and assuring effective stewardship, undertaken directly or on their behalf. The Secretariat are tasked with the development and maintenance of the Fund's control framework. This includes a combination of internal controls such as senior management sign-off, Trustee Board oversight, and internal audit. All important policies and documents go through various stages of internal review and sign-off by authorised persons.

91. In authorising investment managers to make investments on their behalf, the Trustees receive sufficient information to make informed decisions and to understand the risks associated with those investments. Specifically, they take advice from Hymans Robertson, their investment consultant, and receive regular updates in relation to the investment managers' investment performance and stewardship activities.

92. The organisations that provide the Fund's custodianship and administration functions are subject to review by their respective internal audit units, which operate to relevant professional Internal Audit Standards. On behalf of the Trustees, the Secretariat review independent reports on internal operational controls for the custodian and the administrator where appropriate.

93. The Trustees set out in the Fund's Responsible Investment Policy their approach to enable effective stewardship, including policies and processes such as:

Explore the possibility of incorporating the United Nations' Sustainable Development Goals into their investment beliefs and broader policy.	Ongoing
Review the benchmarks of any index-tracking mandate. Seek input from advisers and investment managers to understand the potential implications and impact of ESG factors on different approaches.	At least triennially
Monitor investment managers' compliance with the Principles of Responsible Investing (PRI) reporting requirements.	Annually
Monitor equity managers' records as set out in the Fund's policy on voting and engagement activities.	Quarterly
Request that investment managers provide details of any change in their house voting policy and review any changes against the ISS (Institutional Shareholder Services) guidelines.	Annually
Monitor investment managers' adherence to this policy. Review annual compliance report submitted by managers. Publish a summary of voting and engagement activity undertaken by managers and issues on which they have been challenged as part of the stewardship report submitted to the Financial Reporting Council.	Annually
Aim to meet all investment managers on an annual basis. Managers are asked to address Responsible Investment matters as part of presentations to Trustees, setting out how these are incorporated within the investment process.	Annually

Monitor investment managers' compliance with the UK Stewardship Code and their track record of engaging with companies on issues such as climate change risk, fossil fuels, and broader ESG issues.	Ongoing
Consider analysis of the Fund's carbon exposure and intensity. Monitor exposure to climate related risks within its equity portfolio on an annual basis.	Annually
Complete a report on the Fund's Stewardship and Governance activities, including voting and engagement undertaken on behalf of the Fund, to be included in the Annual Review issued to all members of the Fund. Maintain transparency and accountability to stakeholders, and include disclosure of the Fund's top 20 equity holdings.	Annually
Review Trustees' own adherence to the policy and publish the results of this assessment as part of the annual stewardship and governance report.	Annually
Ensure ongoing Trustee education on a broad range of investment matters. Plan at least one formal training session that is directly focused on Responsible Investment.	Annually
Undertake a review to assess the investment adviser's performance against strategic objectives set by Trustees.	Annually
Review the Responsible Investment Policy to ensure it remains appropriate and in line with the long-term objectives for the Fund, as well as broader industry developments.	Annually

94. As part of internal assurance, the Fund's policies are reviewed regularly and revised from time to time. For example, the Trustees conducted a proxy voting review in 2022 to ensure voting guidelines adopted remain consistent with the Fund's Responsible Investment Policy. Having considered four sets of guidelines, the Trustees concluded that the ISS (Institutional Shareholder Services) Sustainability guidelines are the most robust and comprehensive in addressing ESG issues. As sustainability-minded investors, the Trustees decided to instruct their equity managers to switch to the ISS Sustainability guidelines in line with their responsible investment beliefs.

95. The work of the Members' Pensions team falls within the jurisdiction of the House of Commons' Internal Audit function. Internal audit reviews are carried out periodically. In 2022 an internal audit review of the Members Estimate Control Framework was undertaken. This included key elements of financial processes relating to the Parliamentary Contributory Pension Fund (PCPF). Overall, the report provided the highest rating for the PCPF – which was a Substantial level of assurance over the Framework for the scope areas audited. It was concluded that this opinion was given as there was clarity over scope and roles and responsibilities internally within the House and by third parties contracted to deliver services impacting the Members Estimate and appropriate assurance was obtained over the third party pension scheme administrator's internal controls. In addition, operational processes helped to ensure compliance with rules and policies and supported good quality governance and senior management oversight (monitoring and reporting).

96. External assurance complements internal controls by helping the Trustees manage key risks and evaluate potential pitfalls. The Trustees use independent professional services provided by accountants, lawyers, and other professionals to assure the Fund's key documents, policies, and processes.

97. Audits are one example of services provided by such professionals to assure that stewardship reporting provided to members and the public is fair, balanced, and understandable. The National Audit Office (NAO) carry out independent audits on the Fund's Annual Report and Accounts and scrutinise stewardship information included in the Implementation Statement to assure its accuracy and impartiality. The Implementation Statement is prepared by the Secretariat in accordance with the requirements of the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019, and sets out in detail how the Trustees have complied with the Fund's stewardship policy during the scheme year.

98. The Trustees also seek advice from Sackers, their legal adviser and other authorities regarding any significant changes to the Fund's policies, including those in relation to stewardship practices, before sign-off. For example, the Trustees go through statutory consultation with the Independent Parliamentary Standards Authority and the Minister for the Civil Service on changes made to the Statement of Investment Principles before finalising the document. During the reporting period, Sackers reviewed contractual terms and agreements in relation to the new investment into Insight, and assured the integrity and accuracy of information from a legal perspective.

99. As part of ongoing monitoring of investment managers' compliance with PCPF's stewardship polices, Hymans Robertson, the Fund's investment adviser, is asked to prepare independent voting and engagement reports every quarter, to be reviewed during Trustee meetings. This is to ensure that stewardship reporting is fair, balanced, and understandable and that Trustees can challenge managers where they fall short of expectations.

100. During the reporting period, the Trustees have taken reasonable steps to review their policies, received internal and external assurance in relation to stewardship undertaken directly or on their behalf, and ensured their stewardship reporting is accurate and understandable.

101. The Trustees are satisfied that majority of the Fund's stewardship policies are up to date. With guidance from their investment adviser, the Trustees last reviewed and updated their Statement of Investment Principles, Responsible Investment Policy, and Climate Risk Policy in January 2024. They will also consider the next steps to deliver the Fund's net zero target in line with the Climate Risk Policy.

6. Client and beneficiary needs

Principle 6 - Signatories take account of client and beneficiary needs, and communicate the activities and outcomes of their stewardship and investment to them.

102. The Fund is a contracted-out defined benefit pension scheme. Details on the background and structure of the Fund can be found under Principle 1 and 3.

103. The Parliamentary Contributory Pension Fund (PCPF) Annual Review is the Trustees' main formal written communication to beneficiaries about all scheme matters including stewardship activities and investment outcomes and includes a summary of the accounts for the year. Specific sections are dedicated to responsible investment updates, voting and engagement and investment performance. As well as being posted to all scheme members (active, deferred, pensioner and dependant pensioners) the Annual Review is available in electronic form on the PCPF website.

104. A summary of the Fund's profile as of 31st March 2023 (Fund year end), taken from the Annual Review, is as follows:

- Investment return: -4.6%
- Total assets[3]: £789.8m

105. Below is a summary of the age profile for each set of members as of 31st December 2023:

- Active – 638 members with an average age of 54 years
- Deferred – 284 members with an average age of 56 years
- Pensioners – 807 members with an average age of 76 years
- Spouses/Dependant pensioners – 305 members with an average age of 85 years
- Total membership – 2,034 members with an average age of 68 years

106. Due to the nature of the Fund and the strength of employer covenant (HM Treasury), the Trustees believe that the Fund can take advantage of the benefits associated with a long-term investment horizon as the investments can better withstand periods of price volatility. As a long-term investor, the Fund may choose to gain additional compensation by investing in assets that are illiquid or may be subject to higher levels of volatility (a premium return is required for any such investments).

107. The Trustees acknowledge that climate change is a systemic risk that may negatively impact the Fund as the Fund invests predominantly in long term growth assets. They have developed a Climate Risk Policy to detail their approach to addressing climate related risks. A carbon exposure analysis at Fund level is carried out annually.

108. The Trustees seek to ensure that the Fund's assets provide sufficient liquidity to meet benefit payments as they fall due, and minimise the risk of forced selling. They review cashflow reports and needs at every Investment focussed meeting. Given the membership turnover that is unique to this Fund, with new members joining and active members moving to deferred or pensioner status at each General Election,

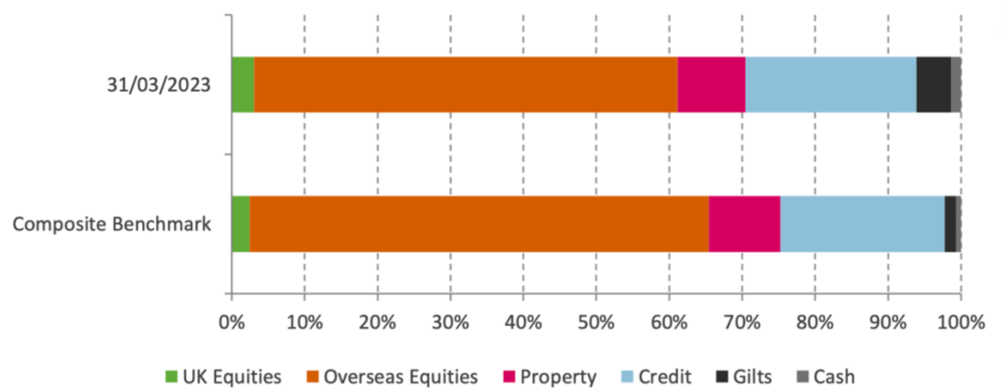
[3] Based on the full Trustees' Accounts for the year ended 31 March 2023.

the Trustees must manage potential liquidity risks as Retirement activity increases from time to time. Historically the Fund has experienced significantly greater cash outflow following a General Election. To mitigate liquidity risks, the Trustees began reviewing the Fund's protection portfolio in February, as one key role of the portfolio is to provide source of liquidity and income.

109. A few alternative structures were initially considered. In May 2023, the Trustees examined the proposal to replace the existing absolute return bond and UK gilts allocations with a dynamic allocation to high quality buy and maintain credit and cash. During periods where it is prudent to build up a cash buffer, for instance in the run-up to a General Election, the cash allocation will increase, otherwise the allocation will predominantly be maturing buy and maintain credit.

110. The Trustees believe that the recommended changes will allow the Fund to build up a cash buffer prior to the next General Election (expected in 2024) and future General Elections thereafter. The restructure will also support ongoing cashflow, by increasing natural cashflow income and removing the dependence on regular equity disinvestments. This will reduce the risk of forced selling and locking into unfavourable pricing. The Trustees agreed to the proposal, as it is expected to better serve the beneficiaries' needs, while not materially altering the expected return of the investment strategy.

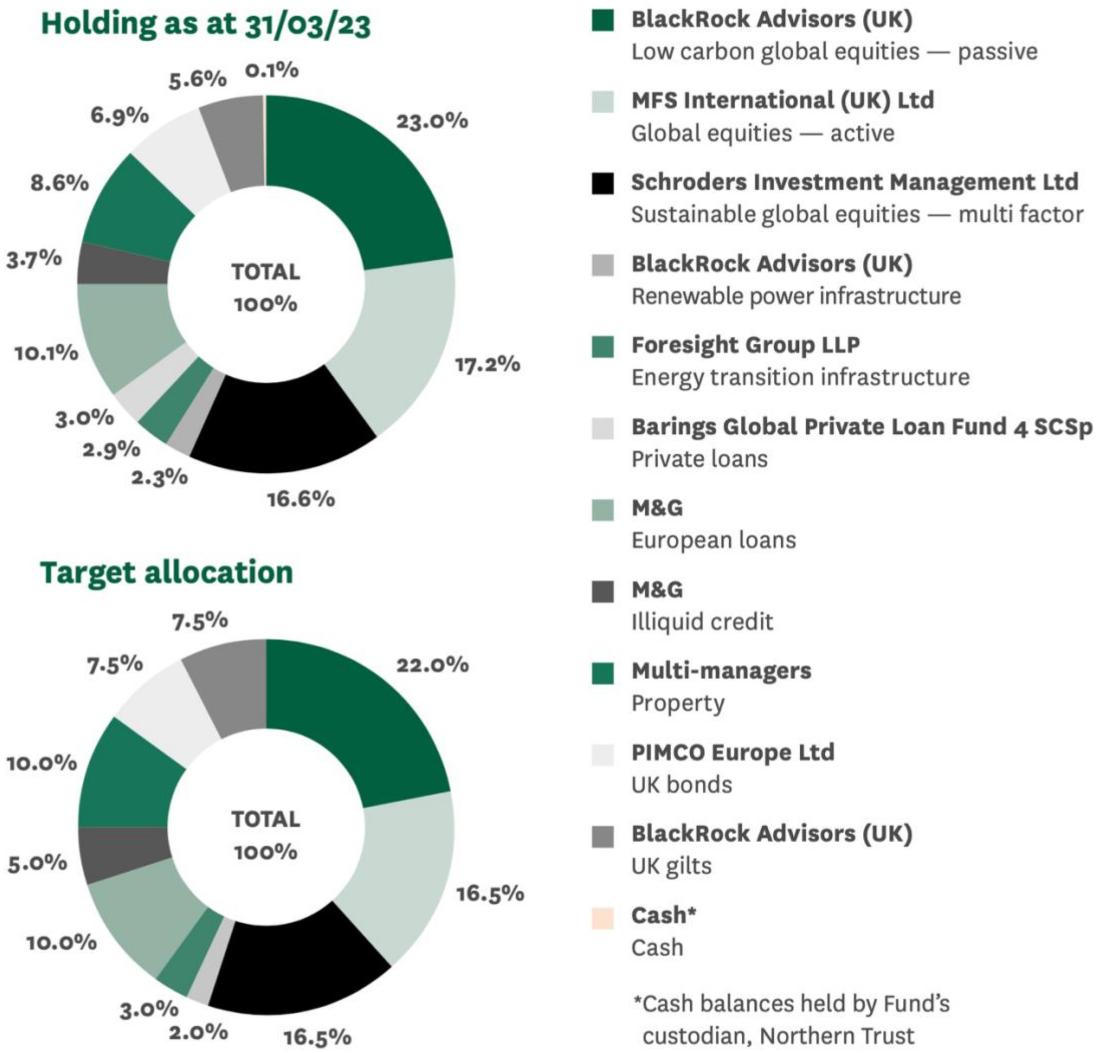
111. Below is an overall breakdown of Fund assets across different asset classes versus the composite benchmark as of 31st March 2023:



112. In addition, a breakdown of Fund assets at the manager and mandate level as of 31st March 2023 is included below:

Fund managers

The manager proportions and mandates at the year-end (31 March 2023) are shown in the charts below:



113. The Fund has committed 5% of assets to the Global Renewable Power Fund managed by BlackRock, and 5% to Foresight Energy Infrastructure Partners. The positions are being built gradually, funded from selling listed equity, as and when the managers call capital.

114. In December 2022, the Trustees made their first investment into Barings Global Private Loan Fund, as a direct replacement for M&G Illiquid Credit, while the latter matured. The target allocation remains at 5%, and the positions are being built gradually as and when the manager calls capital.

115. The PCPF website is an important tool to keep members updated on the Fund's key policies and stewardship reporting. Documents such as the Responsible Investment Policy, Climate Risk Policy, and quarterly voting reports are published and updated in a timely manner. The PCPF Stewardship Report is also available on the website and sets out the work the Trustees have done to integrate stewardship with investment strategies on an annual basis. The Annual Review mentioned above, which is sent to all members, is also available on the website.

116. The Trustees recognise the importance of ensuring members have all the information they need and a forum to express their views. Therefore, regular members' surgeries are held, typically once or twice a year, and after General Elections, for active members to meet the Chair in person, ask questions, and express opinions.

117. During the reporting year, further efforts were made to improve engagement with serving members. The Chair has increased his presence on the estate, by joining the Secretariat at the pensions stall in Portcullis House in March and July. A pension meeting with those impacted by McCloud was also held, for the Chair to engage with members on the complexities of the McCloud response. A number of McCloud focused seminars and communications were arranged throughout the year. In addition, the Secretariat met with members at the House Services Fair in May, a pension stall during Pension Awareness Week in September, and at the Portcullis Hub for three days in December. Through these engagements, the team were able to address various scheme and benefit related queries as well as questions regarding investment stewardship.

118. Pension News, PCPF's annual newsletter, was launched in summer 2022 and also made available online. The newsletter, produced in the summer, provides all active members with a mid-year update on PCPF's investments, along with updates and useful information relevant to serving members. A dedicated Responsible Investment section brings members up to date on key Environmental, Social and Governance (ESG) topics such as climate risk, sustainable investments, and regulatory reporting. The 2023 newsletter featured one of PCPF's underlying assets in action, the Blackhillock project, to illustrate how these investments can be instrumental in helping the UK achieve its decarbonisation target while contributing to the local community. The Trustees are committed to keeping members informed of investment and stewardship activities through new communication methods such as the summer newsletter. This publication also complements the Annual Review which is issued at the start of every year.

119. The Trustees continued to receive ad-hoc correspondence from members throughout the year on important stewardship topics such as climate risk. Information released in the Annual Review and the new annual newsletter has also encouraged members to engage with the Trustees on scheme matters. The Trustees value transparency when communicating with members and where topics of interest become significant across the membership, which tends to occur with the active membership at times, the Trustees are keen to address their responses to all active members.

120. The Trustees recognise that with an increased focus on responsible investment matters, there is potentially greater scope for individual member's views regarding certain aspects of the Fund's investments to conflict with Trustees' fiduciary duty to safeguard the interests of the Fund's beneficiaries. The Trustees strive to manage any potential conflicts of interest and adopt a balanced approach when taking members' views into account. Details on the Trustees' conflicts of interest policy are addressed under Principle 3.

121. Beneficiaries' views are also sought informally. There were four serving Members of Parliament and two members of the House of Lords who sat on the Trustee Board as at the end of 2023. Scheme members who are serving in Parliament often engage with their colleagues who are Trustees to express views in relation to the Fund.

122. The above methods combined have been effective in enabling the Trustees to understand the views of the beneficiaries. While the Trustees respect certain moral/ethical views that could be held by individual members, they have a duty to balance the interests of all members and to act fairly when making investment decisions. Given the nature of the Fund, and the broad spectrum of views that our members hold, it has not always been possible to act on individual member's views. However, in considering these

views and making decisions the Trustees have taken a fair and balanced approach and have ensured that their fiduciary duty is always given the utmost priority.

123. For instance, the Trustees acted in line with many members' views and formulated a Climate Risk Policy in 2020 as this is aligned with their investment beliefs. However, the Trustees have not made a decision to back campaigns such as fossil fuel divestments in the Fund's positioning due to potential conflicts of interest with their overriding fiduciary duty to invest in the best financial interests of the members. Through engaging with their investment managers, the Trustees have seen ample evidence that often the best strategy may well be to exercise their 'voice' more as an investor in the first instance, in preference to simply exiting an investment (see Principles 9-12). The Trustees believe that exploring how to further stewardship and engagement activities should be a precursor to any divestment decisions.

124. Whilst improvements have been made over the reporting year to the frequency and method of communication with active members, the Trustees intend to examine how the PCPF Annual Review could be made more accessible and engaging to all members from 2024 onwards. They may also explore whether additional tools could be used to improve in-year communication with members in the future.

7. Stewardship, investment and ESG integration

Principle 7 - Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

125. The Trustees are responsible for ensuring that the Fund's assets are invested in a manner which meets their overriding objective to pay benefits to members as they fall due. The Trustees recognise that responsible investment considerations pose a financially material risk to the Fund. Responsible investment is considered to be those investment practices where Environmental, Social and Governance (ESG) issues are explicitly or implicitly integrated into investment management processes and asset ownership practices. The Trustees go through regular training on ESG related issues to ensure they are fully aware of the implications ESG factors can have on the Fund's investments.

126. The Trustees acknowledge that there are a broad range of ESG risks which operate over different timeframes with differing potential degrees of impact on the Fund. Of these risks, the Trustees have identified that climate risk warrants more detailed scrutiny given the potentially widespread and uncertain impact on financial, economic, and demographic outcomes. The Trustees also regard executive remuneration as a material governance-related risk and support the mitigation of this risk predominantly through active engagement by investment managers.

127. A stand-alone Responsible Investment Policy was agreed in July 2019 and last updated in January 2024 and sets out the Trustees' policy for incorporating responsible investment (including climate risk) considerations within the investment process. These factors are integrated into each stage of the investment decision-making process: assessing investments prior to holding, monitoring through holding, and exiting investments. The Trustees work closely with the Fund's investment managers to help support good corporate behaviour. The Fund's Responsible Investment Policy enables the Trustees to document their position and expectations for their fund managers and to hold managers accountable for the decisions they make.

<u>Setting investment strategy/structure</u>

128. The Fund's investment strategy represents the broad balance between different asset classes such as equities, debt and real assets. The Trustees frame their investment strategy by reference to long-term risk and return assumptions which make implicit allowance for operational and many systemic ESG risks. The Fund's investment structure represents the allocation to different mandate types within each broad asset class.

129. The Fund's investments are held either directly or through pooled arrangements and both active and passive strategies are used. The Trustees recognise that in practice the means of their engagement with ESG issues will vary depending on how the assets are held and managed, and that the integration of stewardship and investment differs across different types of funds and asset classes.

130. With active investment mandates, the Trustees expect their managers to take account of ESG-related risks and issues as part of their investment analysis. The Trustees engage with their active managers to understand how ESG-related risks are considered in the decision-making process, and to determine that this is consistent with the Fund's policy.

131. With rules-based or index-tracking mandates, the Trustees recognise the influence of benchmarks on the selection of assets by investment managers. Therefore prior to entering into such mandates, the Trustees take into account their ESG characteristics and actively consider alternative approaches in their decision-

making. For example, BlackRock Low Carbon Tracker and Schroders Multi-factor Equity were chosen specifically with Parliamentary Contributory Pension Fund's (PCPF) carbon footprint in mind. BlackRock Low Carbon fund achieved 73% reduction in weighted average carbon intensity (WACI) vs MSCI World Index. Schroders Multi-factor Equity also achieved 50% carbon intensity reduction vs the benchmark by incorporating ESG risk factors at the stock level. The Trustees review the benchmarks of any index-tracking mandate on at least a triennial basis. As part of this process, the Trustees seek input from their advisers and investment managers to understand the potential implications and impact of ESG factors on different approaches.

132. The Trustees also consider opportunities arising from a greater understanding of ESG factors when setting their investment structure and considering new investments. During the year, the Trustees reviewed the Fund's property portfolio, exploring ways to reduce the exposure to core UK property and re-position towards areas of property with greater potential for return and opportunity to add a positive environmental or social impact. In December the Trustees received training on real estate impact investing and will conduct a manager selection exercise in 2024 as they look to re-structure the portfolio.

<u>Setting expectations and monitoring compliance</u>

133. In selecting new investment managers for the Fund, where relevant to the investment mandate, the Trustees explicitly consider potential managers' approach to responsible investment and the extent to which managers integrate ESG issues in the investment process as a factor in their decision-making. The Trustees impose minimum standards for all managers and monitor compliance with these standards on a regular basis. When appointing new managers, the Trustees will consider ESG issues in setting benchmarks, performance criteria, and manager remuneration.

134. The Trustees expect all their investment managers to be signatories to the United Nation's sponsored Principles of Responsible Investment (PRI) or to be able to provide an explanation as to the reasons for not signing. The Trustees aim to monitor their investment managers' compliance with the PRI reporting requirements annually.

135. The Trustees support the Financial Reporting Council's UK Stewardship Code and believe that, where relevant, the Fund's investment managers should be signatories to the Code. The Trustees monitor the investment managers' compliance with the UK Stewardship Code and their track record of engaging with companies on issues such as climate change risk, fossil fuels, executive remuneration, and broader ESG issues on an ongoing basis.

136. The Fund's investment managers are expected to incorporate ESG-related issues into their regular reporting. This includes information on voting and engagement, in addition to details on how they are assessing and managing ESG-related risks in relation to their respective mandates.

137. The Trustees recognise that reporting of ESG integration in asset classes other than listed equity is still evolving and are keen to continue the dialogue with their non-equity managers. As part of the responsible investment workshop held in December 2023, the Trustees invited Barings Private Finance to speak about their actions taken to address ESG and climate risk. Barings also discussed ESG integration throughout the investment process. The manager was a first mover in the middle market to establish criteria in loan documentation which incentivises positive ESG practices and provided case studies to bring such investments to life. When meeting with their property managers, the Trustees asked them to elaborate on plans towards implementing EPC B, as well as stewardship activities such as tenant engagement and sustainable campaigns.

Voting

138. During the reporting period, the Trustees have investment in listed equity assets through three different mandates, managed by MFS (active equity), Schroders (index tracking), and BlackRock (index tracking). The Trustees believe that failing to exercise voting or other rights attached to shares could be contrary to the interest of the beneficiaries of the Fund. They have therefore instructed the investment managers to take this into account in exercising such rights on their behalf. The Trustees have instructed the managers to provide them with a statement on their corporate governance and voting policy, and to report on their voting record in each of these mandates on a quarterly basis.

139. The sustainability voting guidelines issued by Institutional Shareholder Services (ISS) is currently used as the basis for judging good voting practice.

- For segregated mandates, the Trustees have instructed their managers to adopt the ISS sustainability voting guidelines. Where a manager does not vote in line with the ISS sustainability guidelines, this will be reported to the Trustees and explanation will be required.

- For pooled mandates, where possible the Trustees will instruct their managers to adopt the ISS sustainability voting guidelines. Where not possible to instruct their managers how to vote, the Trustees will review the policies employed by the manager against the ISS sustainability guidelines and where appropriate request that the manager take account of the ISS sustainability guidelines in the execution of voting policy.

140. The Trustees seek to ensure that their managers are exercising voting rights and where appropriate, to monitor managers' voting patterns. The Trustees require that their active managers provide an explanation where votes have not been cast in accordance with the Fund's policy. The Trustees review managers' voting activities on a regular basis and challenge managers on voting practices during regular review meetings. The Trustees also monitor investment managers' voting on particular companies or issues that affect more than one company.

141. On an annual basis and where relevant, the Trustees request their investment managers to provide details of any change in their house voting policy and review any changes against the ISS sustainability guidelines.

142. In making any future manager appointments, the Trustees will assess the manager's voting policy as part of the due diligence process.

Engagement

143. The Trustees believe that their investment managers are accountable to them for all engagement activity and should be able to demonstrate, when challenged, the reason for any engagement activity, the objectives of the engagement activity, the approach taken to achieve the objectives, the timeframe over which the engagement is expected to take place, and the consequences should engagement be unsuccessful. The Trustees believe that engagement activity may differ across mandate types and asset classes and is not limited to listed assets.

144. In appointing new managers, the Trustees assess the prospective manager's approach to engagement to ensure consistency with the Trustees' own policies and reporting requirements. The successful candidates are expected to demonstrate that their approach is consistent with the Fund's policies and in line with developing best practice.

145. The Trustees adopt an evidence-based approach to assessing engagement activity by managers. The Trustees receive regular quarterly update on their equity managers' engagement activity. The Trustees recognise the difference in how investment managers carry out engagement activity for non-listed assets such as private debt and real assets, and request that their non-equity managers complete annual compliance reporting providing specific examples of engagement. Where appropriate, the Trustees challenge their investment managers on actions taken.

Stewardship and decision-making

146. The Trustees believe that they can influence the behaviour and practices of their investment managers with regard to stewardship through ongoing and forceful engagement, even where assets are invested through pooled funds. Where the practices adopted by their investment managers differ from the Trustees' policy, the managers will be challenged on their approach. Managers exhibiting weaker practices over a sustained period will not be considered for future appointments to the Fund and their appointment will be reviewed.

147. The Trustees seek to ensure that their asset managers have integrated stewardship and investment on their behalf and ask the managers to provide evidence as part of stewardship reporting. For instance, Schroders used the below case study to demonstrate how they have systematically integrated stewardship and investment to drive change and improve performance. More examples can be found under Principle 9-11.

Case Study: Marks and Spencer

Schroders had already been engaging this British retailer for several years on their sustainability strategy, when we sent a letter in 2023 regarding the company's board composition.

At the time, the company was performing well against sustainability targets, particularly on fair wages in supply chains. Nevertheless, Schroders' investors were dissatisfied considering the tenure of the past three CEOs. They were supportive of fresh thinking, new approaches, and potentially radical action. Our request for leadership and strategy change was shared with the whole board, which was open to change, compared to previous boards that shied away. We met with the Board chair to discuss the company's strengths, including board strategy and execution, succession, and values.

While this momentum was welcome, Schroders expressed concerns with the board's performance, including capital misallocation and lacking accountability. We wanted the Board Chair to step down with a replacement in place by the next Annual General Meeting - an external candidate with good retail experience. A new Board Chair was in place the following year.

We met with the new Board Chair to discuss his plans for the company. He acknowledged that the company faced challenges including poor company culture. He felt there was too much stale talent and communicated how the management structure would need to change going forward. That turnaround could take 5-10 years and we agreed the company needed to be cautious on the balance sheet.

We are satisfied with the steps being taken to manage material governance issues at this company, as we continue to monitor progress and encourage disclosure.

8. Monitoring managers and service providers

Principle 8 - Signatories monitor and hold to account managers and/or service providers.

Monitoring investment consultant

148. The Trustees set strategic objectives for their investment consultant, review their performance against these objectives as part of ongoing good governance, and assess this annually. This is in line with guidance from The Pension Regulator which suggests performance is monitored annually, with a detailed review every three years.

149. Hymans Robertson, the Fund's investment consultant, create and update workplans to translate strategic objectives set by the Trustees into short-term and mid-term tasks and milestones. These workplans are taken to each investment focused Trustee meeting for discussion and approval. As part of ongoing assessment, the Secretariat ensure that Trustees' feedback, outcome of the discussion, and agreed actions are documented and agreed by all parties.

150. The Trustees adopt an evidence-based approach when assessing their investment consultant's performance against objectives. Progress made against the workplans forms the basis of ongoing evaluation. In addition, Hymans Robertson are asked to provide evidence with example measures of success alongside each objective to assist annual assessment.

151. During the reporting period Hymans Robertson were able to demonstrate with quantifiable measures and specific examples that the services have been delivered to meet the objectives. For example, the Fund's performance (net of fees) for the 12-month period to 31 December 2023 was 8.7% p.a., comfortably ahead of the assumed level of investment return used when calculating the long-term cost of benefits of 7.2% (based on the 2023 actuarial valuation assumed return of CPI + 3.25% p.a.). Longer-term performance also remains ahead of the assumed increase in long-term cost of benefits. The funding level as at 1 April 2023 was estimated by GAD to be 122% (based on the 2023 actuarial valuation). Over the period 1 January 2023 to 31 December 2023 the funding level has remained comfortably above 100%. The annual management fees for the 12 months to 31 March 2023 were confirmed to be 0.30%, broadly in line with the level expected.

152. The Trustees provide regular feedback to their investment consultant about the services they deliver and are vocal about any potential areas for improvement. The Trustees are committed to having this type of open dialogue with their investment consultant. Annual in-person review meetings are held with a senior partner at Hymans Robertson, where feedback on their services is shared. During the meeting held in October 2023, the Secretariat reviewed the services received and shared positive feedback on a few minor areas that were raised in the past. In addition, an interim meeting was held in April 2024 to follow up and review recent performance. While there is a formal policy for escalation, the Trustees have been able to address any minor issues through their regular engagement with Hymans Robertson and any feedback provided has been acted upon quickly.

Monitoring investment managers

153. The Fund's investment structure represents the allocation to different mandate types within various asset classes. When appointing new investment managers for the Fund, where relevant to the mandate, the Trustees set comprehensive investment guidelines including benchmarks, performance criteria, manager

remuneration, and responsible investment expectations. The Trustees impose minimum standards for all managers and monitor their performance on a regular basis.

154. The Trustees have delegated voting and engagement activity in respect of the underlying assets to the Fund's investment managers. It is critical that the managers take an active role in the supervision of the companies in which they invest, both by voting at shareholder meetings and engaging with the management on issues which affect a company's financial performance.

155. The Trustees are supported by Hymans Robertson, their investment adviser, in developing stewardship practices to monitor the investment managers. The team have been instrumental in guiding the Trustees as they develop robust procedures to ensure their managers are held to account. Hymans Robertson also prepares quarterly voting and engagement reports to help monitor equity managers' adherence to the Fund's stewardship policies.

156. The Trustees' Responsible Investment Policy, available on the Parliamentary Contributory Pension Fund (PCPF) website, sets out the Trustees' approach to:

- the exercise of voting rights attached to assets; and
- undertaking engagement activity, including how the Trustees monitor and engage with their investment managers and any other stakeholders.

157. The Trustees value regular dialogue with their managers regarding investment performance and stewardship activities, undertaken in conjunction with their investment adviser. They meet regularly with their managers and consider how expectations have been met both during these meetings and through reporting provided by their investment adviser. Hymans Robertson are required to provide input and analysis to assist the Trustees in evaluating asset managers' performance. They prepare quarterly investment monitoring reports and discuss with the Trustees market outlook, asset allocation, manager performance, and manager ratings. The Trustees use these findings to identify any potential issues and inform their decisions regarding any further engagement with the managers.

158. In 2022 the Trustees became concerned about the performance of an investment manager. During the reporting period the Secretariat and the Trustees continued to engage with the manager on multiple occasions to understand what had led to the underperformance and monitored the situation through regular business updates during investment meetings. Having reviewed the Fund's protection portfolio in May 2023, the Trustees decided to implement various changes and to exit this mandate in the process.

159. As mentioned under Principle 7, the Trustees seek to ensure that their managers are exercising voting rights and where appropriate, to monitor managers' voting patterns. The Trustees have asked MFS, BlackRock, and Schroders, their equity investment managers, to report on how votes are cast on a quarterly basis. The results are analysed by Hymans Robertson and taken to Trustee meetings for discussion and a summary is published on the PCPF website to increase transparency. The Trustees also scrutinise significant votes, identified within the Responsible Investment Policy as votes on issues that are of particular concern, i.e., climate change and executive remuneration.

160. The Trustees monitor the managers' voting records and challenge their decisions where appropriate, in particular, where there is a vote against shareholder resolutions, a vote that is not in line with voting policy, or where the managers' opinions differ.

161. In addition, an engagement deep dive exercise is carried out annually with the equity managers, based on the Trustees' agreed priority areas of climate change and executive remuneration. For example, in

May 2023 the equity managers were asked to comment on Union Pacific regarding various key engagement topics including climate change. The Trustees noted their responses below:

- MFS stated that Union Pacific had set science-based targets to reduce scope 1 and scope 2 GHG (Greenhouse Gas) emissions 26% by 2030 and reach net zero by 2050, as well as setting out the technology that will be used to achieve this. MFS showed good knowledge of the company's targets and activities to achieve their targets.
- BlackRock provided some of Union Pacific's high level ambitions for reducing carbon intensity but their response lacked granularity or specific targets the company had set.
- Schroders deem Union Pacific's move to biofuels insufficient and were surprised that the new Science Based Targets Initiative supports this. This, coupled with their assertion that they may push Union Pacific on this point, implies good engagement.

162. The Trustees held one Manager Day in May 2023 and another in September 2023, where they met with all their investment managers in person to address topics such as manager ethos/style, market overview, portfolio positioning, performance review, and ESG (Environmental, Social and Governance) integration. When meeting with the property managers, the Trustees received an update on the suspension of redemptions in the aftermath of the LDI (Liability Driven Investment) crisis and asked how the interest of the remaining investors would be protected as redemptions get fulfilled. The managers were also asked to disclose the status quo of their asset mix's Energy Performance Certificate (EPC) rating and to elaborate on their plans towards implementing EPC B by the deadline of 2030. The Trustees raised the question of divestment when they met with their equity managers. Schroders gave an example of divesting due to ESG concerns, despite the stock being favoured by the model. The active equity managers also emphasised that divestment is only used as last resort.

163. The Trustees believe that they can influence the behaviour and practices of their investment managers through ongoing and forceful engagement. Trustees will challenge their managers if they fail to manage the assets in line with the Fund's investment and stewardship strategy. Managers exhibiting weaker investment performance or stewardship practices over a sustained period will not be considered for future appointments to the Fund and their appointment will be reviewed.

164. The Trustees monitor their investment managers' performance on a regular basis and have been able to address any minor issues through regular engagement with the managers. The Trustees are satisfied that the Fund's investment and stewardship policies have been followed during the reporting period.

9. Engagement

Principle 9 - Signatories engage with issuers to maintain or enhance the value of assets.

165. The Trustees believe that successful engagement with investee companies can protect and enhance the long-term value of the Fund's investments. Day-to-day responsibility for managing the Fund's holdings is delegated to the appointed investment managers.

166. The Trustees consider that, in most cases, their managers are best placed to engage with investee company management due to (a) the practical constraint of investment in pooled funds which limits their own ability to make alternative directions, (b) the resources available to these managers, which are funded by the investment management fees paid by the Trustees, and (c) the existence of relationships between investment managers and the underlying investee companies.

167. The Trustees expect their investment managers to monitor investee companies, engage with company management where necessary, and report on voting, governance, and engagement activity. Reports from investment managers on voting and engagement activity are reviewed on a regular basis.

<u>Index-tracking equity managers</u>

168. As of December 2023, the Fund had allocation to index tracking equity through two pooled funds, BlackRock Low Carbon Tracker (23%) and Schroders Multi Factor Equity (17%).

169. The **BlackRock** ACS World Low Carbon Equity Tracker Fund replicates the MSCI World Low Carbon Target Reduced Fossil Fuel Select Index. It does so by investing in securities that form this index. Therefore, the outcome of engagement has no impact on what securities the fund holds.

170. The BlackRock Investment Stewardship (BIS) team focuses on promoting effective corporate governance through engagement, proxy voting, and participation in market-level dialogue. These three activities are the main components of the stewardship toolkit and are performed all year long.

171. BlackRock Investment Stewardship's policies are the foundation for the team's voting and engagement activities. The policies are comprised of published BlackRock Investment Stewardship Global Principles, market-level voting guidelines, and engagement priorities that provide clients, companies, and other external stakeholders visibility and clarity into the team's areas of focus and the factors considered in engagement and voting. Each year, the team reviews and updates its policies in order to ensure that the BIS policies are aligned with encouraging practices at companies that support their ability to deliver long-term financial returns for BlackRock's clients.

172. When the stewardship team engages with a company, it grounds the dialogue in relevant BIS policies, from the perspective of a long-term investor. Engagement provides BIS with an opportunity to hear directly from company boards and management on how they are addressing business risks and opportunities that impact their ability to deliver durable, long-term financial performance. Similarly, it is an important mechanism for providing feedback on company practices and disclosures, particularly when, in the team's professional judgment, a company does not seem to be appropriately managing material risks that could potentially impact financial returns.

173. In the 12 months prior to June 30, 2023, the BIS team held 4,000 engagements with more than 2,600 unique companies in 49 markets, effectively covering more than 75% of the value of clients' equity assets managed by BlackRock. The stewardship team held multiple engagements with 879 companies.

174. Each year, BlackRock sets engagement priorities to calibrate the work around the governance and sustainability issues considered as top priorities for companies, clients, and shareholders. The key engagement priorities in 2023 include:

- Board quality and effectiveness – Quality leadership is essential to performance. Board composition, effectiveness, diversity and accountability remain a top priority.
- Climate and natural capital – Climate action plans with targets to advance the transition to a low carbon economy. Managing natural capital dependencies and impacts through sustainable business models.
- Strategy, purpose and financial resilience – A purpose driven long-term strategy, underpinned by sound capital management, supports financial resilience.
- Incentives aligned with value creation – Appropriate incentives reward executives for delivering sustainable long-term value creation.
- Company impacts on people – Sustainable business models create enduring value for all key stakeholders.

175. Over the reporting period BlackRock carried out a total of 1,007 engagements with 569 individual companies for the Low Carbon Fund. Below is an overview of the engagement metrics.

Engagements by region[4]	Number	%
Americas	532	53%
EMEA [Europe, Middle East and Africa]	331	33%
APAC [Asia-Pacific Countries]	144	14%
Engagement themes	Number	%
Governance (G)	940	93%
Social (S)	443	44%
Environmental (E)	378	38%
Key engagement topics	Number	%
E- Climate Risk Management	344	34%
S- Diversity and Inclusion	121	12%
S- Human Capital Management	250	25%
S- Social Risks and Opportunities	127	13%
G- Board Composition & Effectiveness	436	43%
G- Business Oversight/Risk Management	309	31%
G- Corporate Strategy	419	42%
G- Executive Management	223	22%
G- Governance Structure	215	21%
G- Remuneration	458	45%
G- Sustainability Reporting	218	22%

[4] Engagements include multiple company meetings during the year with the same company. Most engagement conversations cover multiple topics and are based on BlackRock's vote guidelines and engagement priorities found at: https://www.blackrock.com/corporate/about-us/investment-stewardship#engagement-orities

176. The stewardship team prioritises engagement based on its assessment of the value to the team or the company of direct dialogue. Either a company or the stewardship team can initiate engagement. The stewardship team assesses which companies to engage, and on what, based on the team's engagement history, analysis of a company's governance, material business risks and performance, or recent developments including those related to proxy voting. Companies seeking to engage usually propose an agenda of topics, which helps BIS determine whether direct dialogue would be mutually productive. In engagement with a specific company, the conversation will be informed by the questions the stewardship team may have about the company's approach to material, business-relevant risks and opportunities, which may be driven by the sector in which they operate or unique to their circumstances or business model. The frequency of engagement is informed by context. BIS engages as often as necessary to understand company-specific issues, which may require several meetings in a twelve- month period or a single meeting every two to three years.

177. BlackRock Investment Stewardship aims to build constructive relationships with public companies, engaging in continuing dialogue with company leadership on factors that may be material to a company's ability to generate the long-term financial returns on which BlackRock's clients depend. These conversations extend well beyond proxy season and form the bedrock of open communication, better understanding, and clarity that are essential to making informed stewardship decisions on clients' behalf. Through engagement, the stewardship team may also communicate its views on material risks and opportunities when the team's analysis indicates company leadership may not be acting in the financial interests of long-term investors.

178. BlackRock has been successful in engagements with a significant number of companies and continues to engage with some as the nature of the engagement is longer term. BlackRock will persevere with those companies where engagements have, to date, been less effective than expected and will not support management proxy proposals if a company proves unresponsive to engagement.

179. BlackRock provided a few case studies to illustrate the details of such engagement activity, including:

Case Study: SAP SE (SAP)

<u>Background</u>

SAP SE (SAP), a German multinational software company, serves as a key example in the EMEA [Europe, Middle East and Africa] region where engagement contributed to enhanced disclosures on executive remuneration.

Year-on-year progress on remuneration transparency and disclosures in EMEA, U.S., and UK companies are generally subject to stringent disclosure requirements on executive compensation frameworks and outcomes. While a number of Continental European companies have historically been less transparent on executive pay, many are now making improvements in their disclosures to better explain how their policies and pay outcomes are aligned to strategy and long-term financial value creation. This is due, in part, to the Shareholders Rights Directive II (SRDII).

<u>BIS Response</u>

BIS looks to companies to be transparent on their executive compensation structures and outcomes they are looking to achieve. It is helpful to the BIS team's understanding when compensation committees provide detail on how variable incentive plans deliver on the firm's strategy and incorporate long-term financial value drivers, including the metrics and timeframes by which shareholders should assess performance.

Company Developments

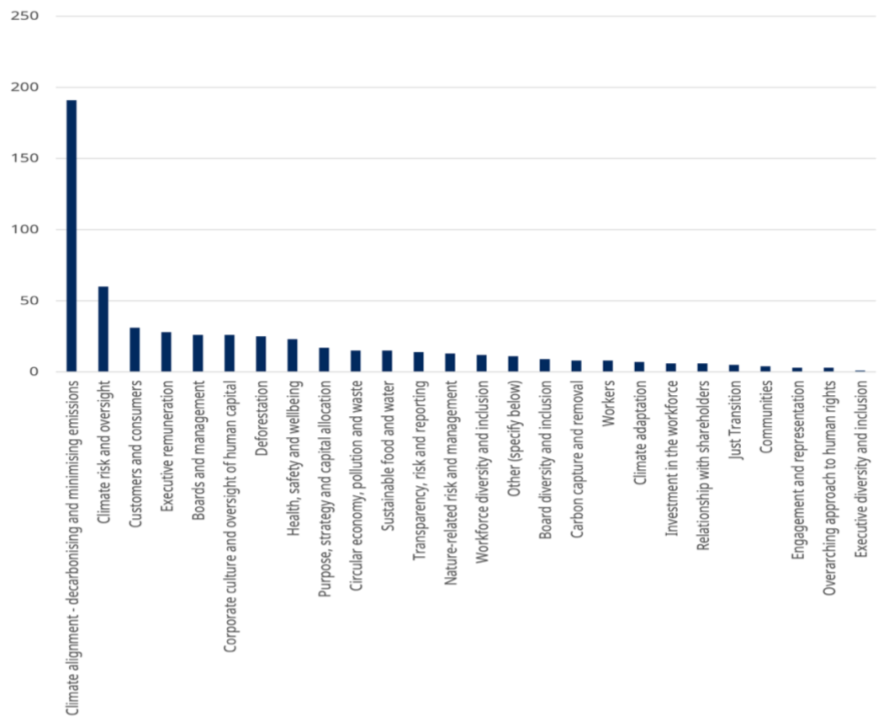
In response to shareholder feedback, SAP improved transparency by outlining specific targets within their long-term incentive plans, revealing actual achievements related to bonuses. SAP also made a series of adjustments to their compensation structure to better align rewards with long-term performance. These positive developments led BIS to support the remuneration proposals at both the May 2022 and 2023 AGMs [Annual General Meetings].

180. **Schroders** seeks to build a process that draws from the strengths of both the Schroders Systematic Investments team (SSI) and Schroders Sustainable Investment team and to put engagement at the core of Schroders' value proposition to clients. SSI provides holdings data along with an engagement score to the Sustainable Investment team. This score can then be used to identify the most urgent engagement targets. The ESG (Environmental, Social and Governance) team will engage the highest scoring names as a priority and will work down the list subject to having available resources.

181. Schroders has a points-based process and stocks accrue points as they hit a range of engagement triggers. Not all triggers attract the same points and the exact formulation for the score will change over time. SSI will actively seek feedback from the Sustainable Investment team. The points system is based on a number of metrics, including: indicators of weak governance, non-disclosure of Scope 1 and 2 emissions, lack of carbon emissions reduction targets, lack of board gender diversity, United Nations (UN) Global Compact Violator or very severe controversies, third party ratings, and SustainEx score vs peer group.

182. SustainEx is Schroders' proprietary ESG metric. It scientifically combines measures of both the harm companies can do and the good they can bring to arrive at an aggregate measure of each firm's social and environmental impact. It quantifies the extent to which companies are in credit or deficit to the societies in which they operate, and the risks they face if the costs they externalise are pushed back onto companies' own books.

183. Schroders engaged with over 39% of the Sustainable Multi-Factor Equity Fund on an asset weighted basis as of December 2023. A summary of engagements grouped by broad topic over 2023 is below.



184. Schroders has also provided examples of engagement activity during 2023, including:

Case Study: Barclays

Banks are facing substantial financial, regulatory, and reputational risks due to the global transition to a low-carbon economy. While the carbon footprint of a bank's operations—such as its offices and branches—is relatively small, the emissions financed by the bank through its clients can have a considerable impact on the climate. Therefore, the key metric for banks in the context of climate change is their 'financed emissions'. Banks have a vital role to play in supporting their clients' transitions away from high-emission activities.

Our engagement with the company on climate change has been intensive and consistent, with discussions taking place around three times a year since 2020.

Initially, we encouraged the company to measure emissions related to its financing activities, set climate targets, and develop robust climate policies. As the company has made progress, our recent engagements have become more technical in nature, focusing on the scope and completeness of targets, assurance over emissions measurement, and providing disclosure on client transition.

As of 2023, the bank has set emission reduction targets for six high-emitting sectors. It has also announced a $1 trillion target to provide sustainable and transition finance to clients, accompanied by a client transition framework to support the shift to lower-carbon business models.

The bank's absolute emissions linked to its financing of the energy sector have fallen by approximately a third over the last three years, indicating significant progress towards its climate goals.

The company has now committed to stop providing financing for oil sands exploration and production companies, as well as financing for the construction of new oil sands production or processing assets or pipelines.

<u>Active equity manager</u>

185. The Fund has a 16.5% target allocation to an active global equity mandate, managed by MFS.

186. During 2023 MFS met with 27 companies held in the Parliamentary Contributory Pension Fund (PCPF) portfolio. Many of these companies were met more than once as part of the research process. There were multiple engagements with management teams, Board members and specific company representatives on a wide range of sustainability and ESG topics, where they are relevant and material to that company.

187. As an active manager, MFS believes open communication with issuers is vital to ensuring all issues, including ESG risks and opportunities, receive adequate attention from management teams and other stakeholders. MFS strive to maintain a regular dialogue with the companies they invest in. Overall, MFS' long-term approach to investing inspires a long-term approach to engagement. Their multi-year engagement horizon typically allows them to develop very strong relationships with portfolio companies. As a result, MFS can have more candid and insightful discussions as they foster these long-term dialogues.

188. MFS believes that engagement is an effective tool to better understand issuers' risk and reward profiles as well as to achieve meaningful change. MFS is committed to engaging with investee companies on a wide range of ESG topics including climate change, plastics, remuneration, succession planning, supply chain issues and workforce disclosure.

189. Below are some examples of recent engagements. Actions and outcomes are ongoing and have helped inform investment decisions, where relevant. While MFS has noted position changes on these securities during 2023, the changes did not necessarily result from the engagement activities because investment decisions are driven by a number of factors, not solely ESG factors.

Example 1: Diageo

During the third quarter of 2023, we met with Diageo to assess the company's decarbonization plans. We noted that Diageo first published emission reduction targets back in 2007. We discussed the company's line of sight to their Scope 1 & 2 emission reduction targets and its dependence on new technologies and improvements in renewable infrastructure in emerging markets. We also discussed the level of sustainability expertise on the board. We will continue to engage with this company as the energy transition progresses.

We added to the position in Diageo during 2023.

Example 2: United Parcel Service

During the second quarter of 2023, we had an engagement call with United Parcel Service where we discussed topics such as the upcoming labour negotiations, employee health and safety, turnover, executive compensation and climate goals. Concerns included steadily increasing reportable incidents and lost time injury numbers, as well as the absolute number of fatalities. We expressed our desire to see a safety metric within the executive compensation incentive plans. We were pleased to hear from company leadership that they are increasing training and monitoring employees in the first 90 days of service, as this is where most of the injuries are concentrated. We feel that this is positive progress, and we will continue to engage around this issue. In addition, we discussed UPS's commitment to being carbon neutral by 2050, including scope 3 but absent an interim science-based target. Unfortunately, their biggest emissions contributor is jet fuel, and there is no current path to a linear reduction in emissions with current Sustainable Aviation Fuels (SAF) technology. However, we will continue to engage with the company on its decarbonization efforts and how they are investing in solutions development.

We maintained the position in United Parcel Service during 2023.

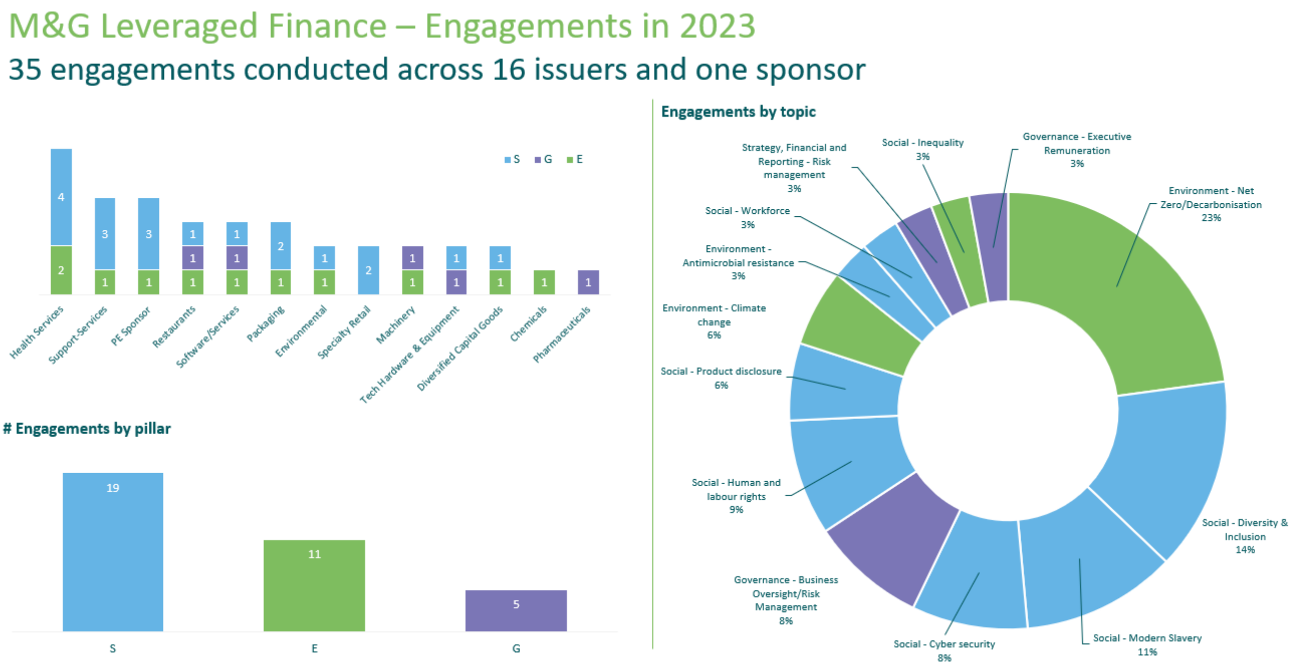
<u>Credit/Private debt manager</u>

190. The Fund has a 15% target allocation in credit/private debt, through M&G European Loan Fund (10%) and M&G Illiquid Credit Opportunities Fund (5%). As the latter matured, Barings Global Private Loan Fund was chosen as a replacement and an initial investment was made in December 2022. The target allocation remains 5%. Approximately 80% of the capital commitment has been funded by end of 2023.

191. **M&G** believes a robust engagement programme with investee companies represents a meaningful way of managing ESG risks. The Private Credit team invest in assets with an asymmetric return profile and implement a long-term buy and hold approach, therefore an effective stewardship policy is needed to protect value over time. The team conducts engagements with both borrowers and sponsors to attest to governance models, environmental and social operating guidelines and to probe on key issues such as climate (with a growing emphasis on net zero), diversity and inclusion, cyber-security and lobbying for greater disclosure. This activity is undertaken jointly by fund managers and analysts and in consultation with M&G's Sustainability & Stewardship team. Engagements are recorded in an automated tracking system to enable holistic views of themes and topics that are material within certain sectors and across multiple asset classes. The benefit of this is that M&G can bring its full influence to bear when investing across the capital structure of the same issuer.

192. M&G's engagement approach has been developed to provide a systematic process around engagements where there is a specific objective and a particular outcome, in line with the UNPRI definition. Prior to commencing an engagement, that objective is clearly set out, with actions and outcomes recorded through the life of the engagement.

193. In 2023, the team conducted 35 engagements across 16 issuers and one sponsor. One key theme that emerged from 2023 was an increased focus on borrowers' climate transition plans as M&G encouraged companies to both set and act on their targets. The topic most often engaged on was the companies' approach to achieving net zero, with it raised as an objective eight times. This focus on climate factors, particularly climate disclosure, comes as no surprise, since the Corporate Sustainability Reporting Directive (CSRD) is expected to launch in 2024. A large number of companies within the Private Credit strategy will be captured and obligated to report, albeit not until 2025/6.



194. The number one topic engaged on during the year related to Net Zero/Decarbonisation, which accounted for almost a quarter of all engagements. Principally this focussed on improving emissions disclosure and setting targets, with notable successful engagements including refuse collection and recycling issuer Beauparc, who committed to achieve net zero by 2040 and set targets for a 1% and 3% reduction in carbon emissions for 2023 and 2024 respectively. The issuer's ESG score rose by four points during the course of the year as a result. Other encouraging climate-related engagements included life sciences measurement and tools company LGC, whom M&G requested to strengthen its existing 2050 Net Zero target by i) disclosing greater detail on their decarbonisation strategy and ii) for the target to become SBTi (Science-Based Targets initiative) accredited. The company is actively working towards SBTi accreditation. Scopes 1 and 2 are already aligned with SBTi, and the company is currently working on scope 3 mapping and engaging with suppliers to establish a framework for science-based targets. M&G recommended that LGC set an interim carbon reduction target to ensure progress towards their net zero goal, to which they confirmed their commitment. The issuer's ESG score rose by two points during the course of the year as a result. Finally, following a climate-related engagement with veterinary group IVCE, a four-point increase in the issuer's score resulted from improved disclosure, including validation of SBTi targets for net zero and capital being allocated to reduce GHG (Greenhouse Gas) emissions (plus waste including single use sterile packaging).

195. Whilst the number one topic was climate-related, social factors were the most prevalent pillar, with Diversity & Inclusion, Modern Slavery and Cyber Security being consistent themes. From a sector perspective, Healthcare and Support Services were engaged with the most often, which aligns with the defensive nature of M&G's strategy, as there is typically an overweight in these sectors versus the index.

196. The **Barings** Global Private Finance (GPF) team leverages engagement activity through direct relationship with key stakeholders, including private equity sponsors and issuer management teams. The focus is on partnering with reputable private equity sponsors, as they play a critical role in influencing ESG practices, given the control they have over the company. The benefit of these relationships and the private nature of the asset class is that Barings is able to stay in constant communication with both the sponsor and the portfolio company management teams. This allows the team to closely monitor any potential ESG-related concerns and a view into the company's controls.

197. Barings continues to recognise that the use of the loan documentation to include an ESG margin ratchet process acts as an important framework to build engagement activity with borrowers. Not only does it benefit issuers in an effort to incentivise good ESG behaviours and outcomes, it also acts as a mechanism to specify expected progress to be made over a period of time against KPIs (key performance indicators) set. Barings recognises that the establishment of the loan agreement requires ongoing engagement to ensure that these provisions convert at scale into the formalised selection of meaningful KPIs. A case study from 2023 is included below:

Case Study: ESG margin ratchet

Barings invested in the #1 provider of subscription-based video applications for automotive repair shops and sales teams within franchised car dealerships across the UK and Europe as well as the #2 for lead management software in the UK. The company's applications provide a key digital service offering to engage with customers, drive sales of high-margin vehicle repairs, vehicle sales and manage dealership sales leads, while complying with corporate data security policies and data privacy regulations.

Barings has provided financing since December 2020 under the previous owner and was able to retain the financing, in part due to a strong relationship with the management team, supporting an acquisition of the business in July 2022.

As part of the acquisition, Barings offered an ESG margin ratchet which was well-received by both the private equity sponsor and management and required provisions were included in the loan documentation with an agreement to set sustainability performance targets and KPIs after closing. In Q1 2023, Barings had an initial call with management to discuss our expectations around gathering data and setting the sustainability performance targets for the ESG ratchet. The company had already appointed a third party ESG consultant, and in Q2 2023 arranged a call with Barings, company management and the consultant to discuss scope of work. The consultant and management agreed to conduct a materiality assessment, an extension of the initial scope that had been agreed with the sponsor, and assist with selecting appropriate sustainability performance targets for the business.

In July we received the completed consultant report as well as a first proposal for sustainability performance targets against relevant KPIs. The proposed KPIs include GHG emissions reduction targets (to be set once a baseline has been established based on an ongoing work throughout 2023), increasing diversity and achieving high levels of training. Barings is currently in the process of negotiating these KPIs with a view to agreeing these before the end of Q3 and activating the ESG margin ratchet.

198. As of 31 December 2023, 61 borrowers across the GPF platform have agreed to embed an ESG ratchet mechanism into loan documentation to enable Key Performance Indicators (KPIs) to be set against margin reductions.

199. Stewardship training was provided to the European Private Finance team in Q4 2023 and to the U.S. Private Finance team in Q1 2024, which has led to initial engagement recording in the proprietary system (with increased reporting expected in 2024). So far, the Global Private Finance team has recorded 22 interactions for 14 distinct engagements with 7 issuers.

<u>Real estate and infrastructure fund managers</u>

200. During the reporting period, the Trustees have investment in real estate assets through three funds, which collectively accounts for 10% of target allocation:

- Schroder UK Real Estate Fund
- UBS Triton Property Fund
- BlackRock UK Property Fund

201. These managers invest directly in real estate assets (and under certain circumstances, other real estate funds) rather than in listed companies, therefore their engagement activity is predominantly focused on occupiers, third party managers and suppliers, community, and investors.

202. For instance, working with appointed Property Managers and on-site Building Managers, **BlackRock** aims to establish active tenant sustainability programmes that regularly engage with tenants on a range of ESG issues. Examples of engagement activities have included focused events on energy efficiency and reduction, including the launch of 'Carbon Challenges' and 'Switch-off Week' campaigns. Energy savings achieved during these campaigns have been reported back to tenants to raise awareness of energy performance 'quick wins' and help encourage longer-term behaviour changes that drive ongoing reductions in energy consumption and wastage. BlackRock's tenant engagement programmes also address wider sustainability issues, including water efficiency, waste management and recycling, local wildlife conservation, and health and wellbeing. Further examples have included 'Waste Aware' and 'Zero Waste to Landfill' campaigns, on-site tree-planting and landscaping activities, introducing tenant yoga classes and other wellbeing activities, and establishing on-site bike rental and cycling clubs.

203. **Schroders** also provided examples detailing engagement activities with local community groups and occupiers, including:

Example: Environment – Net Zero Carbon

One of Schroders Capital's key real estate objectives is to improve the environmental performance of buildings and achieve Net Zero Carbon ('NZC') no later than 2050.

Schroders Capital Real Estate's emissions reduction ambition relates to whole building consumption covering both landlord and tenant controlled consumption. Carrying out NZC audits across the portfolio provides mutual benefit for both landlord and tenant. Engaging with tenants to enhance operational efficiency with regards to emissions improves the reputational drivers of occupiers from an environmental perspective, whilst ameliorating the assets within the Fund portfolio.

Schroders distributed an inaugural sustainability newsletter to all tenants towards the end of 2023, to work with tenants to optimise environmental performance, enhance occupier comfort, and reduce operational costs through a reduction in energy bills.

Further progress has been made through the first phase of NZC audits having been carried out across the Fund. Achieving NZC requires minimising energy demand, improving the energy efficiency of operations, sourcing energy from renewable sources, and lastly offsetting residual emissions through credible schemes such as reforestation. This approach is crucial in combating climate change and creating a sustainable future, whilst also delivering energy security and minimising operational costs. Success is underpinned by engaging with occupiers. Schroders believes taking an active approach to understanding and addressing ESG risks and opportunities is fundamental to delivering resilient investment returns.

204. The Fund has committed 5% of assets to the Global Renewable Power Fund managed by BlackRock, and 5% to Foresight Energy Infrastructure Partners. The positions are being built gradually, funded from selling listed equity, as and when the managers call capital.

205. **BlackRock** Global Renewable Power III (GRP III) Fund is a private market fund that focuses on large scale climate infrastructure assets, with a focus on renewable power generation assets (predominantly wind and solar), as well as a smaller allocation to renewable supporting infrastructure assets such as energy storage, energy distribution and electrified transport.

206. BlackRock's partnership approach appeals to project developers and other industry partners because it gives them confidence around the Team's ability to transact on short timelines, take a balanced and commercial approach to risk sharing, and add value in discussions with key transaction counterparties. An example of this partnership approach includes the engagement with National Renewable Solutions (NRS) on their ESG governances and framework. NRS is an early-stage wind & solar development platform, and because of the team's 'build-to-core' approach the company has matured into late-stage development. The company was recently awarded a 190MW New Mexico solar-plus-storage development project. As the company moves into a new stage of development, BlackRock's ESG team has engaged to provide guidance and direction regarding development of key ESG policies and procedures aligned with international best practice. Through engagement with the BlackRock Climate Infrastructure investment team, commercial asset management and ESG teams, the company has further developed key ESG policies such as a supplier code of conduct, environment and biodiversity policy, employee compensation policy, and compliance guidelines covering topics across environmental, health & safety, anti-bribery and corruption, and human rights. Given the ESG specialists work globally across 15+ platform companies spanning many technologies, the team was able to bring cross platform learning and consistency to drive best practice.

207. The team's ability to take majority or minority ownership positions facilitate engagement with the full spectrum of industry partners from the small project developers that prefer to sell outright to the large utilities that want to retain significant ownership stake. For instance, Chadwick involves an opportunity to aggregate a portfolio of small photovoltaic solar projects in Chile. GRP III's investment represents an opportunity to execute a platform roll-up strategy with its partner and asset manager, Aediles Capital. The team's strategy is to acquire "PMGD" (small distributed generation means) solar projects that are 3-9MW in size and benefit from a unique hybrid PPA (Power Purchase Agreement) offtake structure with long-term price stability. As ESG is fully embedded in the investment process, BlackRock looks to continually seek improvements across the lifecycle of the investment to protect and drive greater impact and maintain alignment to the evolving industry standards. The BlackRock Climate Infrastructure investment, technical, and ESG teams regularly engage with the Company to provide guidance on alignment of their

ESG risk management practices to international and best-industry standards as the Company seeks to enhance its ESG policies and practices. As part of the annual SFDR (Sustainable Financial Disclosure Regulations) review (to ensure fully aligned with our Article 9 status), the ESG specialists collect multiple data points and engage with portfolio companies.

208. **Foresight** has developed the Sustainability Evaluation Tool ("SET") to assess the overall sustainability performance of any investment it makes. This analysis occurs by scoring potential investments against a 'Minimum Threshold' score for each asset class. Every potential investment should meet this minimum threshold in order for the investment to be pursued. Meanwhile areas of under-performance will require justification, mitigation or risk re-profiling in order to continue with the investment process.

209. The five key indicators that Foresight identifies as crucial to its investment process are:

- Sustainable Development Contribution: towards decarbonisation
- Environmental Footprint: localised environmental impacts
- Social Welfare: role in the local communities
- Governance: compliance with laws and regulations
- Third Party Interactions: supply chain sustainability

210. Sustainability and counterparty ESG is a topic which is engaged on early into any investment decision. Foresight considers engagement with companies a key part of its investment process and believes that it will be instrumental in improving their ESG standards. Foresight will typically meet investee companies face to face, primarily during a one-on-one meeting but also as part of group events. Dialogue will take place over email and phone where necessary. The level of engagement between Foresight and the investee company will vary depending on many factors. Meetings to carry out periodic monitoring will be the primary driver of engagement. Where Foresight believes that its engagement will have a beneficial impact on the performance of the company or the standards of their ESG reporting, it may increase its engagement with the management team and, where necessary, the Board.

211. Foresight makes private markets investments into infrastructure assets rather than taking minority positions in listed equities. Typically, the Fund acquires majority or outright ownership positions. There have not been cases of activity that will influence the Fund's position in an investment i.e. to buy, hold or sell. Moreover, through the Fund's approach to active portfolio management facilitated by its 90-strong in-house Portfolio Management team, the Manager has been able to contribute to the management of material ESG and sustainability related risks and opportunities across the Fund's assets.

212. Foresight has provided the below case study to illustrate how engagement works throughout the investment process.

Case Study: Skaftåsen wind farm

One of Foresight's investments is a 231MW 35-turbine onshore windfarm in rural Sweden called Skaftåsen. The project is expected to generate 524GWh of green electricity a year, enough to offset 425,000 tonnes of CO_2 emissions compared to fossil-fuel powered electricity generation.

Community engagement was a key consideration from the early planning-stages and throughout the construction phase. The project experienced delays, notably with supply chains severely impacted during Covid 19, and the municipality needed to extend the permit due to the change in the development plans. Through working with local stakeholders and the community, the permit was approved, which enabled the project to progress. It also provided an opportunity to foster and maintain a good relationship with the local community throughout the site's development and operation as a rapport was established.

The Skaftåsen Grand Opening Ceremony took place in October 2023, serving as an open day for the Härjedalen communities and a celebration of the collaborative partnerships that have brought the project to take-over. The event was attended by over 200 people, including those from the municipality, the regional business association, local schools and key project stakeholders. There were speeches from the Developers, Foresight, the Rural funds association and the Municipality. The following day the Foresight team was invited and attended the local gymnasium to educate the school children on wind farm construction and employment opportunities within the industry, helping to create a lasting, multi-generation impact from the investments. The region holds an important place in Sweden's national transition strategy, representing a focal point for the build out of green hydrogen production, data centres and broader industry, such as green steel. Renewable generation projects such as Skaftåsen are the building blocks in the development of this wider green economy. As it evolves, further job opportunities are expected to be created and principles of circularity and social mobility will be further championed.

Foresight's Sustainability team spoke to several local people, businesses and politicians who emphasised the positive impact the development had on the community and the town, such as job creation and more footfall for the local businesses. Also, the Rural Funds Association will receive the "byggdemedel" or "building money" which equates to 1% of project annual revenue which they are planning on spending to create even more jobs in the region by providing educational courses suited to renewable technologies. They are working with Schools and Universities to provide courses and skills required for the development and maintenance for such sites, as at the moment it is very hard for the young generation to stay in the region as there is not much work. With this money the organisation is now going to give the right education and skills, which should help them to stay in the region and not forced to migrate to bigger cities.

This case study demonstrates the transformational impact of large scale, nationally strategic renewable energy projects in Sweden. Mobilising capital into rural regions to partner with local stakeholders delivers a multitude of benefits aligned with the sustainable development goals, and broader sustainability agenda.

Bond manager

213. During the year, the Fund had a 7.5% target allocation to the Low Duration Opportunities Fund managed by PIMCO.

214. As one of the largest bondholders in the world, PIMCO has a large and important platform to engage with issuers to drive meaningful change on sustainability dimensions. Importantly, PIMCO prioritises engagement where financial exposure, influence and thematic exposure are the greatest. Engagement is an essential tool for delivering impact in ESG investing – PIMCO believes that ESG investing is not only about partnering with issuers that already demonstrate a deeply unified approach to ESG, but also about engaging with those with less advanced sustainability practices. This can be a direct way for PIMCO to influence positive changes that may benefit all stakeholders, including investors, employees, clients, society and the environment.

215. The objective of engagement is to influence change, improve returns and reduce risks for clients. PIMCO believes that bondholder engagement in the research phase is critical to understanding the risk and reward profile of an issuance and ultimately making buy/sell decisions. At present, engagements are focused on the corporate and sovereign asset classes, though PIMCO has engaged on structured credit issuances and with municipal issuers and continues to work to expand coverage of asset classes.

216. PIMCO provided a few examples of engagement activities conducted with issuers held in the Low Duration Opportunities Fund in 2023, including:

Example 1: Banking

Theme	Governance and Green Bond Issuance
Background	PIMCO has connected with the issuer utilizing a two-pronged approach: 1) governance / balance sheet and 2) green credentials.
Engagement	For the first prong, PIMCO has been closely monitoring various iterations of strategic restructurings and management transitions and discussing key considerations with senior management, including capital and balance sheet strength, conflicts of interests, litigation risks, and strategic direction. On the second prong, PIMCO has focused on the issuer's green bond program including expected allocation details, deforestation and ways of factoring in biodiversity, as well as their current practices on climate disclosure and exposure, especially in their engagement with clients.
Looking Forward	The issuer is focusing on continuing to make progress in its restructuring, with an emphasis on servicing corporate clients with a healthy governance structure. They also plan to no longer finance coal mining by 2025 and are ramping up their ESG focus in asset management with stronger disclosure and frameworks.

Example 2: Real Estate Investment Trust (REIT)

Theme	Greenhouse Gas Emissions, Human Capital Management, Human & Labor Rights and Health & Safety
Background	PIMCO met with the head of Investor Relations, Chief Strategy Officer and head of Sustainability, focusing on oversight and management of third-party vendors along with the issuer's emissions reduction targets.
Engagement	Discussed issuer's upcoming corporate social responsibility report and recent corporate actions to improve diversity, which includes hiring a Chief Diversity Officer as well as factoring ESG into executive compensation. PIMCO suggested improving oversight, management and risk mitigation for field third party vendors. Furthermore, PIMCO suggested improving disclosure and reporting on third party vendor management. Issuer's carbon emission reduction targets were recently verified by the Science-Based Targets initiative (SBTi). They have also made substantial progress transitioning to renewable energy solutions where feasible.
Looking Forward	Issuer plans to expand the scope of operations covered by the carbon emissions reduction target verified by the SBTi and PIMCO will continue to monitor their adequate response on improving oversight, management and risk mitigation for field third party vendors.

10. Collaboration

Principle 10 - Signatories, where necessary, participate in collaborative engagement to influence issuers.

217. The Trustees are willing to act collectively with other investors and expect their managers to collectively engage with other investors, where appropriate. They encourage their investment managers to actively participate in collaborative engagements with other investors, fund managers, and organisations where this is deemed to be in the best interests of the Fund. The Trustees will consider opportunities to collaborate with other stakeholders and industry bodies, bearing in mind the resources available to support the Fund.

<u>Index-tracking equity managers</u>

218. **BlackRock** Investment Stewardship (BIS) participates in market-level dialogue to share the team's perspectives with clients, policymakers, and others in the corporate governance ecosystem, on topical and emerging stewardship issues that it believes may impact clients' financial interests as long-term investors. BIS also benefits from hearing from clients, policymakers, and others, on their perspectives on emerging issues. For example, the team may participate in market-level industry discussions on behalf of clients or respond to public policy consultations to offer its perspective on the value of better disclosures for long-term investors.

219. BIS generally engages individual issuers independently, rather than alongside other asset managers or asset owners. BlackRock believes this approach enables the firm to best advance clients' long-term financial interests. Particularly, BIS is sensitive to the regulatory ramifications of collaborative engagement, particularly with respect to U.S. issuers and issuers with U.S.-listed securities. BIS may participate in collaborative engagements with other shareholders in limited instances, where permissible under local regulations and a market norm, and where the clients' long-term financial interests could be more productively advanced through joint dialogue. When BlackRock does engage collaboratively, BIS determines the engagement objectives independently, including with whom and how best to partner.

220. For example, in 2022, BIS included a local insurance company into the engagement with a Taiwanese steel company, to foster the sharing of local perspectives and thus, a more constructive dialogue between investors and the company.

221. BlackRock is a member of several industry associations, including those that are related to sustainability and the transition to a low-carbon economy, which enables dialogue with governments, companies, and financial institutions on matters important to many clients. By being part of these forums, BlackRock is able to represent clients' interests and engage in conversations on their behalf.

222. As an ordinary course of business, BlackRock reviews all of its external memberships on a periodic basis. The firm joins and leaves many working groups and initiatives based on their cadence. For instance, in 2023 BlackRock joined new collective initiatives including the Mexico Green Finance Consultative Council and the Singapore Sustainable Finance Association.

223. During the reporting period, **Schroders** conducted 48 collaborative engagements on topics such as climate change, human capital management, human rights, and natural capital and biodiversity. In particular, 33 of these are in relation to climate change. The manager provided the below case study to illustrate collaborative engagement in action.

Case Study: Shareholder Resolutions at Meta

To provide context for our decision to engage with Meta collaboratively, it is important to discuss the observations we made regarding the company. Initially, we identified Meta as a significant environmental, social, and governance (ESG) risk. Meta has faced systemic issues related to its platform and business model, which are believed to contribute to a lack of social cohesion and human rights concerns. Engaging with Meta has proven challenging, so we have combined engagement topics. We are also participating in a collaborative effort with the Investor Alliance for Human Rights, focusing on digital rights.

Now we clarify why we decided to engage with Meta to strengthen the role of the Lead Independent Director (LID). The LID is a non-executive director appointed or elected by the board to address actual or perceived conflicts of interest associated with the board Chairperson. Having a lead independent director offers numerous benefits, including independent oversight, board leadership and increased investor confidence. Strengthening the role of the LID would enhance the board's understanding of shareholder concerns regarding the combined chair/CEO position.

On November 3, 2023, we participated in a collaborative engagement call with Meta and other investors to encourage the strengthening of the LID's role and greater responsiveness to shareholder resolutions with a majority independent vote.

The company acknowledged investor concerns and appeared to have taken these requests into consideration. Meta explained the collaborative nature of the LID's role with the chair/CEO and the wider board in setting the agenda for board meetings, but they were open to formalizing this arrangement. Regarding the dual-class structure, the company stated that it considers proposals with majority independent support and is open to improving proxy disclosure documents.

<u>Active equity manager</u>

224. **MFS** believes that collaborative engagement can generate positive impacts for industries, individual companies and a wide range of stakeholders, including shareholders. MFS actively participates in a number of industry initiatives, organizations and working groups that seek to improve, and provide guidance on, corporate and investor best practices, ESG integration and proxy voting issues. MFS is a member of or signatory to a variety of organizations and initiatives that promote and coordinate collaborative engagement on ESG topics, such as Climate Action 100+, the Workforce Disclosure Initiative (WDI), and the UK Sustainable Investing Foundation (UK SIF).

225. MFS joined several new collaborative initiatives in 2023, including the United Nations Global Compact (UNGC). The UNGC is a non-binding United Nations pact to get businesses and firms worldwide to adopt sustainable and socially responsible policies, and to report on their implementation. Signatories are expected to internalise the ten principles of the UNGC into their business. The decision to become signatories was motivated by MFS' desire to learn, share and implement best practice around the principles of human rights, labour, environment and anti-corruption into its own operations over the long-term and to strengthen existing activity in these areas. The investment teams will also continue to integrate the risks and opportunities highlighted by the UNGC principles when they are believed to be financially material to the investment case of the issuer being evaluated.

226. During the first quarter, MFS joined the AIGCC (Asia Investor Group on Climate Change) with the goal of building a greater understanding of the energy transition in Asia and the opportunity to engage with Asian Corporates and other stakeholders as Asian markets and companies develop their Net Zero pathways.

MFS has joined the Deforestation and the Energy transition working groups within AIGCC and believes that participating in this group is well aligned with MFS' firmwide Net Zero commitment.

Credit/Private debt manager

227. **M&G** has provided various examples of collaborative engagement undertaken during 2023. Below is a selection of these examples:

228. UK Endorsement Board (UKEB)

We held an engagement with the UKEB to provide feedback from an investor point of view on climate-related risks on financial statements. There was a discussion on why there may be differences between front-end disclosures and what is disclosed in the (back end) financial statements. We also discussed that the focus from M&G was on the impact of a company on the environment and not on climate-related risks to the company itself and/or its supply chain. We felt it was hard for companies to reflect climate-related risks in the financial statements because, for the most part, they simply don't know how best to. We also pointed out many companies have already written down significant parts of their existing projects, which are unlikely to be materially impacted. We agreed with the comment from UKEB about retaining a principles-based approach to accounting standards for this topic.

229. Financial Reporting Council

We attended a round table being run by the Department for Business and Trade and the Financial Reporting Council who are conducting a review on non-financial reporting requirements and were asking for initial thoughts on various topics. The context for the meeting was to look at this area given the framework has been built up over time, so there is a need to review consistency across policy, as well as post-Brexit opportunities and the changes currently being progressed on audit and assurance.

Key areas of discussion/concern: the need for consistency of data across time, geography and industry to help with investor decision making; the need for a set of standards for data and assurance that supports this; the ability to be able to tie the data back to company strategy and what it means for the strategy and financial returns and; the need to try and simplify.

230. CDP (Carbon Disclosure Project)

We are a signatory to the CDP's Non-Disclosure Campaign (NDC). The NDC is a collaboration with capital markets signatories to engage with companies that have failed to respond to requests to disclose through CDP's climate change, forests and/or water security questionnaires. The NDC runs alongside the main CDP disclosure request, to boost transparency and drive-up rates of corporate disclosure. As part of this campaign, M&G engaged with Bank Rakyat Indonesia and ING Group.

231. In 2023, **Barings**' various teams have been the lead or collaborating investors for Climate Action 100+ and the Emerging Markets Investors Alliance. Barings is a member of the European Leveraged Finance Association (ELFA)'s Private Debt ESG Committee. In 2023, the Global Private Finance team has participated in periodic meetings to discuss and share best practice on topics such as:

- potential solutions to overcome the ESG data gap in private markets (e.g., through the use of an industry-aligned questionnaire)
- opportunities to educate borrowers and liaise with sponsors
- processes on how to show progress to investors

232. In addition, the ELFA participated in a panel at Barings' Global Private Finance Conference in November 2023 on topic of Sustainability in Private Finance. Going forward, the committee will also be considering collaboration with 9Fin (a data and analytics platform) on the streamlined collection of ESG data from borrowers.

<u>Real estate and infrastructure fund managers</u>

233. The real assets managers recognise the importance of industry engagement, the contributions they can make to progress the sector, and the value that such engagement can bring to their own investment strategies and methodologies.

234. **Schroders** believes landlord-tenant collaboration is critical to maximising fund performance. Greater landlord-tenant collaboration presents a wider opportunity for landlords to enhance overall tenant relations. The manager developed a number of initiatives to collaborate with occupiers, local community and the general public, for instance, quarterly retailer meetings at Bracknell (usual attendance of 50 retailers), bi-quarterly restaurant/café meetings at Bracknell and Mermaid Quay, continuation of the refill campaign at Mermaid Quay, and the 'Lexicon Awards', an organic social competition over 6 weeks for retailers, restaurants and cafes at Bracknell.

235. Through a combination of on-site perks, digital tools, and greater management visibility, Schroders is ensuring the presence of occupier engagement strategies which support the health and wellbeing of the community. These strategies can create cost savings for the Fund and support productive and happy occupiers, ultimately leading to better tenant advocacy and retainment.

236. The **BlackRock** GRP III team believes that its consultative approach, where the Team seeks to create value for its partners while structuring attractive investments for the Fund, will enable asset optimization and downside risk mitigation. The active management on flood mitigation with Jade, a portfolio of battery storage system in the UK, exemplifies BlackRock's partnership approach. Immingham is one of the assets in Jade, which is currently under construction c.1km from the Humber estuary of the East coast of England. The site is subject to flood risk in the event of a breach of the estuary coastal defences. As a result, it is essential to have effective flood mitigation measures in place to ensure the safety of the site and its occupants. The technical and ESG team conducted a full review during the due diligence stage of the investment being acquired by the Fund, identifying this risk as an area of focus for active management during BlackRock's ownership.

237. The BlackRock Climate Infrastructure Technical team have engaged with the project developer to ensure key flood mitigants are in place. The primary flood mitigation measure is to raise all electrical equipment, including the battery units, substation equipment and control room to a height of 1.9m above ground level. This ensures that these essential facilities will remain above predicted flood levels as identified in the project Flood Risk Assessment. The Immingham site will also be registered with the Environment Agency's flood warning scheme. This means that the site is closely monitored for potential flood events, and personnel are promptly alerted if there is an imminent risk of flooding. Finally, the Immingham site has used flood resilient construction in the steel and concrete platform to which the equipment will be anchored. The effects of a flood would be limited to restricted access during the event, and so long as the wider grid infrastructure is unaffected the site should remain operational.

238. **Foresight** Energy Infrastructure Partners (FEIP) has collaborated with investors in the form of co-investment acquisitions, such as the Skaftåsen wind farm, located in Harjedalen municipality of Central Sweden, which would be the first in the world to feature the most powerful onshore wind turbines developed to date.

239. In addition, below is a selection of collaborative engagement initiatives that members of the FEIP team have taken part in during the reporting period:

Date	Who with	Subject	Detail
May-23	Green Finance Institute	Industry Engagement: TNFD [Taskforce for Nature-related Financial Disclosures] Roundtable – Asset Management	TNFD framework Asset Management feedback session. Session covered the following points: • The usability of the TNFD framework and the sector specific guidance. • How you plan on integrating the framework into existing operating models and reporting frameworks. • A discussion of the challenges and benefits you have found to date when piloting TNFD guidance.
May-23	Arise	Supplier Engagement: Supply Chain Due Diligence and Engagement	Discussion covering: Carbon accounting; supplier due diligence; human rights; low-carbon procurement.
Sep-23	Principles for Responsible Investment (PRI)	Industry Engagement: Nature Reference Group	Participation in Nature Reference Group – assessing implications of TNFD on investment and management activity.
Oct-23	HSBC	Industry Engagement: HSBC – Sustainable Supply Chains	Discussion hosted by HSBC with representatives across the industry and business leaders from their client base to discuss the challenges around identifying, quantifying and reporting scope 3 emissions.

<u>Bond manager</u>

240. PIMCO's effort on collaborative stewardship through engagement includes joining other investors in outreach to companies as well as developing and shaping ESG guidance for companies alongside industry groups.

241. Below is a small subset of the collaborative initiatives that PIMCO has developed or led to drive sustainable finance in fixed income, with a focus on various environmental and social topics.

Example 1 – Tech company

PIMCO engaged their sustainability, risk and IR (investor relations) team to discuss their progress on setting SBT (science-based targets), disclosing Scope 3 emissions, materiality of minerals and indirect supplier oversights. Limited exposure to contractors and universal benefits across part-time and full-time workforce. We shared best practices on physical risks disclosure, green bond impact reporting, Diversity, Equity & Inclusion, transition plan and transparency on supply chain sustainability due diligence and grievances. We also followed up on a controversy regarding the issuer's products being found in weapons used by Russia, clarifying the issuer's current approach and plan around distribution screening and tracing for potential use against UN Global Compact violations and sanctions.

Example 2 – US Bank

PIMCO has been engaging with the issuer both collaboratively with other investors through IIGCC (International Investors Group on Climate Change) on climate change and bilaterally on broader ESG topics. There has been some progress in target setting and assessing client transition progress and positive acknowledgement on methane reduction as part of their engagement with oil and gas sector. However, there remain gaps in their climate ambition (e.g. falling short on using the most ambitious net zero scenarios for target setting, weak link between GHG (Greenhouse Gas) targets and financing policy, etc.). We encouraged the issuer to consider further alignment between sectoral targets and their financing policy (e.g. setting time-bound expectations for carbon-intensive sectors to have a credible transition plan and/or Paris-aligned greenhouse gas emissions targets in place), greater transparency in absolute GHG emissions and client engagement on net zero.

Example 3 – European Bank

We have been engaging with the issuers over the years on various sustainability topics, including climate ambition, deforestation and ESG bonds. In 2022 and early 2023, the issuer has made notable progress in establishing governance and internal capacity to implement net zero targets, but still lags European peers. PIMCO highlighted the importance of linking expectations and assessment of client's credible transition plan to overall financing policy and practices rather than a standalone transition finance framework. We also reached out bilaterally to share our feedback on their Green Financing Framework for aligning with best practices such as more stringent eligibility criteria and alignment with EU Taxonomy.

11. Escalation

Principle 11 - Signatories, where necessary, escalate stewardship activities to influence issuers.

242. Responsibility for day-to-day interaction with issuers is delegated to the Fund's investment managers, including the escalation of engagement when necessary. Managers are expected to disclose escalation activities as part of their annual statement of compliance with the Fund's stewardship policy.

Index-tracking equity managers

243. **BlackRock** believes that engagement meetings should have an agenda and an anticipated outcome. The manager expects that an engagement will help shape a company's approach to an issue, improve a company's disclosure, or inform a voting decision.

244. BlackRock Investment Stewardship (BIS) often engages in lieu of voting against management's recommendations. In the case of concerns, BIS generally prefers to first engage with a company and give management time to address the issue. BIS will vote in favour of management proposals where the team supports the approach taken by a company's management or where it has engaged on matters of concern and anticipates management will address them.

245. BIS tracks its engagement activities in a database, which portfolio managers can also access to deepen their understanding of a company's governance profile. Features in the database allow BIS to record if a company is in line with the team's global governance standards, track developments at the companies engaged, and define and note engagement outcomes. This tracking and monitoring mechanism enables the stewardship team to measure improvements over time, especially as many of the engagements are long-term and ongoing.

246. When authorised to do so by clients, BlackRock Investment Stewardship votes to formally communicate support for or concerns about how companies are serving the financial interests of BlackRock's clients as long-term investors. The vast majority of matters that the stewardship team votes on are routine and it is generally supportive of management. When BIS determines that it is in clients' financial interests to signal concern to companies through voting, the team does so in two forms: 1) it might not support the election of directors or other management proposals; or 2) it might not support management's voting recommendation on a shareholder proposal. Voting to elect directors to the board is a near-universal right of shareholders globally and an important signal of support for, or concern about, the performance of the board in overseeing and advising management.

247. Should a company not be responsive to BlackRock Investment Stewardship's engagement or concerns, the stewardship analyst, in consultation with senior team members as appropriate, determines when and how to escalate, which may include voting against management, when authorised to do so by clients. Voting action may be considered at the company's annual general meeting in the year following engagement and may involve not supporting director elections or not supporting management's voting recommendation on a shareholder proposal. Escalation does not involve filing shareholder proposals, proposing candidates for director elections, nor engaging in public campaigns.

248. As a predominantly indexed investor, BlackRock does not have the option to selectively divest from companies in most strategies, as is the case with the Low Carbon Fund. Below case study illustrates how BlackRock's engagement escalation process works in action.

Case Study: First Quantum Minerals

Background

First Quantum Minerals is a metals and mining company that is primarily focused on copper production in Africa, Australia, Europe, and Latin America. Since 2017, BIS has engaged alongside Active Equity colleagues to discuss with company leadership a range of governance topics, particularly director independence and succession planning.

BIS has had a number of concerns with First Quantum's board composition and effectiveness arising from the familial relationships within the boardroom and senior management team. BIS has not supported the election of certain directors since 2021 to signal concerns about poor succession planning. We have shared our view that greater board independence and regularly introducing new directors to the board would be conducive to long-term financial value creation.

BIS Response

In advance of the May 2023 AGM, BIS engaged with the lead independent director again to flag continuing concerns about board quality.

BIS learned that the board has initiated a multi-year process to retire longer-tenured directors and bring in new members over the next three years. As a result, one of the directors BIS did not support at the 2021 and 2022 AGMs did not stand for election in 2023.

Succession planning remains a concern as the company seems to have an outsized key person risk in relation to the founder/board chair (who is the father of the current CEO).

Outcome

BIS withheld support for three directors standing for election. BIS remained concerned about the succession planning process, the lack of responsiveness to feedback on board quality issues, and BIS' assessment that the board and management team still appear to be beholden to the Board Chair. Ultimately, in our view, the lack of robust succession planning exposes First Quantum to potential long-term risks if the Board Chair is suddenly no longer able to serve.

249. **Schroders** sees the actions of escalation as a spectrum and it may be appropriate to work through the various sanctions step by step over a multi-year period. It may also, from time to time, be appropriate to escalate to more severe sanctions. Below is a summary of the Schroders escalation approach.

250. For the purposes of Sustainable Multi-Factor Equity (SMFE) there is an additional escalation option that falls between voting against and full divestment. Forced Underweights are essentially soft divestments and may be most appropriate for use on-the-way to a full divestment or for large index companies where divestment may create unacceptably high levels of tracking error.

251. Below is an example of escalation being used in practice:

Case Study: Berkshire Hathaway In January 2023, Schroders Systematic Investments (SSI) team's engagement prioritisation framework highlighted Berkshire Hathaway as the highest priority target for engagement. This was mainly driven by a significant lack of environmental and social data disclosures across priority engagement themes, including climate and human capital. We discussed this with the Schroders Active Ownership team as part of our quarterly review, and it was noted that there had been some prior engagement attempts on climate disclosures but without success. SSI and Active Ownership agreed that we should engage here and broaden the scope of previous engagements to capture issues such as disclosures on human capital management. We sent Berkshire Hathaway a letter to ask for a meeting regarding their oversight of key Environmental, Social and Governance (ESG) risks identified in their 10-K, with the aim to obtain better insight into how the company is overseeing ESG risks, including cyber, human capital and climate risks. The company does not have a monitored email address, so the letter was sent by post. Indications are that the company is unlikely to respond to queries by investors, and Schroders' credit analyst covering the name confirmed that this is a long-standing issue. Given we had not received any response from the company, in May 2023 we decided to escalate by supporting a shareholder resolution which asked the company for disclosures around their diversity and inclusion efforts. Through the Active Ownership blog, we provided advanced disclosure of our intention as well as our rationale, noting that we had been unable to engage with the company to date. We will continue to monitor the company's engagement score and any developments in engagement activity in our quarterly reviews. This engagement did not lead to divestment; divestment is our most extreme form of escalation and is reserved for the most severe cases.

Active equity manager

252. MFS believes escalating an engagement is an effective way to assert influence and ultimately be a good steward of client's capital. MFS does not maintain a prescriptive framework with rigid milestones for engagement escalation as the manager views every engagement as a unique endeavour. Also, MFS

does not prioritise specific issues for escalation as all engagement and investment decisions are rooted in economic materiality, which by its nature varies depending on the company and the circumstances it faces. MFS does, however, recognise that its unique position as a large shareholder often allows it to garner more attention from management. Therefore, when it is in the clients' best long-term interests, MFS does not hesitate to escalate an engagement on issues that are considered economically material.

253. MFS' escalation methods are the same regardless of account type, asset or geography. If the outcome of direct engagement is unsatisfactory, MFS may consider using a variety of escalatory tactics. The approach taken depends on the circumstances and may change in light of progress made by the company or other developments.

254. MFS provided the below example where escalation has already been effective and changes have or are being made by the issuer.

Case Study: Danone

During the first quarter of 2023, we continued to engage with Danone as part of our participation in Climate Action 100+. Some of the key topics discussed were climate change, natural capital and deforestation, plastics, decarbonization planning, Science Based Targets initiative (SBTi) certification and capital allocation. Overall, we note that progress has been made in several areas on the company's climate plans. For one, Danone's SBTi validation was accepted in December 2022 and is now aligned with a 1.5 degree Celsius pathway including new forestry, land use and agriculture targets. Danone's greenhouse gas (GHG) emissions for the agricultural business segment represent 60% of overall GHG emissions, which was challenging when setting targets before the publication of the Forestry, Land Use and Agriculture (FLAG) report. Before the FLAG report, sectoral pathways applicable to Danone were not defined. FLAG now provides companies with very precise guidance and tools that are specific to the FLAG sector — land-based emissions and removals. Removals are key to the FLAG sector. The company stated that it participated in several working groups to shape the FLAG pathway. Targets have been filed for scope 1, 2 and 3. Danone's commitment is now more complicated and will require precise monitoring. Regarding plastics, the company has released KPIs (key performance indicators) on plastic and packaging and this is one of the major topics for the company. As for the targets, Danone stated that in staples sector it is perceived as one of the leaders with regards to its approach on plastics and packaging; it is focusing on increasing recyclability and finding alternatives as well as trying to find new innovations.

In November 2023, members of our investment team continued our engagement program with Danone on the topics of board composition, CEO remuneration and plastics. In the meeting, we noted significant improvement in the company's board composition since 2022 in terms of independence and diversity of talent. We welcomed the company's efforts to recruit new directors with international experience, understanding of sustainability and transition risks and sectorial expertise.

On remuneration, we discussed the changes to the CEO's Short Term Incentive Plan (STI) and Long Term Incentive Plan (LTIP) which was approved at the 2023 AGM. We believe these changes better aligned CEO remuneration with long-term shareholder interests by incorporating strategic sustainability criteria to the incentive plans. However, we communicated our desire to see greater clarity in how the CEO would be differently rewarded for greenhouse gas emissions reductions across the company's value chain in the LTIP and STI. We shared that we would like to see the GHG component of the LTIP broken down further to ensure that the emissions reduction payout isn't unnecessarily duplicated.

Lastly, we discussed a recent litigation against Danone filed by ClientEarth and others. The litigation claims that the Company's reporting has been misleading with regards to its plastic water bottles recycling rate. The company stated that it is actively engaging with the claimants and has further communicated that it is heavily investing in recycling infrastructure in order to ensure that its bottles and other single use plastics are widely recycled. The company also started lobbying for regulation that requires all producers to switch to recycled plastic for their bottles so it is not disproportionately impacted by the higher cost of using 100% recycled plastic in its packaging.

We have requested to talk to the company's plastic expert as well as to its plastics focused innovation team, and we will continue to closely monitor the progress. We also discussed the allegations with one of the claimants against Danone.

Credit/Private debt manager

255. **M&G** believes that being able to track the progress and effectiveness of active ownership activities is key, and uses a 'traffic light' system to highlight whether an engagement's objective has been achieved or not, or if the engagement is ongoing.

- Green - The objective has been achieved
- Amber - The engagement is ongoing
- Red - The objective has not been achieved and requires escalation

256. Of the engagements initiated in 2023, almost 15% achieved their objective, with the majority flagged as ongoing. Stewardship, especially in private assets, is a multi-year process requiring a close relationship with the borrower. Often, the companies are on different stages of their ESG journey and therefore will require multiple touch points after the initial engagement. It is also important to remain cognisant of the fact that the success of an engagement can be inherently subjective, and M&G's influence may not be the sole driving force behind any changes.

257. Where M&G has flagged an engagement as 'red', this typically occurs as one of the engagement objectives has not been met adequately. One example is Xsys, a printing manufacturer. The engagement with the issuer covered three topics, including a request for greater disclosure of female representation across the company. The issuer confirmed that they do not currently disclose the gender statistics requested and could not commit to a timeline to disclose in the future. However, the issuer did respond positively to the other topics (climate disclosure and cyber security), and therefore from an investment perspective M&G retained the name within the strategy. M&G will engage further on the topic of gender disclosure with this issuer again in 2024.

258. **Barings** recognises that the Global Private Finance Team's direct positioning or relationship with private equity sponsors can be leveraged to pursue the progression of engagement objectives. Barings will attempt to partner with borrowers through meaningful dialogue to achieve engagement objectives over time, before seeking to escalate engagements. Barings is looking to continue and strengthen its engagement approach with borrowers, with a focus on the pursuit of ESG data collection and the leverage of sustainability linked margin ratchets.

Real estate and infrastructure fund managers

259. The managers have commented that escalation (with issuers) in the traditional sense does not apply to funds investing directly in real assets. However, engagement, and escalation where appropriate, form part of the property manager and vendor monitoring process.

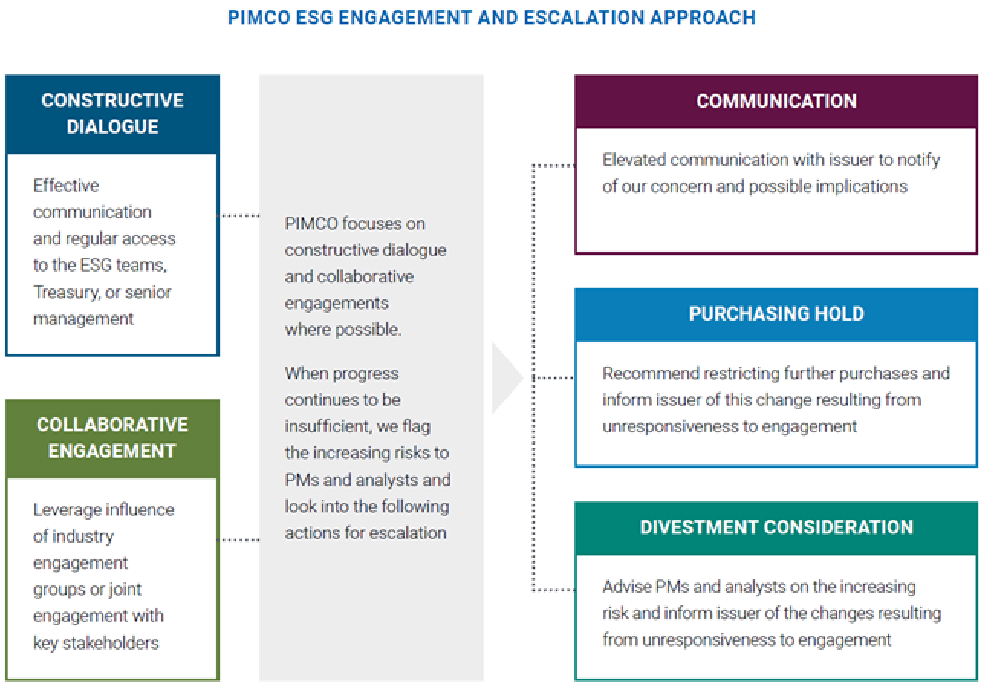
260. For instance, the Property Manager will speak with the relevant BlackRock Asset Manager to discuss the outcomes of annual tenant satisfaction surveys and ensure that any issues or complaints are formally actioned against agreed objectives and timescales. Any issues identified through the surveys, or through wider conversations with tenants, are also addressed in the Quarterly Meetings held between BlackRock and Property Managers. The Property Managers also share the responses of the tenant surveys, and other tenant engagements, with the Global Head of Real Assets Sustainable Investing to enable wider discussions on how environmental and social performance can be improved across the entity, and to help determine any assets which should be prioritised. The outcomes of the surveys are also reviewed by BlackRock to consider the improvements that can be made to future tenant engagement activities and how the collation of tenant feedback can be enhanced.

261. BlackRock also commented that across the 19 investments within the renewable energy infrastructure fund, it has not yet been necessary to conduct any escalatory activities given the effective collaborative engagement approach.

<u>Bond manager</u>

262. PIMCO views stewardship and engagement as a long-term and dynamic process that evolves over several years. While changes may take time (years) to materialise, PIMCO analysts reinforce and follow up on ESG engagement objectives as part of their regular interactions with issuers. PIMCO has found incorporating sustainability issues into this regular dialogue across multiple touchpoints to be a highly effective method of steering for long-term improvement. PIMCO's escalation approach applies consistently across assets, geographies and funds, in line with their obligation of fiduciary duty and treating clients fairly.

263. Progress is tracked by both the interim steps taken by issuers and effective communication (e.g., responsiveness, openness to suggestions and references). If there is a need for accelerating progress, PIMCO focuses on potential breakthrough points via constructive dialogues (e.g., providing references and examples to overcome technical hurdles, or meeting with senior management).



264. Engagements may be escalated in the following scenarios:

- Controversy Driven: Negative idiosyncratic event/controversy occurs and issuer fails to communicate mitigation efforts or resolve.
- Inadequate progress: Moderate ESG-performing issuer with engagement aspirations showing limited progress in pace or level of ambition.
- Reluctance to engage: Issuer lacking willingness to participate in constructive ESG discussions, to disclose key and/or quality ESG information.

265. While PIMCO does not disclose specific engagements where progress may be slower than desired, any lack of progress or response is taken into consideration. Ultimately, the persistent lack of response or progress from issuers and prevailing evidence of ESG risks is reflected in the issuer ESG assessment, sustainability bond assessment, and investment recommendations for PIMCO strategies, including dedicated ESG portfolios.

Example – ESG Escalation with a U.S. Based Real Estate Investment Trust (REIT)

Background:

The company issued a sustainability bond in 2020 with some disclosure practices falling short of market best practices, including second party opinion and indication of impact reporting post issuance. They did not provide any impact report until two years after the issuance. This is misaligned with standard market practice, per International Capital Market Association (ICMA) guidance to publish annually, starting one year after issuance.

Engagement:

Given the slightly weaker disclosure at issuance, PIMCO engaged with the company to share our expectations on impact reporting and best practices for ESG bonds more broadly. When they failed to publish any impact reports two years into the three-year maturity, PIMCO reached out to the company about the timeline for the impact report publication and did not receive any expected timeline for the disclosure. We escalated to the company that we would assume the bond program misaligned with ICMA principles in the absence of an update, and highlighted the lack of plan to align its overall environmental disclosure with industry standards including Task Force on Climate-Related Financial Disclosures (TCFD), Carbon Disclosure Project (CDP), Global Reporting Initiative (GRI) or Sustainability Accounting Standards Board (SASB). PIMCO spoke with the company's Treasury team several times to reinforce our recommendations and potential impacts on ESG assessment for the program.

Progress to date:

The company published an allocation report and obtained a second-party opinion for the program, including impact metrics, showing some progress in improving disclosure. PIMCO plans to continue engaging the issuer on best practices including more ambitious eligibility criteria and impact metrics.

12. Exercising rights and responsibilities

Principle 12 - Signatories actively exercise their rights and responsibilities.

266. The Fund has delegated to its investment managers the responsibility for voting and engagement in relation to the investments that they manage on the Fund's behalf. Failure to exercise voting or other rights attached to the assets could be contrary to the interest of the beneficiaries of the Fund. The Trustees expect investment managers to take this into account in exercising such rights on their behalf.

267. As mentioned under Principle 7, the Trustees have asked their equity investment managers to report on how votes are cast on a quarterly basis. The Trustees have also monitored what shares and voting rights they have and any significant votes cast through these quarterly reports. For segregated mandates, the managers have been instructed to adopt the Institutional Shareholder Service (ISS) Sustainability voting guidelines. For pooled mandates, the Trustees will review the policies employed by the manager against the Institutional Shareholder Services (ISS) Sustainability guidelines and where appropriate request that the manager take account of them in the execution of voting policy.

<u>Index-tracking equity managers</u>

268. As a fiduciary, **BlackRock** is built to support the long-term value of assets the clients are invested in. From BlackRock's perspective, sound management of business-relevant sustainability issues can contribute to a company's sustainable long-term financial performance. Incorporating these considerations into the investment research, portfolio construction, and stewardship process can enhance long-term risk adjusted returns for clients.

269. When authorised to do so by clients, BlackRock Investment Stewardship votes to formally communicate support for, or concerns about, how companies are managing material governance or business risks and opportunities. When the stewardship team determines it is in clients' financial interests to signal concern to companies through voting, the team typically does so in two forms: 1) it might not support the election of directors or other management proposals, or 2) it might not support management's voting recommendation on a shareholder proposal.

270. In the 12 months prior to June 30, 2023, BlackRock Investment Stewardship voted at more than 18,000 shareholder meetings on more than 171,500 management and shareholder proposals in 69 markets. The vast majority of matters that the stewardship team voted on were routine. The team generally supported management's recommendation because, in its assessment, the company was appropriately governed and managed; less than 1% of votes were on shareholder proposals.

271. While BlackRock Investment Stewardship may reference data and analysis produced by proxy research firms, the team does not rely solely on this information in taking voting decisions, nor does it follow any proxy research firm's voting recommendations.

272. In 2022 BlackRock expanded the voting choice options available to clients invested in certain index strategies. The Parliamentary Contributory Pension Fund (PCPF) took the opportunity to instruct BlackRock to vote in line with the ISS Sustainability guidelines for the investments in the Low Carbon Fund. BlackRock confirmed on 30th September 2022 that this has been implemented as requested.

273. Under certain scenarios a market is considered out of scope and the selected voting choice cannot be applied, for instance some markets do not allow split or partial voting and some require share-blocking.

For in scope markets, the shares are voted in line with the selected voting policy and for out-of-scope markets, they are voted in alignment with BlackRock's voting policy.

274. Below is an overview of voting metrics in relation to the Low Carbon Tracker fund for the year 2023.

Summary Voting Statistics	Number	%
Votable Meetings	940	
Meetings Voted	930	98.94%
Votable Ballots	979	
Ballots Voted	969	98.98%
Votable Proposals	**Number**	**%**
Total	13761	
Proposals Voted	13523	98.27%
FOR Votes	12130	88.15%
AGAINST Votes	941	6.84%
ABSTAIN Votes	57	0.41%
WITHHOLD Votes	36	0.26%
Votes WITH Management	13008	94.53%
Votes AGAINST Management	515	3.74%
Management Proposals	**Number**	**%**
Total	13234	
Proposals Voted	13003	98.25%
FOR Votes	12108	91.49%
AGAINST Votes	449	3.39%
ABSTAIN Votes	55	0.42%
WITHHOLD Votes	32	0.24%
Votes WITH Management	12502	94.47%
Votes AGAINST Management	501	3.79%
Shareholder Proposals	**Number**	**%**
Total	527	
Proposals Voted	520	98.67%
FOR Votes	22	4.17%
AGAINST Votes	492	93.36%
ABSTAIN Votes	2	0.38%
WITHHOLD Votes	4	0.76%
Votes WITH Management	506	96.02%
Votes AGAINST Management	14	2.66%

275. BlackRock publishes vote bulletins[5] detailing the analysis, engagements, and votes in relation to a small number of high-profile proposals at company shareholder meetings, so that interested clients and others can understand the rationale behind BlackRock's votes.

[5] See website: https://www.blackrock.com/corporate/about-us/investment-stewardship#vote-bulletins

276. A selection of case studies of stocks held in the Low Carbon Fund[6] is included below to illustrate how BlackRock has exercised voting rights on behalf of the PCPF, with a focus on executive remuneration and climate change risk.

Case Study 1: Oracle Corporation - Advisory Vote to Ratify Named Executive Officers' Compensation

Voted against the proposal and against management

Rationale: A vote AGAINST the proposal is warranted. Following the 12th consecutive low say-on-pay vote result, the proxy vaguely described shareholder engagement efforts, and though feedback is clearly disclosed, the committee did not make any substantive changes to the executive pay program to address shareholders' concerns. Additionally, while CEO pay and company performance were reasonably aligned for the year in review, there are concerns noted within the pay program. Most notably annual equity grants to certain NEOs do not utilise performance-conditioned equity, which is inconsistent with prevailing market practices. This concern is heightened given the magnitude of certain awards and specific shareholder requests for performance-conditioned equity during engagement. Additionally, Chairman Ellison received excessive security fee perquisites in FY23, and no additional disclosure is provided regarding a sharp increase in the value of this perquisite.

Case Study 2: Procter & Gamble Company - Advisory Vote to Ratify Named Executive Officers' Compensation

Voted for the proposal and with management

Rationale: A vote FOR this proposal is warranted. Although certain annual incentives lack disclosure of targets and actual results, bonus pay-outs are commensurate with financial performance. In addition, half of the long-term equity awards are performance-conditioned, and performance stock units (PSUs) are measured over a multi-year performance period with forward-looking goals disclosed.

Case Study 3: Microsoft Corporation - Report on Climate Risk in Retirement Plan Options

Voted for the proposal and against management

Rationale: A vote FOR this resolution is warranted. While the company offers an option to employees that want to invest more responsibly, it is unclear how well employees understand the retirement plans available to them. The information requested in the report would not only complement and enhance the company's existing commitments regarding climate change, but also allow shareholders to better evaluate the company's strategies and management of related risks.

277. **Schroders** recognises the responsibility to make considered use of voting rights. Schroders votes on all resolutions at all Annual General Meetings/Extraordinary General Meetings globally unless restricted from doing so (e.g., as a result of share blocking). Schroders aims to take a consistent approach to voting globally, subject to regulatory restrictions that is in line with published ESG (Environmental, Social and Governance) policy.

278. In 2023, of votes relating to companies held in the Fund, Schroders voted on approximately 94% of total resolutions and instructed a vote against management at 14.7% of the votes. In total, Schroders voted on 5,564 proposals.

[6] Based on quarterly voting reports received from BlackRock.

279. Schroders will engage and vote on any issue affecting the long-term sustainable value of an investee company. The majority are targeted around issues required by local stock exchange listing requirements (e.g., director elections, acceptance of reports and the allocation of income, approval of remuneration policies and reports). Schroders also actively engages and votes on shareholder resolutions and has dedicated sustainable investment analysts who use their expertise to make these voting decisions.

280. On a monthly basis, Schroders produces a global voting report which details shareholder proposals for companies during the period and how the votes were cast, including votes against management and abstentions, along with the rationale behind these decisions. Schroders also publishes a public voting history with the rationale for votes against management, or for management when the matter is contentious. It is Schroders' default process to follow up any votes against management with an email outlining the reasons for voting against them.

281. Schroders does not blanket follow the recommendations of a proxy voting provider. Schroders evaluates voting resolutions and, where it has the authority to do so, votes in line with fiduciary responsibilities in what is deemed to be the interests of the clients. Schroders' Corporate Governance specialists assess each proposal, applying the voting policy and guidelines to each agenda item. In applying the policy, Schroders considers a range of factors, including the circumstances of each company, long-term performance, governance, strategy and the local corporate governance code. Schroders' specialists will draw on external research, such as the Investment Association's Institutional Voting Information Services and ISS, and public reporting. Schroders' own research is also integral to the process; this will be conducted by both the financial and Sustainable Investment analysts. For contentious issues, Corporate Governance specialists consult with the relevant analysts and portfolio managers to seek their view and better understand the corporate context.

282. Schroders provided the below case study to illustrate how voting has been combined with other engagement approaches to drive change:

Case Study: Amazon

Schroders have been engaging the major North American technology company since 2015. In the past, engagements focused on pushing for greater disclosure on culture and turnover rates. We are pleased that Amazon has improved disclosure, and now reports on injury rates and lost time training. However, we are continuing to encourage the company to consider disclosing a more in-depth breakdown of health and safety data and turnover statistics, such as by employee type.

Over 2022, we engaged with the company several times on the root cause of safety issues and increased workforce disclosure. We wrote to the company ahead of its Annual General Meeting (AGM) in May 2022 and went public with concerns by pre-declaring our voting intentions on workforce issues ahead of the 2022 AGM. This led to us supporting three different shareholder proposals related to workers.

We continued our dialogue on worker issues throughout 2023. In January, we wrote to the company to reiterate our request for increased transparency on health and safety and turnover rates. Subsequently the company invited us for a tour of a fulfilment center. We followed up with a call to clarify the performance management systems in place and how the company ensures the implementation of safety policies in fulfilment centers.

We reiterated our perspectives on health and safety in writing to the company and ahead of the May 2023 AGM.

We met again in person in October to discuss a range of sustainability topics, delving into grievance mechanisms and the use of contractors in relation to human capital management. We followed up the in-person meeting by sharing examples of other companies that disclose contractor safety data. Moving forward, we will continue to engage with Amazon on human capital management issues and remain appreciative of the responsiveness of the company to our engagements. We look forward to continued dialogue on these and other sustainability topics.

Active equity manager

283. As requested, MFS votes in line with ISS' Sustainability Proxy Voting Policies effective 1st December 2022. Some key features of the policy are around board of directors, shareholder proposals on corporate governance and executive compensation, and shareholder proposals on social and environmental topics.

284. Below is a summary of overall metrics provided by MFS in relation to the voting activity during 2023:

How many meetings were you eligible to vote at?	87
How many resolutions were you eligible to vote on?	1,495
What % of resolutions did you vote on for which you were eligible?	100%
Of the resolutions on which you voted, what % did you vote with management?	89.83%
Of the resolutions on which you voted, what % did you vote against management? *	10.17%
Of the resolutions on which you voted, what % did you abstain from voting?	0.13%
In what % of meetings, for which you did vote, did you vote at least once against management?	47.67%
* Abstentions are counted as votes against management	

285. MFS highlighted votes during the reporting period that they considered most significant, including:

SIGNIFICANT VOTES FOR THE SCHEME	VOTE 1
Company name	United Parcel Service, Inc.
Date of vote	04/05/2023
Summary of the resolution	Adopt Independently Verified Science-Based Greenhouse Gas Emissions Reduction Targets in Line with the Paris Climate Agreement
How you voted	As requested by the client, MFS voted in line with ISS recommendations: Against Management.

Rationale for the voting decision	ISS Sustainability policy deemed a vote FOR this proposal is warranted, as additional information on the company's efforts to reduce its carbon footprint and align its operations with Paris Agreement goals would allow investors to better understand how the company is managing its transition to a low carbon economy and climate change related risks.
Outcome of the vote	19.8%
On which criteria have you assessed this vote to be "most significant"?	Vote is linked to certain engagement priorities, vote considered engagement with the issuer, vote relates to certain thematic or industry trends, etc.

SIGNIFICANT FOR THE SCHEME	VOTE 2
Company name	Alphabet Inc.
Date of vote	02/06/2023
Summary of the resolution	Report on Framework to Assess Company Lobbying Alignment with Climate Goals
How you voted	As requested by the client, MFS voted in line with ISS recommendations: Against Management.
Rationale for the voting decision	ISS Sustainability policy deemed a vote FOR this proposal is warranted. The request is not considered overly onerous or prescriptive, and shareholders would benefit from greater transparency of the company's framework for addressing misalignments between its climate goals and direct and indirect lobbying, and how the company would plan to mitigate any risks that might be identified.
Outcome of the vote	14.1%
On which criteria have you assessed this vote to be "most significant"?	Vote is linked to certain engagement priorities, vote considered engagement with the issuer, vote relates to certain thematic or industry trends, etc.

Credit/Private debt manager

286. Unlike public equity holders, who may only own a tiny fraction of a company's shares, in **M&G**'s private debt business, the manager often is one of the primary sources of finance for the borrower, which can provide significant access and influence to engage. Within Leveraged Loans M&G's approach is to utilise its status as a very large, private-side lender, and exploit the lobbying and questioning opportunities that this affords. This status also provides M&G with a platform to encourage meaningful change directly with the borrower.

287. Approach to seeking amendments to terms and conditions in indentures or contracts:

Within Fixed Income, investment analysts seek to engage with companies prior to investment to enhance covenant packages where possible, in the context of market norms. For private assets, the relevant analyst is responsible for the initial legal, structural, financial and credit due diligence of each asset prior to investment, as well as the ongoing monitoring throughout its life. Generally, these are buy and hold assets, and this places increased responsibility on the analyst to review the relevant transaction documents at the time of the investment and to enhance any covenant packages where possible. Amendments are typically sought by the borrower, not the investor, but M&G will typically engage with the issuer to determine whether these are appropriate and, where necessary, to secure changes to the proposal and/or compensation for investors to agreeing to the waivers. The work on amendments is undertaken on a case-by-case basis, and is based on the merits of the request in hand.

288. Approach to seeking access to information provided in trust deeds:

Other than as summarised or replicated in the disclosure documents, access to trust deeds will generally only be undertaken by M&G's legal representatives at the time of an amendment request or specific stressed scenario. On occasion Trust Deeds have formed part of the original suite of disclosed transaction documents, but this is unusual.

289. Approach to impairment rights:

Following on from the above, M&G notes that many developed market financial sector borrowers are covered by legislative resolution regimes and regulatory requirements, which limit M&G's ability to amend contract terms and conditions here. Financial sector analysts, therefore, seek a deep understanding of the laws and regulations in the borrower's host country, in order to assess the impairment risk for a particular investment. In some cases, analysts are able to engage with and/or provide feedback to a particular jurisdiction's regulators and/or resolution authorities, in order to play a part in informing their policy stance.

290. Approach to reviewing prospectus and transaction documents:

For private assets, due diligence is carried out at the initial structuring phase to determine the borrower's ability to repay and avoid default. One of the benefits of private assets is the close ongoing relationship with borrowers which can give M&G significant access and influence to engage. M&G has active, iterative relationships with its borrowers and consequently the borrowers are willing and able to engage on any ESG issues or improvements identified. M&G's due diligence process involves assessing all investment risks which have the potential to impact on the performance of the investment – including ESG risks. The analyst will be responsible for this process as per above.

291. Across **Barings** private credit, sustainability-linked margin ratchets are offered to all new borrowers and a large number of borrowers agree to include provisions in their loan agreements to encourage post-closing conversations. Where a company meets a certain number of specified ESG criteria, it can get a reduction in its borrowing costs (5–15bps). Criteria can include actions such as improved board oversight, internal sustainability professional oversight, data improvements and measured positive change through KPIs.

292. A case study from 2023 has been provided below:

Case Study: ESG-linked margin ratchets

Headquartered in France, a global provider of Regulatory Affairs, Pharmaco-vigilance and Product Compliance consulting and outsourcing services for the pharmaceutical industry, offers end-to-end specialist services across the whole drug life-cycle from product development and pre-market approval to long-term pharmaco-vigilance and regulatory monitoring support. The company is one of only 3 players with a global footprint with direct access to 50 countries and +150 countries covered via its network of qualified partners.

As part of refinancing, Barings offered an ESG margin ratchet which was well-received by both the sponsor and management, and an agreement to set targets and KPIs within 6 months after closing was included in the loan documentation. In May 2023, management provided Barings with an initial proposal regarding the ESG issues the Group wanted to address. After further discussions regarding our expectations around setting sustainability performance targets, we agreed a 6-month extension of the negotiation period to ensure management had enough time to select the appropriate KPIs with a third-party consultant. Simultaneously, as part of the underwriting of an add-on financing, the loan documentation was amended to align with Barings' sustainability linked loan guidance.

Management appointed an ESG consultant to prepare an initial assessment in line with the LMA [loan market association] guidelines for the definition of 3 meaningful, quantifiable and ambitious targets, further reflecting for each of them the benchmark, sustainability performance targets (SPTs) and methodology. We received a revised proposal of SPTs based on the consultants work in October 2023. One of the proposed KPIs was a net promoter score reflecting employee satisfaction, for which the methodology was to be based on an internal survey and which thus would not have been able to be benchmarked. After further discussions with management and the consultant, the KPIs and methodology were amended to align with sustainability linked loan guidance and agreed. KPIs include carbon emissions reduction targets (Scope 3), increase of gender diversity in senior/managing position across the organisation and achievement of better employee engagement through lower attrition of new hires. First reporting is due for FY23, which will activate the ESG target. The consultant will be responsible for calculating and certifying these targets annually.

Real estate and infrastructure fund managers

293. The real estate managers do not invest in any listed companies and as such exercising voting rights in the traditional sense does not apply. However, they do recognise that there are other forms of rights and responsibilities in this asset class.

294. For instance, in terms of responsibilities, **UBS** sees climate change, energy needs and water scarcity as among the biggest challenges of the century. UBS Real Estate & Private Markets (REPM) recognises that real assets such as properties and infrastructure contribute significantly to CO^2 emissions and the consumption of natural resources.

295. UBS has established a comprehensive approach to environmental and social factors, and to corporate governance across each of the investment disciplines. Responsible ownership and operation of real property can have a significant positive impact on the environment and returns for clients, and REPM operates with this in mind.

296. UBS incorporates environmental, climate change, resilience and social risks into the evaluation criteria when making investment decisions at both an asset and portfolio level. Information is collected via a standardised sustainability checklist in order to capture relevant issues for Investment Committee approval. This includes an assessment of greenhouse gas emissions with the sustainability consultant for an initial net zero pathway analysis. UBS is a founding member of the Net Zero Asset Managers initiative and is committed to achieving the goal of net zero greenhouse gas emissions by 2050 or sooner, with interim targets for 2030 being set.

297. While environmental considerations have started to become mainstream in assessing real estate and infrastructure, the "'S" in ESG has been traditionally harder to measure. UBS recognises that standing investments – offices, shopping centres, industrial estates – benefit local communities even though it may not be obvious at first sight.

298. UBS has pioneered a relationship with the Social Value Portal to collect data to calculate a social value for the fund's properties to understand and measure local employment levels, traineeships, jobs for young offenders, community events held at the property and volunteering. Having collected the data, the Social Value Portal were able to calculate – in monetary terms – a social value for each property, which is then mapped to the UN's Sustainable Development Goals. UBS has used the data collected to embed social value measures into property management supply chain and implement targeted activities.

299. **BlackRock** also highlighted how new technologies and developments in the real estate industry can help the Fund make a material impact on energy reduction. The manager has integrated a system called IBOS (Intelligent Building Operating System) into seven office properties (some have been sold during 2023). IBOS fully optimises building systems to maintain optimal environmental conditions, assisting with reducing the building's baseload to support the energy pathway toward net-zero, with excellent results.

300. For example, at BlackRock's office asset in Tunbridge Wells, Brockbourne House witnessed a 48% reduction in energy for the period 01 March 2023 to 30 September 2023 (7 months). This equates to 434,677 kWh and £152,969 (or 92 tonnes of CO_2) of energy savings during that same time period based on current contract rates. It is anticipated that further energy savings will be achieved across the office portfolio due to the IBOS implementation.

301. **Foresight** Energy Infrastructure Partners (FEIP) seeks to maintain full control over investments through representation on the Boards of the Project Companies owned. Foresight therefore retains the right to choose which third-parties are contracted. Throughout the process of contracting a third-party, companies are asked to provide all their ESG policies as part of the due diligence.

302. Foresight seeks to exercise control over the boards of portfolio companies or other investment vehicles, and to maintain sufficient governance rights to ensure ESG factors are properly managed. In the case of assets which are directly held (for example wind and solar projects, and other direct infrastructure which does not have management teams, and where there are no co-investors), boards primarily comprise Foresight employees.

303. This majority ownership enables FEIP to incorporate ESG into relevant board agendas and implement initiatives across the portfolio. The advantage of Foresight's presence across the infrastructure portfolio lies in the ability to share, approve and implement best practices.

304. For instance, the integration of Foresight's ESG metric requirements that are used to monitor ESG performance were employed with ease across both FEIP I and the broader infrastructure portfolio, facilitated by Foresight's prevalent board representation. This has been significant in the development of the Infrastructure Fund sustainability reporting.

<u>Bond manager</u>

305. PIMCO believes that for financial markets to prosper over the super secular horizon, growth cannot come at the cost of society. The economic disruption from poorly managed ESG risks is already being felt and the winners and losers of the transition to a net zero carbon economy are emerging. This is particularly relevant for bond investors, as ratings agencies increasingly report on bond issuers' ESG risks in a way that affects their cost of capital.

306. PIMCO takes the rights and responsibilities as a bondholder seriously, and looks to work with issuers through a variety of credit events, including new issuances and reverse enquiries, changes to their capital structures through restructurings and defaults as well as through collaborative engagement on material ESG topics.

307. PIMCO engages with issuers by proactively reviewing prospectuses of green, social, sustainability and sustainability-linked bonds (SLBs). PIMCO engages issuers to discuss the rationales and stringency of their ESG-labelled bond frameworks and shares its view on best practice, looking to raise the standards on ESG bonds.

308. Sustainability-linked bonds are particularly pertinent to PIMCO's approach to stewardship and engagement, especially in the context of exercising its rights and responsibilities on seeking amendments in bond indentures and contracts. SLBs are bonds where key performance indicators are structurally linked to the issuer's achievement of climate or broader Sustainable Development Goals (SDGs), such as through a covenant linking the coupon of a bond. In this case, progress, or lack thereof, toward the SDGs or selected KPIs then results in a decrease or increase in the instrument's coupon. These bonds can play a key role in encouraging companies to make sustainability commitments at the corporate level, particularly through aligning to the UN SDGs or Paris Agreement. The market also continues to grow quickly, since the International Capital Market Association (ICMA) released its Sustainability-Linked Bond Principles in June 2020 (a set of voluntary guidelines aimed at improving the transparency and overall integrity of the SLB market), exceeding $70 billion in issuance over 2022. PIMCO believes that the experience accumulated so far thanks to this rapid rise in issuance provides an opportunity for issuers to include more relevant and ambitious sustainability targets and enhance bond characteristics.

309. PIMCO engages regularly with companies on the issuance of SLBs, as well as the associated KPIs, reporting, and disclosures. In 2022, the ICMA updated the illustrative KPI registry and the Q&A related to SLBs, which complement the Sustainability-Linked Bond Principles, to clarify in particular the key performance indicators (KPIs), the credibility of the targets, coupon step-up, and structures that SLB issuers should use. PIMCO is a coordinator of the SLB working group and a contributor to the guidance documents.

310. PIMCO is also an elected member of the ICMA Green Bond Principles and Social Sustainable Bond Principles Executive Committee, whose goal is to uphold the credibility of the market and engage policymakers on sustainable bonds.