Implementation Statement

TMD Friction UK Pension Scheme

This paper has been produced for the Trustee of the TMD Friction UK Pension Scheme (the "Trustee" and the "Scheme"), as the Trustee prepares its Implementation Statement ("IS").

At a glance…

The first part of this document, provides information to the Trustee of the TMD Friction UK Pension Scheme in relation to the preparation of the IS, including information regarding the regulatory background, data gathered, significant votes and next steps.

The remainder of the document includes the draft IS that has been prepared for the Trustee to review.

Regulatory background

On 6 June 2019, the Government published the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 (the "Regulations"). The Regulations require that from 1 October 2020, pension scheme trustee of defined contribution pension schemes (or hybrid schemes that provide both defined benefit and defined contribution benefits) produce an Implementation Statement ("IS"). The IS must include:

- A summary of the changes made to the Statement of Investment Principles ("SIP") over the scheme year;
- Evidence on how the pension scheme trustees have fulfilled the objectives and policies included in the SIP over the scheme year; and
- Describe the voting behaviour by, or on behalf of the trustee (including the most significant votes cast by trustee or on their behalf) during the scheme year and state any use of the services of a proxy voter during that year.

The Trustee must publish the IS online, before 1 October 2021 and the Trustee is also required to include the IS in the annual Trustee Report and Accounts.

Contents

Why bring you this paper?

This document provides the information relating to preparation of the IS, and the initial draft of the IS for the year ending 31 March 2021.

Next steps

- Trustee to review details in relation to the preparation of the IS.
- The finalised IS must be included in the Scheme's Annual Report and Accounts.
- The IS will also have to be published on a publicly accessible website.

Prepared for: The Trustee
Prepared by: Aon
Date: 9 June 2021

QAS Institute and Faculty of Actuaries ® Quality Assurance Scheme

Aon

Preparing the IS

Data

Aon has gathered information from your asset managers, when preparing this document. Due to varying stewardship reporting styles, the information is not in an exactly consistent manner. Over time we expect industry wide templates to be more widely adopted and more consistent information received from respective managers. We believe it is reasonable to use the information in this document for the purpose of this year's IS.

While information was gathered and reviewed from all managers, to keep the statement relatively concise we have disclosed detailed stewardship information in a proportionate way.

Significant votes

The investment managers have provided the voting statistics (where relevant) and examples of "significant" votes. Each of the managers has their own criteria for determining whether a vote is significant. In terms of what constitutes a significant vote, this can be described as:

- a vote that was contentious that had more than 15% against management; and/or
- against a management recommendation or different from the service provider recommendation; and/or
- vote that is connected to a wider engagement initiative with company management; and/or
- a vote that demonstrates clear and considered rationale; and/or
- a vote that the Trustee considers inappropriate or based on inappropriate rationale; and/or
- a vote that has significant relevance to members of the Scheme.

Materiality considerations

This statement does not disclose stewardship information on any investments in Liability Driven Investments or cash due to the limited materiality of stewardship to those asset classes.

This statement also does not disclose information on the additional voluntary contribution ("AVC") platform providers or funds on the grounds of materiality.

Next steps

The Trustee should review the document to ensure that it is comfortable with the statements being made on its behalf. Once the Trustee has reviewed, it should agree and finalise the IS.

The IS is required to be included in the Scheme's Report and Accounts. In addition, the Trustee is required to publish a copy of the IS on a publicly available website.

Further actions to engage with your investment managers

Having reviewed some of the examples provided we recommend that the Trustee considers engaging with Aon Investments Limited (“AIL”) to better understand the underlying managers’ voting and engagement practices in more detail and how these reconcile with the Trustee's responsible investment policies. For example, this could be done by inviting AIL to a meeting during 2021 to discuss responsible investment in more detail.

In particular, BlackRock, LGIM and Schroders did not provide transparency on engagement examples in relation to the specific strategies invested in on behalf of the Trustee. These managers have said that they plan to improve their reporting on engagements in the future following engagement by AIL on behalf of the Trustee.

Your IS

The remainder of this document provides the Trustee with its IS to be reviewed and agreed.

Implementation Statement

Introduction

On 6 June 2019, the Government published the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations (“the Regulations”). The Regulations amongst other things require that the Trustee produces an annual implementation statement which outlines the following:

- A summary of the changes made to the Statement of Investment Principles ("SIP") over the Scheme year;
- Evidence on how the Trustee has fulfilled the objectives and policies included in the SIP over the Scheme year; and
- Describe the voting behaviour by, or on behalf of the Trustee (including the most significant votes cast by Trustee or on its behalf) during the scheme year and state any use of the services of a proxy voter during that year.

This document sets out the details, as outlined above. This Implementation Statement has been prepared by the Trustee and covers the Scheme year 1 April 2020 to 31 March 2021.

Summary

The Trustee is satisfied that the managers are exercising their respective voting and engagement duties, where applicable, to a satisfactory level, and that the Trustee's stewardship policy is being appropriately implemented on its behalf. In some instances, the Trustee noted it would require more specific, fund level information, which was not available for this reporting period. The Trustee and its investment adviser have expressed this to the underlying managers and welcome the efforts they are undergoing to improve their reporting on this topic. The Trustee recognises that it has a responsibility as a large institutional investor to encourage and promote high standards of stewardship in relation to the assets that the Scheme invests in.

The Trustee will continue to use its influence to drive positive behaviour and change among the managers that it has employed to invest the assets of the Scheme, and with other third parties that the Trustee relies on such as its investment adviser. The Trustee will monitor, assess and ultimately hold them to account to ensure that the assets of the Scheme are appropriately invested.

The Trustee is also satisfied that its other policies in place during the accounting year have been implemented.

Changes to the SIP over the year to 31 March 2021

A revised SIP has been drafted in response to the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019. The revisions outline:

- The reduction in the Return Target from 2.0% to 1.5% p.a.
- Updates to the legal name of the fund manager and investment advisor.
- The Trustee's policies on the arrangements with its asset managers, including how costs and performance are monitored and assessed.
- Extended policies in relation to stewardship of investments.
- The AVC arrangements no longer held with Equitable Life.

The above revisions are effective from 24 September 2020. The Trustee also agreed to reduce the Return Target from 1.5% to 1.0% p.a. in December 2020, during the reporting period which was updated in the SIP after 31 March 2021 year end.

Meeting the objectives and policies as set out in the SIP – DB and DC/AVC section

The Trustee outlines in the SIP several key objectives and policies. These are noted in blue in this report, together with an explanation of how these objectives and policies have been met and adhered to over the course of the year. The Trustee has delegated certain decision-making powers to Aon Investments Limited ("AIL") who is referred to in this document as the "Fiduciary Manager". References to “underlying asset managers” refers to those asset managers which AIL in turn appoints to manage investments on behalf of the Trustee or any other direct investments that the Trustee may make from time to time.

Ongoing Monitoring

Investment monitoring takes place on a quarterly basis with monitoring reports being provided to the Trustee by the Fiduciary Manager and its investment consultant, Aon. The Trustee receives these reports on a quarterly basis which monitor the performance, strategic asset allocation and risk management of the Scheme's investments, covering a number of different objectives and policies set out in the SIP. These are;

Quarterly Investment Reports from the Manager and Aon which include;

- Absolute performance and performance relative to the liability return over the quarter, one year, three year, five year and since inception periods
- Asset allocation relative to the previous quarter
- Detailed commentary on the performance and any relevant management or portfolio developments, including strategic changes
- Overview of the interest rate and inflation hedging levels
- Economic market review and outlook

Annually, the Fiduciary Manager provides a fee breakdown showing the annual aggregate management charge of the underlying asset manager.

Strategy

The Trustee's objectives are:

- *An overall objective to invest the Scheme's assets in such a way that sufficient money is available to meet the liability to provide benefits to the members of the Scheme into the future.*
- *A shorter-term objective of investing the Scheme's assets to achieve returns in excess of the growth in the liabilities, whilst maintaining a prudent approach to meeting the Scheme's liabilities.*

Following improvements to the Scheme's funding position over the reporting period, the Trustee made the decision to de-risk the Scheme's investment strategy and to adopt a lower investment objective to outperform the Liability Benchmark by 1.0% p.a. over rolling three year period in December 2020. This replaced the October 2019 objective, which was to outperform the Liability Benchmark by 1.5% p.a. over rolling three-year periods.

The Fiduciary Manager also hedges 100% of the interest rate and inflation risk, as a proportion of assets, using a liability driven investment strategy, to mitigate performance volatility relative to the Scheme's liabilities.

Environmental, social and governance considerations

As part of their delegated responsibilities, the Trustee expects that the Fiduciary Manager or other appointed investment manager will take into account corporate governance, social, and environmental considerations (including long-term risks posed by sustainability concerns including climate change risks) in the selection, retention and realisation of investments. Any decision should not apply personal ethical or moral judgments to these issues but should consider the sustainability of business models that are influenced by them.

The Trustee is taking the following steps to monitor and assess ESG related risks and opportunities:

- *The Trustee will have periodic training on Responsible Investment to understand how ESG factors, including climate change, could impact the Scheme's assets and liabilities.*
- *As part of ongoing monitoring of the Fiduciary Manager or other appointed investment managers, the Trustee will monitor the level of ESG integration on an annual basis by using ESG rating information provided by the Fiduciary Manager, where relevant and available.*
- *The Trustee will request that the Scheme's directly appointed investment managers, including the Fiduciary Manager, provide their Responsible Investment policy and details of how they integrate ESG into their investment*

decision making process on an annual basis. Should the Trustee of Fiduciary Manager look to appoint a new investment manager, this information will be requested as part of the selection process. All responses will be reviewed and monitored with input from their investment consultant.

Please see the below section "Engagement – AIL" for more details on the Fiduciary Manager's engagement with the underlying asset managers.

The Trustee attended a Responsible Investment workshop hosted by Aon in February 2019, acknowledging the Fiduciary Manager's responsibility to engage with the underlying asset managers, and will receive more of these sessions as the need for them arises.

The Trustee receives regular updates on ESG metrics on its underlying asset managers, and uses these to monitor the managers, with the support of the Fiduciary Manager.

The Trustee annually reviews the stewardship activity of the Fiduciary Manager to ensure the Scheme's stewardship policy is being appropriately implemented in practice. The Trustee will receive annual reports on stewardship activity carried out by the Fiduciary Manager. These reports include detailed voting and engagement information from underlying investment managers.

As part of the Fiduciary Manager's management of the Scheme's assets, the Trustee expects the manager to:

- *Ensure that (where appropriate) underlying investment managers exercise the Trustee's voting rights in relation to the Scheme's assets; and*
- *Report to the Trustee on stewardship activity by underlying investment managers as required.*

The Trustees will engage with the Fiduciary Manager as necessary for more information, to ensure that robust active ownership behaviours, reflective of their active ownership policies, are being actioned.

The Trustee may engage with their Fiduciary Manager, who in turn is able to engage with underlying investment managers, investee company or other stakeholders, on matters including the performance, strategy, risks, social and environmental impact, corporate governance, capital structure, and management of actual or potential conflicts of interest, of the underlying investments made. Where a significant concern is identified, the Trustee will consider, on a case by case basis, a range of methods by which it would monitor and engage so as to bring about the best long-term outcomes for the Scheme.

The Trustee monitors the stewardship activity of the Fiduciary Manager on a regular basis, with more detail on the stewardship and voting activity of the Fiduciary Manager provided in the "Engagement – AIL" section.

Risks

The Trustee reduces its exposure to the Scheme's risks by careful structuring of its funding and investment management arrangements and through its contracts with the Scheme's Fiduciary Manager and investment managers.

The Trustee also closely monitors the Scheme's risks and receives formal regular reports on funding, cash flows, investment managers (including performance) and diversification. Please refer to the "Ongoing Monitoring" section for further details on how risks within the Scheme are monitored and reported.

Mismatching risk is reviewed as part of the triennial actuarial valuation process and has been mitigated with the use of a LDI strategy.

Operational risk is reduced as far as possible by due diligence on the appointment and review of investment managers and advisers, and by contracts of engagement, as detailed below in the "Engagement – AIL" section.

Cost and transparency considerations

The Trustee is aware of the importance of monitoring their Fiduciary Manager and other appointed investment managers' total costs and the impact these costs can have on the overall value of the Scheme's assets. The

Trustee recognises that in addition to annual management charges, there are other costs incurred by asset managers that can increase the overall cost incurred by their investments.

The Trustee will receive annual cost transparency reports from their Fiduciary Manager. These reports present information in line with prevailing regulatory requirements for fiduciary managers.

The Trustee received a cost disclosure statement from the Fiduciary Manager for the period 1 January 2019 to 31 December 2019. The report provides information on costs and charges, including a breakdown of the annual management charge required by law. The Trustee will continue to receive and review this report on an annual basis.

The Trustee assesses the (net of all costs) performance of the appointed Fiduciary Manager at least every three years against the Scheme's specific liability benchmark and investment objective. The remuneration paid to the Fiduciary Manager and fees incurred by third parties appointed by the Fiduciary Manager are provided annually by the Fiduciary Manager to the Trustee. This cost information is set out alongside the performance of the Fiduciary Manager to provide context. The Trustee monitors these costs and performance trends over time.

The Trustee agreed to the change in the base fee charged by the Fiduciary Manager, from 0.30% p.a. to 0.25% p.a. in January 2021. The remuneration paid to the Fiduciary Manager and fees incurred by third parties appointed by the Fiduciary Manager are provided annually by the Fiduciary Manager to the Trustee and will continue to do so. The Trustee will continue to monitor the cost and performance, at least every three years.

Meeting the objectives and policies as set out in the SIP – DB section

Arrangements with asset managers

The Trustee delegates the ongoing monitoring of the underlying investment managers to the Fiduciary Manager. The Fiduciary Manager monitors the Scheme's investments to consider the extent to which the investment strategy and decisions of the underlying investment managers are aligned with the investment objectives of the Scheme. This includes monitoring the extent to which the underlying investment managers:

- *make decisions based on assessments about medium to long-term financial and non-financial performance of an issuer of debt or equity; and*
- *engage with issuers of debt or equity in order to improve their performance in the medium- to long-term.*

The Trustee receives regular reports, at least quarterly, and verbal updates from the Fiduciary Manager on various items including the investment strategy, performance, and longer-term positioning of the portfolio.

The Trustee is supported by the ongoing monitoring and engagement activities undertaken by the Fiduciary Manager, with respect to the underlying investment managers in which it invests.

The Trustee also receives annual stewardship reports on the monitoring and engagement activities carried out by the Fiduciary Manager, which supports the Trustee in determining the extent to which the Scheme's engagement policy has been followed throughout the year. More details regarding the Fiduciary Manager's engagement activities over the reporting year can be found in the section "Engagement – AIL".

Meeting the objectives and policies as set out in the SIP – DC/AVC section only

It is the Trustee's policy to review the DC and AVC investments and to obtain written advice about them at least every three years.

The Trustees asked their DC investment advisers to review the DC and AVC arrangements during this reporting period. The review was used to provide supporting materials for the Chair's Statement and covered provider suitability (in terms of financial strength, charges and quality of administration, where relevant) as well as quality and suitability of investment options offered to members. The report was issued to the Trustees on 3 September 2020.

Engagement – Aon Investments Limited ("AIL")

Under the Trustee's fiduciary mandate, managed by Aon Investments Limited ("AIL"), AIL appoint underlying asset managers to achieve an overall target return. The Trustee delegates the monitoring of ESG integration and stewardship quality to AIL and AIL have confirmed that all equity and fixed income managers have been rated 2 or above on AIL's four-tier ESG ratings system. This means that all the appointed underlying asset managers are at least aware of potential ESG risks in the investment strategy and have taken some steps to identify, evaluate and potentially mitigate these risks.

The Trustee received the AIL Annual Stewardship Report in October 2020 and is content that AIL is using its resources to appropriately influence positive outcomes in the strategies in which it invests.

AIL have undertaken a considerable amount of engagement activity over the period, some examples of which have been outlined within this statement. AIL held around 35 ESG specific "deep-dive" meetings in 2020 predominantly covering the equity and fixed income managers that are invested in by AIL across all delegated funds in which AIL's clients invest. At these meetings, AIL were able to analyse and discuss the voting and engagement activities undertaken during calendar year 2020, highlighting areas of improvement and discussing manager strategy in the area of Responsible Investment moving forward. Meetings have been ongoing through the beginning of 2021.

Aon Solutions UK Limited ("Aon") also actively engage with asset managers and this is used to support AIL in their fiduciary services. Over the period, Aon's Engagement Programme maintained a dialogue with one its leading global asset managers on behalf of many of their clients which invest with the manager. This culminated towards the end of 2020 in a discussion with their Global Head of Stewardship with respect to numerous areas of concern regarding stewardship, in particular the manager's ability to demonstrate commitment to publicly stated climate change goals. Discussions were held regarding the following:

- Aon's analysis of the manager's voting actions over the period showed that the manager had not been voting in a manner consistent with their public pledges nor rhetoric on the importance of sustainability issues. The manager acknowledged that there was a disconnect between vote decisions made in the first half of 2020, but that the manager had markedly changed its voting policies in the second half of 2020, and reassured Aon that moving forward, vote decisions would better align with their stated positions on such ESG matters. Aon expect to see this reflected in voting actions by mid-2021.
- Aon expressed concern that given the level of potential influence the manager had, the manager was unable to bring shareholder resolutions to those companies with which it had reason to engage. Reasons for this are regulatory and concern its investor classification status. The manager acknowledged Aon concern and agreed to follow up with further detail. While its situation has not yet changed, it is possible that regulatory restrictions may be eased in the future allowing the manager to use shareholder resolutions as a tool. The manager has since stated its intention to use its vote for shareholder resolutions brought by other organisations, to greater effect.

The manager has since provided further information on how it is updating their policies in a manner consistent with their strategy of intensifying engagement on sustainability. For example, in areas such as the transition to the low carbon economy; diversity, equity and inclusion; voting on shareholders proposals.

Aon welcome the improved stance on ESG issues from the manager and their proactive updating of their policies to more closely align with their responsible investment goals. Aon will continue to monitor and engage with the manager, scrutinising their voting and engagement actions. Aon is encouraged that the manager plans to strengthen their influence with invested companies to better effect, especially the changed stance around supporting appropriate shareholder proposals.

Voting and engagement – equity investments

Over the year, the Scheme was invested in the following equity funds;

- Legal and General Investment Management ("LGIM") Multi Factor Equity Fund (DB Section)
- Legal and General Investment Management ("LGIM") Multi-Asset Fund (DC Section)
- Legal and General Investment Management ("LGIM") Global Equity Fixed Weights (60:40) Index Fund (DC Section)
- BlackRock Emerging Markets Equity Fund (DB Section)

The Trustee considers a significant vote broadly as a vote which the respective manager deems most significant to the Scheme, or, in line with AIL's definition of a contentious vote in its annual Stewardship Report, a vote where more than 15% of votes were cast against management.

Voting Statistics

	LGIM Multi Factor Equity Fund	LGIM Multi-Asset	LGIM Global Equity Fixed Weights (60:40) Index	BlackRock Emerging Markets Equity Fund
% resolutions voted on for which the fund was eligible	99.90%	98.98%	99.97%	96.77%
% that were voted against management	17.99%	17.71%	16.29%	9.21%
% that were abstained from	0.23%	0.56%	0.15%	2.77%

LGIM Multi Factor Equity Fund, Multi-Asset Fund and Global Equity Fixed Weights (60:40) Index Fund ("LGIM")

<u>Voting</u>

LGIM make use of the Institutional Shareholder Services' ("ISS") proxy voting platform to electronically vote and augment its own research and proprietary ESG assessment tools, but does not outsource any part of the strategic decisions. It has put in place a custom voting policy with specific instructions that apply to all markets globally, which seek to uphold what it considers to be minimum best practice standards all companies should observe. Even so, LGIM retains the ability to override any voting decisions based on the voting policy if appropriate, for example, if engagements with the company have provided additional information.

Voting example

In September 2020, LGIM voted against a remuneration policy put forward by an investee company Pearson. Pearson issued a series of profit warnings under its previous Chief Executive Officer ("CEO"). Despite this, shareholders have been continuously supportive of the company, believing that there is much value to be gained from new leadership and a fresh approach to their strategy. However, the company decided to put forward an all-or-nothing proposal in the form of an amendment to the company's remuneration policy. This resolution at the extraordinary general meeting ("EGM") was seeking shareholder approval for the grant of a co-investment award, an unusual step for a UK company, yet if this resolution was not passed the company confirmed that the proposed new CEO would not take up the CEO role.

This is an unusual approach and many shareholders felt backed into a corner, whereby it was keen for the company to appoint a new CEO, but were not happy with the plan being proposed. However, shareholders were not able to vote separately on the two distinctly different items, and felt forced to accept a less-than-ideal remuneration structure for the new CEO.

LGIM spoke with the chair of the board earlier this year, on the board's succession plan's and progress for the new CEO. LGIM also discussed the shortcomings of the company's current remuneration policy.

LGIM spoke with the chair directly before the EGM, and relayed their concerns that the performance conditions were weak and should be re-visited to strengthen the financial underpinning of the new CEO's award. LGIM also asked that the post-exit shareholding requirements were reviewed to be brought into line with expectations for UK companies. In the absence of any changes, LGIM took the decision to vote against the amendment to the remuneration policy.

33% of shareholders voted against the co-investments plan and therefore, by default, the appointment of the new CEO. While this resulted in the plan being passed, it highlighted concerns around governance, which LGIM has stated will need to be addressed through continuous engagement going forward.

<u>Engagement</u>

LGIM has a six-step approach to its investment stewardship engagement activities, broadly these are:

1. Identify the most material ESG issues,
2. Formulate the engagement strategy,
3. Enhancing the power of engagement,
4. Public Policy and collaborative engagement,

5. Voting, and
6. Reporting to stakeholders on activity.

More information can be found on LGIM's engagement policy here.

Example engagement

Over 2020 LGIM engaged with Proctor and Gamble (P&G). P&G uses both forest pulp and palm oil as raw materials within its household goods products. A key issue identified was that the company has only obtained certification from the Roundtable on Sustainable Palm Oil for one third of its palm oil supply, despite setting a goal for 100% certification by 2020. Furthermore, two of their Tier 1 suppliers of palm oil were linked to illegal deforestation.

Following a resolution proposed by Green Century that P&G should report on effort to eliminate deforestation (that was voted on in October 2020), LGIM engaged with the P&G, the resolution proponent, and with the Natural Resource Defence Counsel to fully understand the issues and concerns.

Through this round of engagements, LGIM decided to support this resolution as although P&G has introduced a number of objectives and targets to ensure the business does not impact deforestation, LGIM felt it was not doing as much as it could. LGIM has asked P&G to respond to the Carbon Disclosure Project Forests Disclosure and continue to engage on the topic and push other companies to ensure more of their pulp and wood is from Forest Stewardship Council certified sources. More detail on this stewardship example can be found here.

BlackRock Emerging Markets Equity Fund ("BlackRock")

<u>Voting</u>

BlackRock use ISS's electronic platform to execute their vote instructions, manage client accounts in relation to voting and facilitate client reporting on voting. BlackRock's voting decisions are informed by internally-developed proxy voting guidelines, their pre-vote engagements, research, and the situational factors for each underlying company. Voting guidelines are reviewed annually and are updated as necessary to reflect changes in market standards, evolving governance practice and insights gained from engagement over the prior year.

Over 2020, BlackRock has increased their level of reporting by publishing more voting bulletins with detailed information and rationale for voting decisions. These specific significant votes are chosen by BlackRock based on a number of criteria such as level of public attention, and impact of financial outcome.

Voting example

On 9 December 2020, BlackRock voted against a management proposal of the Yanzhou Coal Mining Company and recommended that shareholders vote to approve an Equity Interests and Assets Transfer Agreement between Yankuang Group Company Limited and Yanzhou Coal Mining Company Limited. In September 2020, Yanzhou Coal proposed to acquire the equity interests held by Yangkuang Group in seven business entities for a total cash consideration of CNY 18.4 billion. The key assets to be acquired include a coal liquefaction project, a supporting coal mine and a coal-fired power plant, as well as other ancillary facilities.

BlackRock duly noted Yanzhou Coal's rationale for making the acquisition. Namely, to expand its coal chemical business and to extend the industrial chain for profit enhancement. Nevertheless, BlackRock believes it is in its clients' best long-term economic interests to vote against the proposed acquisition due to two primary concerns:

1. The underlying valuation for the terms of the transaction; and
2. Management's oversight of potential stranded asset risk.

With respect to the latter, BlackRock is cautious about the potential stranded asset risks at Yanzhou Coal following the asset purchase. The transaction was announced shortly after China pledged to achieve carbon neutrality by 2060 with carbon emissions peaking by 2030. Yet Yanzhou Coal as, a state-owned enterprise, did not articulate how the acquisition of these coal-related assets aligns with China's stated goals, including the new Nationally Determined Contributions to be updated at the UN Climate Change Conference (COP 26). In particular, concerns remain about Yanzhou Coal's decision to acquire a coal-fired power plant as part of this transaction. The coal-fired power sector in China is already facing numerous challenges such as tightened emission standards, overcapacity, as well as declining utilization hours. The sector is expected to become even more challenged as more provinces anticipate grid parity for renewable energy. Therefore, such an acquisition could well exacerbate the company's stranded asset risks and delay progress to achieve the company's decarbonization targets.

BlackRock has communicated the above concerns with management and requested the company considers reporting on its approach to the energy transition in alignment with the recommendations of the Task Force on Climate related Financial Disclosures ("TCFD"). The BlackRock Investment Stewardship team ("BIS") will continue to closely monitor Yanzhou Coal's progress on sustainability reporting and engage to advocate for business practices aligned with long-term value creation.

More detail on the vote rationale can be found at the vote bulletin here.

<u>Engagement</u>

BIS states its key engagement priorities include:

1. Board quality
2. Environmental risks and opportunities
3. Corporate strategy and capital allocation
4. Compensation that promotes long-termism
5. Human capital management.

Over 2020, BIS had over 3,500 engagements — an increase of 35% against 2019 – with 2,110 unique companies, covering nearly 65% by value of their clients' equity investments. BIS also had 936 engagements on the impact of COVID-19.

More information, including case studies, can be found in the BlackRock Investment Stewardship Annual Report 2020 here.

Engagement – Fixed Income

While Equity managers may have more direct influence on the companies they invest in, Fixed Income managers are also increasingly influential in their ability to encourage positive change. Some examples provided by the most material fixed income funds the Scheme invests in are outlined below.

Robeco

The Scheme is invested in multiple fixed income funds with Robeco.

Robeco is particularly focused on improving business conduct and function of the companies it invests in. Robeco carries out extensive baseline research on the companies it invests in, measure changes in company performance relative to engagement objectives and allow three years for engagement. Any cases closed unsuccessfully are considered for potential exclusion.

Engagement example

In line with this focus, over the last few years, Robeco has engaged with senior employees of a multinational oil company various times. The focus of the engagement was that if the world fails to limit global warming to well below 2 degrees Celsius, then the world, and therefore industries, will be increasingly exposed to significant transitional and physical risks, both acute and chronic.

The oil company announced its aim to reduce the net carbon footprint of its energy products by around half by 2050. Robeco was supportive but continued to push the company to set short term targets and link these to remuneration packages. In addition to announcing its long-term goal, the manager agreed a joint statement with the company who agreed to start setting shorter term targets. The manager believes the company now leads the sector in terms of its planning and positioning for the energy transition.

BlackRock

BlackRock believes bond investors, with their often-multiyear perspective, are well-positioned to engage collaboratively with management to endorse and promote sound ESG practices. Such engagements enhance BlackRock's credit analysis, by providing it with more comprehensive credit profiles of its borrowers.

BlackRock's firm-wide engagement program also benefits investments in corporate bonds issued by companies. BIS is positioned as an investment function, which allows for the mutual exchange of views with active portfolio management teams across equity and credit. In addition, BlackRock's Global Fixed Income ("GFI") Responsible Investing ("GFI-RI") team may partner with BIS both to reflect ESG related topics from GFI investors as well as to attend or host engagement meetings on certain highlighted ESG flagged holdings. An ESG flagged holding is one where BlackRock hold a significant exposure in GFI portfolios, and the issuer is flagged as low rated/controversial by external ESG rating providers or is highlighted by their credit research.

Engagement example

The GFI-RI has an ongoing engagement with Exxon. In the discussion with the company, the company discussed several engagement topics such as governance structure, corporate strategy, environmental risks and opportunities. These included questions from the GFI-RI team including, the company's approach to the European regulatory environment, its views on electric vehicle penetration as a risk to their business, and risk management in relation to physical climate change risks.

The Trustee believes that engagements of this nature are key to reducing ESG risks within the Scheme's portfolio, as well as having the added benefit of contributing to the transition towards a low carbon economy.

Further details of this engagement can be found here.

Insight

Insight proactively engaged on industry and regulatory issues that have implications for clients and the wider market.

Engagement example

In 2020, Insight engaged with Total as the company considered issuing transition bonds on the back of its new ESG strategy. Insight held an ESG centric call with Total during an energy conference to discuss in further detail its ESG strategy and provide feedback on the potential transition bonds proposed. Insight has also engaged with the company on concerns relating to the board and accounting practices and states it will continue to engage with the company to gain additional disclosure.

Schroders

At a firm level, Schroders is currently engaging with banks on their fossil fuel financing. Schroder's credit team, along with a number on equity teams, selected around 50 banks in Europe, North America and Asia for deeper analysis and engagement. Following each engagement, Schroders highlighted three to four objectives it would like the bank to work on over the next 12 months. Examples include:

- Development of a commitment to align the banks' financing activities with the goals of the Paris agreement, plus related milestones and targets.
- Reviewing and strengthening the banks' fossil fuel policies in line with the latest science and/or good practice.
- Development of the TCFD/climate risk reporting, including disclosure of additional climate metrics.

For banks that have already made progress in these areas, their discussions have focused on the robustness and evolution of their measurement and target-setting methodologies in relation to the banks' commitment to align their financing activities with the Paris Agreement. Schroders has said it is still too early to assess the impact of these discussions, however, it has had good response from banks so far. Out of the 50 banks contacted over the last 6 months, it has met with 21 as of the end of March 2021.

Engagement Activity – Alternatives

Alternative investment managers are also increasingly influential in their ability to encourage positive change. An example provided by the most material liquid alternative fund the Scheme invests in is outlined below.

Leadenhall

Leadenhall Capital Partners (who manage an Insurance Linked Securities Fund within the AIL strategy) assesses adherence to ESG principles by considering specific factors, examples may include:

- Environmental impact including pollution prevention (via underwriting standards) and remediation (via providing capital for protection), reduced emissions, preventing the spread of pandemic disease and adherence to environmental safety and regulatory standards;
- Social impact including human rights, welfare and community impact issues; and
- Governance issues including board structure, remuneration, accounting quality and corporate culture

Pricing for climate change risk is an inherent part of Leadenhall's analysis of potential investments. MS Amlin, part of Leadenhall's parent group (MS&AD) and a reinsurer with sourcing and underwriting resources that Leadenhall leverages, is very active in monitoring, studying and looking at ways to tackle climate change. It is a Member of the Cambridge Institute for Sustainability Leadership and ClimateWise. Through this, MS Amlin aims to better communicate, disclose and respond to the risks and opportunities associated with the climate-risk protection gap.

Leadenhall performs a detailed review of its investment counterparties policies and controls including those concerning its explicit ESG and Corporate Social Responsibility frameworks. Where appropriate Leadenhall will make recommendations to avoid investment counterparties who are not aligned with ESG policies.

Summary

Based on the activity over the year to 31 March 2021 by the Trustee and their service providers, the Trustee is of the opinion that the stewardship policy has been implemented effectively in practice. The Trustee notes that their fiduciary manager was able to disclose strong evidence of voting and engagement activity.

The Trustee continues to expect improvements over time in line with the increasing expectations on asset managers and their significant influence to generate positive outcomes through considered voting and engagement.

Signed on behalf of the Trustee: [redacted]

Date:

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.