Mineworkers' Pension Scheme
2020 Stewardship Report

The Mineworkers Pension Scheme (the "Scheme") has been a long-term signatory to the UK Stewardship Code. This report sets out how the Trustees of the Mineworkers' Pension Scheme Ltd (the "Trustee") has ensured the Scheme has fulfilled its stewardship responsibilities through 2020 and the outcomes of this activity. The UK Stewardship Code 2020 has 12 principles and this report has been presented according to those 12 principles.

<u>Principle 1: Purpose, Beliefs, Strategy and Culture</u>

The Mineworkers' Pension Scheme is a UK based pension scheme providing benefits to 135,900 members as at 30 September 2020. The Scheme was established in 1952 and remained open to contributions until 1994 when the Coal industry was privatised. At this point the Government took over the role as Guarantor for the Scheme from British Coal. In 1994 a provision was included that 50% of any surplus in the fund at future valuations would be used to increase members' benefits through "bonuses" with the other 50% being paid to the Government.

The Trustee has ultimate responsibility for decision-making on investment matters. Coal Pension Trustees Investment Limited ("CPTI") is responsible for providing investment advice and investment management services to the Trustee. The Trustee delegates responsibility for the day to day management of the assets to appointed investment managers. The Trustee's objective is to pay all member benefits from the Scheme's assets whilst achieving the returns required in order to deliver future bonuses.

The culture of the Trustee and CPTI, driven by senior leadership and the nature of the Scheme, is one focussed on long-term investing, considering all relevant risks and opportunities. This includes a rigorous focus on stewardship.

The Trustee has agreed a set of investment beliefs, which align with its culture and cover return, risk, future expectations, illiquidity, complexity, sustainability and internal governance structure. The Trustee has a specific belief in relation to sustainable investment provided below:

"Long-term investment success should come from a focus on sustainability. In particular, environmental, social and governance ("ESG") factors can have a material impact on long-term investment returns. They should be considered before any investment is made.

- *Investments with good or improving ESG 'credentials' are more likely to deliver long term sustainable returns*

- *The more long-term an investment, the more important ESG factors become*
- *Ignoring environmental and societal issues can create investment and reputational risk, which ultimately reduce return*
- *Being a good steward of assets can lead to better risk adjusted returns"*

This belief is included in the Scheme's responsible investment policy an overview of which is included on the Scheme website (see link). This covers a number of strategic considerations built around the UN Sustainable Development Goals ("SDGs"), ESG integration, stewardship as well as reporting and communication. This policy in turn guides our approach to stewardship, investment strategy and decision making. The Trustee plans to update this policy in 2021 and this will include providing more detail on stewardship beyond public equities.

The Trustee supports the UK Stewardship Code and believes that widespread adoption of good corporate governance and responsible business practices will improve the quality of management leading to sustainable benefits for the company, environment and society. The Scheme seeks to uphold good stewardship as well as hold to account the Scheme's investment managers and service providers.

Through 2020 CPTI, on behalf of the Trustee, undertook a detailed review of all public markets external investment managers in relation to responsible investment and stewardship to ensure the investment managers were aligned with the Trustee's beliefs. This review included a range of considerations including:

- Firm-wide responsible investment resources and capabilities;
- Firm-wide commitment to relevant responsible investment codes/principles/initiatives;
- Level of active engagement including voting for equities;
- ESG integration into the investment process for Scheme specific investments;
- ESG reporting on Scheme specific investments.

From the review, a rating process was developed that highlighted the leaders and laggards in this area. Several points were followed up with different managers where there was any doubt that the Trustee's requirements were being met. Where there has been explicit action points identified, CPTI plan to engage further with external managers over 2021, and expect to either evidence that these action points have been adhered to, and/or, there have been significant improvements in terms of the direction of travel into 2022. ESG ratings for investment managers will be kept under review as part of CPTI's formal quarterly monitoring process on behalf of the Trustee.

Principle 2: Governance, Resources and Incentives

The Trustee provides the oversight on responsible investment and is accountable for ensuring stewardship is embedded within the organisation and investment processes. CPTI ensures ESG and stewardship considerations are factored into the day-to-day investment decision making processes. This includes from an investment strategy/asset allocation perspective and also from a manager selection, monitoring and reporting perspective. When specific investments and disinvestment are being evaluated, ESG considerations are always considered.

Going forward, ESG data and metrics will be included at weekly CPTI meetings and quarterly Trustee meetings. Stewardship, including ESG risks, opportunities and outcomes, will be formally reviewed at Trustee or investment sub-committee meetings.

The Trustee has appointed EOS at Federated Hermes (EOS) to assist in fulfilling its fiduciary responsibilities as a long-term investor in global equities and corporate bonds. EOS is a dedicated stewardship service provider whose purpose is to assist asset owners and asset managers in adding long-term value to their investments and managing their risks, by engaging with companies and policy-makers on environmental, social, governance, strategic and financial issues. Their approach is to engage in person and at board or executive level wherever possible, in order to effect positive change. EOS provide ongoing assistance to the Scheme and their involvement, as well as the scope of their services, is kept under regular review. For certain public equity mandates it is the Scheme's investment managers who vote and engage on the Scheme's behalf with further detail provided under principle 9.

The Trustee believes that the engagement activities within public equity and corporate fixed income holdings by EOS and directly by some of the appointed investment managers, enables it to implement a high standard of stewardship on behalf of the beneficiaries of the Scheme.

Outside of core public assets the Trustee relies upon CPTI to undertake effective due diligence and ongoing monitoring to ensure that environmental, social and governance considerations are taken into account in the management of its private markets investments. In particular, investment managers must be able to demonstrate their consideration of ESG risks and return opportunities, and their consideration of wider stakeholders affected by the management of assets the Scheme is invested in. This is monitored and assessed through quarterly monitoring meetings and additional ESG focused meetings where necessary.

In 2020 the Scheme appointed a new Sterling Investment Grade Credit manager. Sustainability and ESG was a key input into the manager selection process including evidence that ESG factors were built into the research process. More detail is provided on this example under principle 7.

Resources

The Scheme has limited internal resource provided by CPTI. However, the senior leadership of CPTI is committed to ensuring strong ESG and stewardship practices. There are two members of the CPTI team spending dedicated time on responsible investment including stewardship and all members of the team are knowledgeable on incorporating ESG and stewardship across all areas. Given the limited internal resource and the use of external managers for investments and the appointment of EOS for stewardship services, a key focus for CPTI is ensuring that investment managers and EOS have sufficient resources to engage effectively.

EOS engagement is conducted on behalf of the Scheme by an experienced team with expertise across industries, professions, cultures and languages (including 13 nationalities and 10 languages). On average engagers have at least 14 years of professional experience. EOS have specially selected their team to include a diverse range of expertise and experience with background including industry, academia, law consultancy and sciences. This is to enable the team of engagers to engage most effectively in a variety of markets, sectors, and issue areas. The EOS engagement plan (see link) provides further detail on their approach to engagement and voting, and the influence that comes from combining the Scheme's assets with other institutional investors around the world. LGIM is the investment manager with the largest voting share for the Scheme's public equities after EOS – their key themes in term of engagement include tax, executive pay, diversity, climate change, cyber security and board accountability.

CPTI is in the process of reviewing the investment managers conducting engagement and voting on the Scheme's behalf in public markets. It is also in the process of reviewing data and activities across private markets.

Data, research and analysis

The Scheme has access to a large amount of ESG and stewardship data through various reports and platforms including:

- Holdings-based risk and exposure system, BlackRock Solutions, where it is now possible to assess and monitor ESG and climate related analytics using Sustainalytics data for public managers and asset classes.
- EOSi – EOS platform on company level engagements, information, and high-level engagement topics.
- Engagement and voting reports from investment managers.
- ESG reports, examples and data from investment managers.

Going forward the Trustee intends to conduct climate scenario analysis in 2021 as part of its TCFD requirements. It will also place greater scrutiny on ESG data and on its engagement and voting outcomes.

Incentives

All investment decisions taken on behalf of the Scheme by CPTI consider ESG factors in the decision-making process. A number of members of CPTI have specific responsible investment objectives, which reflect the dedicated time they spend on this including in relation to stewardship. CPTI's senior leadership also have specific objectives in relation to responsible investment including stewardship. These objectives are a critical input to year end appraisal and any decisions on performance related pay. CPTI has not set investment managers specific ESG targets or outcomes, however CPTI's monitoring will increase going forward and a greater understanding of outcomes will be sought.

Reflection – Principle 1 and 2

Having reviewed the Scheme's approach to stewardship during 2020, the Trustee believes the Scheme's purpose, beliefs, governance structure, and choice and use of service providers has enabled it to be a strong steward of assets. The effectiveness is demonstrated through the data and case studies provided in this report. That said there are a number of areas where more work is required and which are detailed throughout the report. The Trustee plans to review its beliefs and corporate governance policy during 2021 and will consider stewardship and ESG updates as part of this review.

<u>Principle 3: Conflicts of Interest</u>

The Trustee has developed policies to identify, manage and disclose any potential conflicts of interest that may arise, which includes in relation to stewardship activities. The Trustee's conflicts of interest policy covers the Trustees themselves, key advisers to the Scheme and CPTI staff. The policy is posted on the Scheme website at the following link.

One potential conflict relates to the principal/agent problem where a member of CPTI staff or a Trustee has an ethical or moral view that might not be aligned with members' financial outcomes. This is addressed by ensuring the Trustees and CPTI staff have a strong focus on the fiduciary duty to members and delivery of the financial outcomes required.

In terms of conflicts related to stewardship, it is believed that appointing a separate stewardship provider (EOS) who does not make active investment decisions reduces inherent conflicts. Additionally, CPTI ensures that all investment managers have robust conflicts of interest policies and actively investigates any conflicts it sees in the management of the Scheme's assets.

EOS conflicts are maintained in a group conflicts of interest policy and conflicts of interest register which requires that it identifies and manages actual or potential conflicts of interest between itself and its clients, or between different clients of EOS. In the event that a conflict occurs between EOS and its client then it is the clients' interests that are put first.
As part of the policy, staff report any potential conflicts to the EOS compliance team to be assessed and, when necessary, the register is updated. The conflicts of interest register is reviewed by EOS senior management on a regular basis.

In addition to conflicts regarding clients and prospects, the EOS policy also addresses conflicts in relation to staff members involved in engagements and this is reviewed at Board level. EOS identified one conflict in February 2020 in relation to a company it engaged with on the Scheme's behalf, where one of the engagers had been a former employee of this company. As a result, it was decided to remove the nominated engager from the process to avoid any appearance of a potential conflict of interest.

Some examples of actual conflicts previously identified, recorded and escalated by EOS are provided on the final page of their policy. EOS Stewardship conflicts of interest policy can be found at the following link:
https://www.hermes-investment.com/ukw/wp-content/uploads/2020/05/stewardship-conflicts-of-interest-policy-2020.pdf

Principle 4: Identifying and responding to market-wide and systemic risks to promote a well-functioning financial system.

CPTI considers any market-wide and systemic risks at weekly team meetings and discusses market-related considerations with the Trustee quarterly. The Scheme has a customised asset liability modelling tool as well as cashflow forecasting technology. These models and tools are key inputs to look at different Scheme risks and stress test different downside scenarios. Two examples of significant market-wide risks are climate change and inflation. CPTI continually engages with the Trustee, advisors, asset managers and other asset owners to discuss market-wide and systemic risks.

Climate change

CPTI and the Trustee believe climate risk, in all its forms, could significantly impact the long-term performance of the Scheme's assets. As such, and in line with TCFD recommendations, CPTI will be undertaking scenario analysis for the Scheme and acquiring further ESG and carbon data. This will allow CPTI to better identify and understand the risks to the Scheme's assets from climate change and the ways in which the Scheme can reposition assets to reduce risk as well as capture new opportunities. From an opportunity perspective, the Scheme has been investing in infrastructure assets with a strong environmental focus in addressing climate change including wind farms and solar parks. In 2020, the Scheme invested in an Energy for Waste plant, which is expected to reduce net annual carbon dioxide emissions by 82,000 tonnes per annum compared to landfill, by preventing the aerobic breakdown of the waste while producing energy (more details are provided in section 7). EOS and a number of the Scheme's investment managers name climate change as a key focus in their stewardship priorities and CPTI is reviewing all external managers in relation to their approach in this area. Through EOS and certain investment managers, the Scheme participates in industry initiatives such as Climate Action 100+, which engages with the world's largest corporate greenhouse gas emitters to ensure they take necessary action on climate change. The effectiveness of this work is described in case studies such as the one on Rolls-Royce in Principle 10.

Inflation

Inflation has been at low levels for several years and this may continue to be the case. However, inflation is a risk to the Trustee delivering its objectives given the inflation linked pensioner benefits promised to members. The extraordinary monetary and fiscal policies seen in response to the COVID crisis may have long term implications on inflation. The risks of higher than expected inflation and ways of mitigating against such risks are constantly reviewed. The Scheme has significant allocations to real assets including property and real estate where there is either direct inflation linked cashflows or the assets themselves provide some level of inflation protection.

CPTI continually engages with external investment managers and service providers in discussions around market level risks and opportunities, and seeks to ensure the Scheme is resilient through a range of scenarios. Stewardship is one key way to mitigate the risk that parts of the Scheme's portfolio are not prepared for various future scenarios. CPTI also actively engages with EOS on its stewardship priorities to ensure that these reflect the Trustee's own concerns.

EOS engagement

On behalf of Scheme, EOS regularly engages with a wide range of stakeholders, including government authorities, trade bodies, unions, investors and NGOs, to best identify and respond to market-wide and systemic risks. Through EOS, the Scheme also promotes effective regulation in the markets in which it invests to encourage governance structures that facilitate the accountability of companies to their owners, to give companies the certainty they need to plan for the future and to promote a level competitive playing field, which enables companies to prioritise long-term profitability.

EOS has a comprehensive programme of engagement with legislators, regulators, industry bodies and other standard setters to help shape capital markets. Their public policy work includes:

- Engagement on issues and written responses to consultations on behalf of the Scheme;
- Providing the Scheme with the opportunity to endorse or co-sign responses to consultations; and
- Providing the Scheme with written responses to consultations for use as a basis for their own communication.

One EOS engagement example in 2020 was in relation to the UK government's consultation on moving forward the date for the ban of new petrol, diesel and hybrid cars and vans. Hybrid vehicles have played an important role in the transition to electric vehicles ("EVs") but eliminating the use of fossil fuels in cars and vans as soon as possible will help the UK meet its climate ambitions. There are key challenges in achieving the transition to low carbon vehicles such as the current lack of infrastructure in the UK. It will take time and significant investment to install the required infrastructure to support a fleet of EVs. However, EOS explained that many of these costs will be incurred whether the ban is introduced in 2030 or 2035, and if investment is incentivised appropriately the required infrastructure should be scalable to meet increasing demand. Automobile companies will need to adapt, prioritising research, development and marketing of EVs whilst phasing out internal combustion engine models by the date the ban comes into force. However, such technologies and models already exist, and forward-looking automobile companies should already have been moving in this direction given the previous intention to ban such vehicles from 2040 in the UK and emissions targets in the EU. Lastly, in EOS's response to what measures are required by government and others to achieve the earlier phase out date they included detailed measures regarding: targets, charging/refuelling infrastructure, subsidies for EVs, decarbonisation of power and upgrading of electricity networks, alternative transport, human rights in the supply chain, and private sector collaboration.

Reflection

The Trustee believes the dedicated in-house resource at CPTI has been effective in assessing and reviewing market wide and systemic risks. 2020 was a challenging year for investment markets but the Scheme was able to navigate successfully the downturn in the first half of the year. Through EOS and the Scheme's investment managers, CPTI has ensured the Scheme has been effective in promoting a well-functioning financial system.

Principle 5: policy review, process assurance and assessment of the effectiveness of activities.

The Scheme is continuously seeking to improve all policies and processes in relation to stewardship wherever possible and these are continuously under review. In 2020, on behalf of the Scheme, CPTI expanded the engagement by EOS to cover the Scheme's public credit investments. At the end of 2020, CPTI also started a review of the public equity investment managers that engage and vote on the Scheme's behalf to ensure they remain best in class and can justify the retention of the Scheme's voting rights. An early conclusion from that review is to delegate more engagement and voting in relation to the Scheme's public equity portfolio to EOS in 2021.

Every year the Scheme requests internal controls reports (AAF 01/06, SOC1, ISAE3402 or SSAE18) across all the Scheme's investment managers and reviews these. The Scheme has chosen this approach as these are comprehensive industry standard reports which are carried out by independent assurance providers who ensure the relevant controls are in place, tested and working effectively. CPTI, on behalf of the Scheme, plan to consider in 2021 how these reports could specifically be used to assure the investment managers processes in relation to stewardship.

EOS obtains an independent AAF 01/06 assurance report on an annual basis and makes this available each year to the Scheme. This report provides an independent review to the Scheme regarding EOS's provision of stewardship services to the Trustee.

EOS engagement case studies are reviewed by the named companies in advance of publication to enable them to correct any aspects of reporting. CPTI has a number of ways in which it reviews EOS's activities and provides feedback on behalf of the Scheme. These include regular reporting (client portal, quarterly and annual reporting), quarterly meetings and the bi-annual EOS client conference.

The Scheme is an active owner of a large amount of private markets assets and takes ESG factors into consideration across these assets. Stewardship examples in private markets are included under principle 7, however, the impact of the Scheme's ownership in these areas is something where the intention is to provide greater visibility in future.

Principles 6: Taking account of client and beneficiary needs, and communicate the activities and outcomes of their stewardship and investment to them.

The Scheme is a UK based pension scheme with 135,900 members as at 30 September 2020. The Scheme's members are mostly pensioners (91.8%) but also include deferred members (8.2%). Five members of the ten-person Trustee body are elected from the membership. The five elected members represent geographical constituencies across the UK and any member is entitled to stand for election for five-year terms.

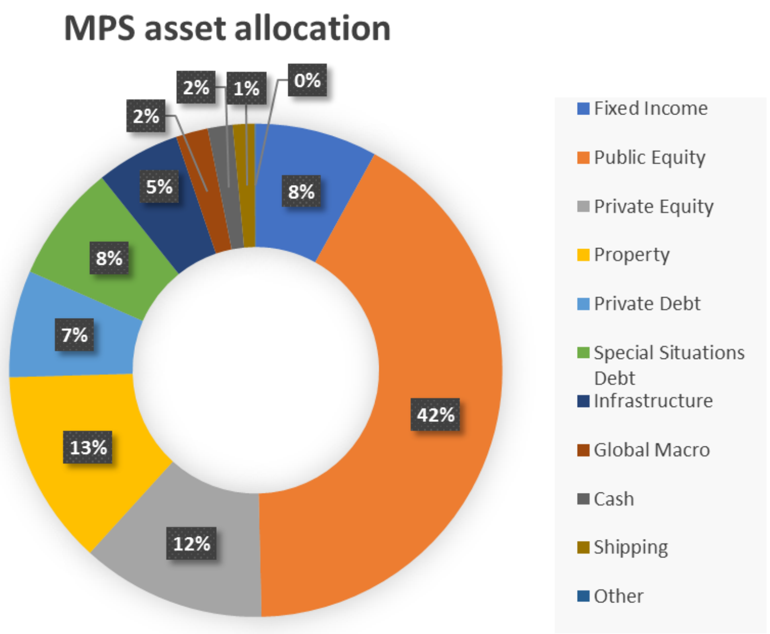
Communication to members

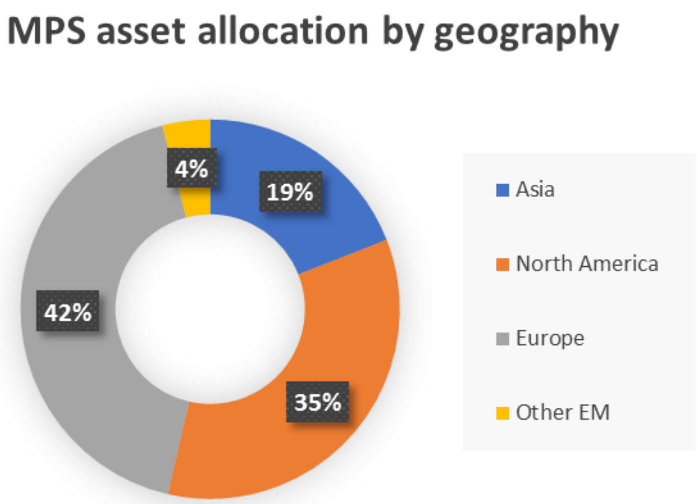
The Scheme discloses, on a quarterly basis, summary details of its voting and engagement on public equities as undertaken by EOS and the Scheme's investment managers. Summary statistics show the key issues on which EOS and the investment managers have engaged with the companies the Scheme is invested in. The Scheme also discloses Public Policy highlights reported by EOS, including key activities and achievements in discussions and consultations with regulators during the quarter. Reporting is publicly available to members on the Scheme's website (https://www.mps-pension.org.uk/about-mps/responsible-investing). Stewardship across the Scheme's other assets is reported to and discussed with the Trustees at quarterly Trustee meetings.

Members have contact details for the Scheme secretariat and any queries or views that may be communicated are passed from the secretariat onto CPTI to consider and respond. In addition, the Scheme publishes a yearly newsletter and sends out letters to members on important topics of relevance.

Assets under management

The Scheme's audited net assets as at 30 September 2020 totalled £11.22 billion and the estimated asset value totalled c. £11.32 billion as at 31 December 2020. An estimated summary of the Scheme's assets by asset class and geography as at 31 December 2020 are provided below:





Time horizon

The primary responsibility of the Trustee is to administer the Scheme in accordance with the rules and for the benefit of all beneficiaries over the whole life of the Scheme. Given the specific context of the Scheme, the Trustee has considered its own objectives carefully. The provisions of Scheme lead the Trustee to adopt a long-term time horizon when considering investment strategy. By careful management of short-term risks and the Scheme's very high cash flows, the Trustee can accept some degree of volatility in asset values, within carefully defined parameters. As a long-term holder of assets, stewardship is a significant tool in the Scheme's investment approach.

Principle 7: systematically integrating stewardship and investment, including material environmental, social and governance issues, and climate change.

The Scheme takes an integrated approach to stewardship. Across CPTI all members of the team take ESG considerations into account when making investment decisions and dedicated resource to responsible investment including stewardship and ESG was increased in 2020 with two employees spending significant proportions of their time in this area. The Trustee has outlined its beliefs related to stewardship and ESG, and these beliefs help frame the Scheme's responsible investment policy. More specifically on climate change the Trustee in 2020 agreed a specific focus on climate change as a systemic risk and opportunity set going forward.

The Scheme is adding ESG and carbon data to its tools during 2021 and will be reviewing the implications of this data over the next several months.

The Scheme holds its investment managers to account on their management of ESG risks and opportunities. All public markets managers have been assigned a rating in this regard and this ratings approach is also being rolled out to private markets managers. External managers are also expected to consider external initiatives such as the UN Sustainable Development Goals (SDGs) and Sustainability Accounting Standards Board (SASB) framework. Climate change is a specific risk that is focussed on given the large potential market impact and investment managers are expected to integrate climate risk guidelines, such as the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD), into their decision making and reporting.

For public equity, the Scheme primarily uses EOS as the formal voting and engagement mechanism, which enables the Scheme to implement stewardship goals, particularly around company engagement and voting, to a high standard. As referenced in principle 5, CPTI expanded the engagement by EOS to cover the Scheme's public credit investments in 2020. EOS research and engagement insights provide useful information for CPTI on the Scheme's holdings across a number of investment managers, which can be used to challenge and scrutinise their investment decisions.

CPTI's manager selection process now considers stewardship to a far greater degree than it did even 18 months ago, with investment managers ability to integrate stewardship and investment including considering ESG factors being a key input to the research and tendering process for new managers and the oversight of existing managers.

Private equity

In private equity, investments in funds and co-investments are regularly evaluated. Consideration of ESG factors for both fund and co-investment opportunities is a critical input to the decision-making process. For example, ESG considerations were a key part of a decision to decline a co-investment opportunity with a prepaid card programme manager. Our research showed that the investment included exposure to the payday loan market as, whilst the provider did not provide loans themselves, their cards were used as a tool for these providers. The social impact of payday loans with egregious levels of interest was identified as unsustainable and at high risk of increased regulation, which has already been seen in this area. This risk was a key input to the decision to decline the opportunity.

In December 2020 the Scheme committed more capital to a private equity investment manager that has delivered strong returns for the Scheme and has shown a proactive approach to stewardship including incorporating ESG principles across the portfolio. The Scheme's investments with this manager include a wide range of individual portfolio companies that deliver positive impacts from either a social or environmental perspective. One example investment that was realised in 2020 was in a provider of high acuity nursing care in residential homes in the North of England to people with complex physical and mental health needs. The investment manager had focused on the sector for five years prior to the investment and won exclusivity with the sellers who were more concerned with culture and stewardship than price because the manager could demonstrate its understanding of the sector. The investment is a good example of how the standard of care quality and efficiency could be improved at a care provider serving both NHS and the private sector. Care within their homes offers a better quality of life for a weekly fee that is significantly (40%) below the cost of the only alternative, a local hospital bed. During its ownership, the investment manager improved the quality of care by introducing new KPIs and inspection regimes, reduced the use of agency workers and adopted a zero tolerance of care incidents. As a result, by exit, 24 of the 26 homes had a CQC (Care Quality Commission) rating of either Good or Outstanding (up from 13 at entry) which far exceeds the industry average of 59%. It also rolled out new homes. Six were opened in 2019 and five this year. Additionally, capacity of existing sites was expanded with the opening of 37 “One Care” beds for users with a higher degree of independence.

Real estate

The Scheme’s real estate investment manager takes an active approach by investing in existing properties both to improve their resilience to climate risk and to transition the portfolio to be consistent with net zero emissions by 2050. Work done through 2020 has been aligned to the UN SDGs 7, 11 and 13 including:

- desktop modelling of the energy use intensity at asset level;
- review of third-party climate risk providers for TCFD reporting; and
- consideration of flood risk at acquisition.

In 2021, the manager will undertake a net zero carbon audit for all the Scheme’s assets to identify key obsolesce risks and associated capital expenditure required. The Scheme will also work with the manager on asset level climate risk data in line with TCFD reporting.

The manager has also been focused on responsible consumption (UN SDG 12) for the Scheme including procuring 100% renewable energy contracts across all assets. During 2020 the Scheme’s overall Energy Performance Certificate (“EPC”) ratings continued to improve and in 2021 a review of EPCs for all the Scheme’s assets is planned to provide an asset-level cost for improving the EPCs to a minimum B rating.

Shipping

The Scheme’s shipping manager and CPTI’s oversight of them has had a strong focus on stewardship given the significant environmental impact of the industry and the importance of crew welfare. The manager is a member of the Getting to Zero Coalition, which is committed to getting commercially viable zero emission vessels in operation by 2030. The Scheme has been in close contact with the manager on crew welfare throughout 2020 given the challenges in rotating crews during the COVID-19 pandemic. The following strategies have been employed to facilitate rotations and avoid delays:

- Undertaking deviation voyages (in co-operation with charterers) to ports that allow crew changes;
- Approving delays (in co-operation with charterers) to existing schedules to facilitate rotation; and
- Organising joint chartered flights (with multiple technical managers) for crew members.

Throughout the pandemic the manager has ensured that all regulations including International Maritime Organisation ("IMO") protocols are followed including the provision of additional personal protective equipment and disinfection supplies. Mental health has also been a key focus with the manager ensuring the provision of a free mental health hotline available to all crew members as well as access to wi-fi on board to be able to communicate with friends/family.

UK Infrastructure

The Trustee's investment belief is clear that being a good steward of assets can lead to better risk adjusted returns and the longer term an investment, the more important ESG considerations are. Infrastructure is a very long-term illiquid investment and therefore stewardship including ESG integration has been a key focus of CPTI's oversight of the Scheme's infrastructure managers. The Scheme's investments include renewable energy and projects that support energy efficiency.

One investment in 2020 was the construction of an Energy from Waste plant. The plant will deliver significant environmental benefit with a net annual carbon dioxide savings of 82,000 tonnes compared to landfill, by preventing the aerobic breakdown of the waste while producing energy. Furthermore, the investment manager considered the social aspects by locating the plant at an existing industrial site far away from households and areas of special scientific interest, limiting potentially harmful effects of emissions on health and the local environment. Local businesses will also be given a discount on the electricity produced, which has helped build local buy-in.

Principle 8: Monitor and hold to account managers and/or service providers.

CPTI applies its formal monitoring framework across all the Scheme's external managers to make sure they align with the Scheme's expectations for responsible investing including stewardship. All external managers are encouraged to have formal policies covering stewardship and engagement. If external managers do not have a formal policy, engagement occurs to understand why, then where possible work is undertaken with external managers to help create formal policies.

When conducting formal manager monitoring updates, CPTI will discuss with external managers portfolio activity, and how stewardship including ESG considerations were factored into the decision-making process at the individual security level. CPTI has developed a rating and view for each manager across asset classes, based on multiple factors which include:

- firm-wide responsible investing resources and capabilities;
- firm-wide commitment to relevant responsible investment codes/principles/initiatives;
- level of active engagement including voting for equities;
- ESG integration into the investment process for Scheme specific investments; and
- ESG reporting on Scheme specific investments.

The Scheme is currently working to improve its internal climate and ESG monitoring of managers. This is in part being achieved through the holdings-based risk and exposure system, BlackRock Solutions, where analytics using Sustainalytics data for public managers and asset classes is now available. CPTI also intend to implement these tools into regular monitoring processes which will better enable managers to be held to account in this area and any areas which cause concern escalated. CPTI is also looking to improve oversight of engagement outcomes across the portfolio.

In ongoing reviews of our shipping and real estate assets, stewardship including ESG risks will be one of the key drivers in decision-making around the managers, the assets and capital expenditure.

EOS is a key stewardship service provider for the Scheme and therefore CPTI regularly review their service on behalf of the Trustee including the scope of their engagement work for the Scheme. As referenced in principle 5, CPTI expanded the engagement by EOS to cover the Scheme's public credit investments in 2020 and an early conclusion from a review of public equity engagement and voting is to delegate more engagement to EOS in 2021. Through regular communication with EOS, as outlined in principle 9, CPTI hold EOS accountable for the stewardship services they provide.

Case study

In September 2020, all managers were asked for their policies in relation to responsible investment, stewardship and ESG. After this engagement, one of the Scheme's private equity managers asked for CPTI's input as they were in the process of updating their ESG policy. They were interested to understand any suggestions for areas of improvement. As a result, CPTI worked with them in identifying areas to improve their ESG policy.

Principle 9: engagement with issuers to maintain or enhance the value of assets.

EOS and a number of the Scheme's investment managers have been appointed to undertake engagements on behalf of the Scheme with companies on issues that may impact their long-term sustainable value. The Trustee expects proposals for engagement to involve some breach of generally accepted financial, strategic, operational, legal, social, environmental, ethical or governance best practice. Engagements may relate to longer-term strategic, environmental, social or governance issues, which may not have immediate stock-specific impacts, for example, where the company's shares or debt are already fully valued and the intent is to preserve that value.

The Trustee expects company specific engagements to be undertaken where it is believed that:

1. Engagement will lead to an increase in value of a company's shares and/or debt over the long term
2. Engagement will prevent or limit a decrease in the value of a company's shares and/or debt over the long term.

In determining whether and how the engagement is taken forward, due regard should be given to the likelihood of engagement success and potential to bring about positive change. Such considerations should be based around an assessment of the likely impact of the engagement and the ultimate benefit to the value of the Scheme's holding.

Engagements may involve:

- Meetings with executive and non-executive directors.
- Meetings with other company representatives.
- Discussions with the other shareholders of the company.
- Participation in collaborative investor initiatives.
- Submission of shareholder resolutions at general meetings as appropriate.

EOS engage for all the Scheme's public credit investments and a large proportion of the Scheme's public equity investments. Summarised below is the breakdown of the Scheme's split of public equity voting and engagement activity across EOS and the other investment managers as at 31 December 2020.

Managers undertaking Voting & Engagement activity	Public equity allocation based on value of assets at 31/12/2020
EOS	50.1%
LGIM	31.3%
Baillie Gifford	10.8%
Schroders	3.0%
Green Court	2.7%
AQR China	2.2%

The Trustee's expectations in term of public market engagement, as summarised above, are set by CPTI through regular meetings with EOS and the Scheme's investment managers. CPTI, on behalf of the Trustee, keeps those currently delegated to engage and vote on the Scheme's behalf under review. As referenced in principle 5, an early conclusion from the current review is to delegate more engagement and voting in relation to the Scheme's public equity portfolio to EOS in 2021.

On behalf of the Scheme, EOS undertakes company-specific engagements with the objective of achieving beneficial and sustained change at the companies and the societies in which they operate. EOS analyses company performance, policies and practices based on corporate disclosures and research on Environmental, Social and Governance (ESG) factors. During 2020 EOS engaged on the Scheme's behalf with 535 companies on 2,037 issues and objectives covering the following topics: environmental (25.5%); social and ethical (17.9%); governance (37.6%); and strategy, risk and communication (19.0%). More detailed disclosure on EOS's engagement on behalf of the Scheme through 2020 including objectives by sector/priority themes and outcomes of engagement are in the annual reporting available on the Scheme's website (link).

CPTI, on behalf of the Scheme, provide feedback to EOS on engagement priority areas and process as part of the annual refresh of the Engagement Plan (as referenced in principle 2). CPTI can also provide feedback through the bi-annual client advisory council events, client advisory board and the Scheme's relationship managers. In 2020, CPTI also had dedicated calls on the voting policy of EOS covering areas such as board independence, over-boarding, gender and ethnic diversity, climate change and executive pay. CPTI also covered these issues with other investment managers that vote and engage on the Scheme's behalf with a significant focus on LGIM given the size of the mandate.

The engagement work with investee companies on behalf of the Scheme is aimed at achieving sustainable investment returns through the promotion of long-term responsible business strategies. Engagements undertaken on behalf of the Scheme are guided by the

Scheme's Corporate Governance Policy which can be found at https://www.mps-pension.org.uk/about-mps/responsible-investing.

EOS and the investment managers monitor company performance on issues relevant to long-term value on an ongoing basis. Such issues include corporate strategy and governance; capital structure; board structure; directors' pay; social, environmental and ethical matters; and risk management. An example of an ongoing engagement conducted on the Scheme's behalf by LGIM on board composition is set out below.

Case study: Hyundai Motor

Hyundai Motor is an automobile manufacturer based in South Korea. LGIM identified concerns with the composition of Hyundai Motor's board due to its lack of diversity, experience and independence. LGIM believe boards that lack diversity and independence may create weaker corporate governance due to groupthink and inadequate oversight. LGIM undertook a number of engagements with the company in which they raised their concerns regarding the board's composition. LGIM supported a shareholder resolution proposing to, amongst other objectives, appoint two new independent directors. Although the shareholder resolution was defeated, the company did respond to the sustained pressure by LGIM and other investors by agreeing to appoint two new outside directors. Hyundai Motor responded to the vote with the following statement: "we will not neglect the voices of our shareholders who have opposed to the Board's proposal in this year's Annual General Meeting. Their opinions and advice will not go unnoticed and will be valuably treated."

Real assets

Engagement in real assets such as infrastructure and real estate has a focus on ensuring these assets retain value and resilience in the future. The examples under principle 7 show activity within the Scheme's real estate assets to focus on increasingly becoming more energy efficient and reducing the climate risk impact. In infrastructure, the Scheme is allocating capital to investment opportunities that are contributing towards the decarbonisation of the economy. Across all the Scheme's real assets the Trustee and CPTI ensure the external managers consider employment policies including particularly worker safety and welfare – the shipping example in principle 7 has been a key focus for the Scheme through 2020.

Principle 10: Policy on Collaborative Engagement

The Scheme collaborates with other investors through the relationship with EOS where engagement with companies is conducted based on assets aggregated across multiple asset owners. The Trustee believes this allows the Scheme to pool resources and to increase leverage for influencing positive change at companies in order to protect and enhance shareholder value. On behalf of the Scheme, EOS's dedicated stewardship team of over 30 engagers were able to engage with 535 companies during 2020.

CPTI also participate in quarterly meetings of the UK Pension Scheme Responsible Investment Roundtable to share ideas and best practice across UK pension schemes. This covers a range of topics including stewardship, climate change and diversity. The Scheme is also a signatory to the UN Principles for Responsible Investment (PRI), which works to promote the incorporation of ESG factors into investment decision-making. In 2020, CPTI had discussions with other industry organisations such as the International Corporate Governance Network and Institutional Investors Group on Climate Change and expect to become more active participants in such collaborative groups in the future.

EOS and the Scheme's investment managers are involved in a number of regional and industry initiatives including the UN PRI, Climate Action 100+, Institutional Investors Group on Climate Change, Asia Investor Group on Climate Change, Ceres, International Corporate Governance Network (ICGN), Council of Institutional Investors, Eumedion, Focusing Capital on The Long Term, Corporate Governance Forum and Investor Forum. An example of a collaborative engagement is set out below.

Case study: Rolls-Royce (Climate Action 100+)
The Climate Action 100+ engagement with Rolls-Royce has been led by EOS, along with seven additional collaborating signatories to Climate Action 100+. Engagement continues to be considerate of the challenges faced by the company due to the coronavirus pandemic, in particular a significant drop in revenue due to reduced flying hours of planes using its engines. This has led the company to seek additional fund raising via a recapitalisation package which includes a rights issue, a bond offering and a new term loan facility. A constructive dialogue between Climate Action 100+ signatories and the company has been ongoing since the launch of the initiative in late 2017, including with internal specialists, senior management and the chair of the board. There were three meetings with the company in the past twelve months including a visit to a production facility to meet with additional internal experts. At the company's 2020 annual general meeting, EOS welcomed the company's goal of net-zero emissions by 2050 and presented questions related to engagement priorities. The CEO reiterated that, despite the immediate pressures of the coronavirus crisis, the climate emergency had not waned, the company remained committed to playing a leading role in enabling the vital sectors in which it operates to get to net zero emissions by 2050 and that this must be a core part of the post-coronavirus recovery of aviation in particular. Ongoing engagement priorities with the company covered during the year included:

- Encouraging the setting of new interim targets, including goals to address Scope 3 produce use emissions, in line with a pathway to net zero.

- Gaining reassurance over climate-related scenario analysis undertaken and its integration into business planning.
- Requesting the company to continue to advance its climate related financial disclosure and specifying where further detail is needed.
- Asking for the company to consider tying executive compensation to climate performance metrics.

Principle 11: Escalating stewardship activities

We expect the Scheme's investment managers and EOS to escalate engagements according to the nature and severity of the concerns. Escalating engagements may be necessary where the company is not receptive to engagement, no progress is being made or progress is too slow. Escalations may include attempting engagement at a more senior level, letters to the board of directors, collaborating with investors or other stakeholders, questions or statements at annual meetings, recommending votes against annual meeting items, shareholder resolutions or open letters. CPTI monitor escalations for public equities through regular reporting on engagement including voting and are exploring at present how to expand this monitoring for other asset classes. CPTI also review EOS's and managers' escalation policies as part of reviews of stewardship approaches.

On meeting EOS's rigorous criteria for escalation, companies are included in EOS's engagement programme based on a formal proposal approved internally by the Engagement Committee which oversees the process. The most recent engagement plan can be found at the following link:
https://www.hermes-investment.com/ukw/wp-content/uploads/2020/02/eos-engagement-plan-2020-2022_public.pdf

Two examples of escalated engagements conducted on the Scheme's behalf by EOS and LGIM are set out below.

In private markets escalations are more direct given the direct ownership of assets – examples can include personnel changes, strategy changes, manager changes or litigation.

Case study: Alphabet

In April 2018, EOS began engaging with the company on how its technologies manage the prioritised content of Google Search and on YouTube to avoid human rights concerns arising through the application of AI. In June 2018, Google's CEO posted a blog that set out the company's principles for responsible AI. In October 2018, EOS engaged with a senior member of the legal team, the assistant secretary at Google, and encouraged the company to go beyond publishing principles, to demonstrate how the principles are being applied. In

December 2018, on an investor conference call, EOS again questioned how Alphabet's Google intends to demonstrate the application of AI principles. In March 2019, the company set up an AI ethics advisory council. However, this was abruptly terminated only 10 days after it was established due to conflicts amongst council members. EOS therefore stepped up engagement with the board, including writing to the chair of the board explaining in detail concerns around the management of AI ethics. EOS requested that the letter be shared with other board members prior to in-person attendance at the 2019 annual shareholder meeting. EOS asked the company to provide further disclosure on its approach to content governance, including how social impact is assessed and measured. EOS recommended a formal and inclusive feedback system from employees, as well as other stakeholders, in its AI ecosystem to ensure that technology deployment is subject to robust product design and impact assessment throughout the value chain. This goes beyond its existing education initiatives such as Machine Learning Fairness and Grow with Google. In January 2019 the company published a 30-page white paper on AI governance, covering five areas where stakeholder collaboration is needed, namely: explicability, assessment of fairness, safety, human-AI collaboration and a general liability framework. It acknowledged that the responsible use of AI is needed to address ethical, technological, legal and other challenges and that AI implementation may affect the brand and demand for products, and have a financial impact on revenues and operating results. In November 2020, Alphabet changed its audit committee to become an audit and compliance committee (ACC). The ACC's charter now includes sustainability, data privacy and civil and human rights risks as items which must be reviewed by it, increasing its responsibilities, and becoming closer to meeting our request for enhanced board oversight. The nominating and corporate governance committee will review the Alphabet board's committee membership each year and review the chairs of each board committee every three years to consider if a rotation is appropriate. This review will include an evaluation of each member's performance, participation, and skill set, as well as membership on private boards.

Case study: Pearson

Pearson Plc is a British multinational publishing and education company. Pearson issued a series of profit warnings under its previous CEO. Yet 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) in September 2020 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 they were 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 plans and progress for the new CEO. LGIM also discussed the shortcomings of the company's current remuneration policy and spoke with the chair directly before the EGM to relay 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 their expectations for UK companies. In the absence of any changes, LGIM took the decision to vote against the amendment to the remuneration policy.

At the EGM 33% of shareholders voted against the co-investment plan and therefore, by default, the appointment of the new CEO. Such significant dissent clearly demonstrates the scale of investor concern with the company's approach. It is important that the company has a new CEO, a crucial step in the journey to recover value; but key governance questions remain which LGIM will address through continuous engagement.

<u>**Principle 12: Exercising rights and responsibilities**</u>

Voting

The Trustee believes that voting is an important investor right and responsibility. Through EOS and certain investment managers, the Scheme seeks wherever practicable to vote responsibly on every resolution at all meetings of companies in its portfolios except where a stock is on loan in the stock lending program. Voting is regarded as an important constituent of the Scheme’s stewardship and in achieving positive change. The use of voting rights attached to shares held by the Scheme are appropriately aligned to its overall responsible investment policies and objectives.

The Trustee expects EOS and the Scheme’s investment managers voting recommendations to be made based on the unique circumstances of each company taking into account local best practice and regulation. Voting should be undertaken pragmatically and in pursuit of positive change. The purpose of the vote is to achieve beneficial change in company behaviour, not simply to register dissatisfaction. Whenever practicable, the Scheme, through EOS and the investment managers, seeks to communicate with portfolio companies in advance of casting a vote against management to explain the Scheme’s rationale and to seek change to the company’s position. Where a vote against management is cast, communication should be continued with the company to explain the voting action and to discuss possible solutions to avoid a recurrence.

The Scheme has a number of specific voting policies in relation to the following areas: board behaviours and composition; remuneration; risk management and audit; promotion of equitable shareholder rights; and shareholder proposals. These specific voting policies are detailed within the Scheme's Corporate Governance Policy, which is published on the Scheme's website at the following link: https://www.mps-pension.org.uk/about-mps/responsible-investing.

The Scheme will typically follow the voting recommendation made by EOS where this has been delegated to them although the Scheme retains the right to vote differently. This is facilitated through the ISS Governance Services voting platform, in accordance with the Scheme's own policy. The process differs for each investment manager. Where the Scheme is invested through a pooled fund, the Scheme does not have the right to change the investment managers vote but CPTI, on the Trustee's behalf, engages with the investment manager on their voting policy and decisions. CPTI monitors the voting done by EOS and the Scheme's investment managers by looking at how they have voted on specific resolutions particularly in relation to board diversity, remuneration and climate. As referenced in principle 9, CPTI held dedicated calls with EOS and a number of the Scheme's investment managers in 2020 on their voting policies as well as covering the rationale for decisions on specific resolutions.

In reaching voting recommendations, EOS implements the Scheme's Corporate Governance Policy. EOS also takes account of its own regional voting guidelines which have been reviewed by CPTI and can be found at
https://www.hermes-investment.com/stewardship/eos-library/.

Summarised historic voting information is publicly available at
https://www.mps-pension.org.uk/about-mps/responsible-investing. Information is disclosed quarterly in arrears to avoid compromising dialogue with companies in the portfolios, whilst being fully transparent and accountable. The below table summarises the Scheme's voting record in 2020 from EOS and the investment managers who vote on the Scheme's behalf.

Investment manager	**Resolutions eligible to vote**	**Percentage of resolutions voted**	**Percentage of voted resolutions that were against management**
EOS	35,438	100%	11%
LGIM	48,560	100%	16%
Baillie Gifford	372	100%	2%
Schroders	985	100%	3%
Green Court	1,034	100%	10%
AQR China	3,598	100%	6%

The below case study is an example of EOS voting on shareholder resolutions for Barclays on the Scheme's behalf.

Case Study: Barclays shareholder resolutions

At Barclays there were two climate-related resolutions in 2020, one backed by the company and the other filed by ShareAction, a charity that advocates for responsible investment. The development of the company-backed resolution followed intensive engagement by investors and their representatives, including EOS. EOS have worked closely with Barclays over several years to enhance its management of climate-related risks. EOS recommended voting in favour of both climate-related resolutions. The company-backed resolution passed with almost unanimous support (99.9%) and committed the bank to aligning all of its financing activities with the Paris Agreement, to become a net-zero emissions bank by 2050. ShareAction's resolution went further, calling for a phase out of financing for fossil fuels and utility companies that are not aligned with the Paris climate goals, and was supported by 24% of the investor base.

Following the vote, the bank has given a further update on the framework towards aligning its financing portfolios with the Paris Agreement, across both lending as well as its capital markets activity (see for example: https://home.barclays/society/our-position-on-climate-change/highlights/). Multiple steps have been taken by the bank, following the announced ambition last year to become a net-zero bank in 2050 – in particular the development of its own methodology for measuring its financed emissions within its energy and power portfolios. Transparency has also improved materially, reflected in the use of a public climate dashboard (https://home.barclays/society/our-position-on-climate-change/our-climate-dashboard/) and enhanced TCFD reporting.

Stocklending

The Scheme has an active stocklending programme but is always ready to recall stock from a loan where it appears that this would be an appropriate way to safeguard the Scheme's financial interests. Over the course of 2020 the Scheme did not recall any stock for the purpose of voting. The Scheme is reviewing its stocklending approach at present and considering whether a more active approach is needed to recall stock for all major votes.

Fixed income

Whilst EOS engage on the Scheme's behalf on public fixed income, the Scheme's public fixed income investment managers have an important stewardship role. As an example, details are provided below in terms of how one of the Scheme's fixed income managers, addresses their stewardship role for the Scheme.

Fixed income credit analysts, in partnership with their syndicate desk and portfolio managers, regularly engage with companies and sell-side banks to discuss and provide feedback on prospectus documents and deal terms. Specifically, credit teams are focused on making sure that the credit covenants within a deal provide adequate protection to bondholders. For example, as bondholders lending to an investment-grade-rated company, change-of-control provisions in case of a downgrade to high yield should be included. Such provision are considered to be more supportive of a sustainable, long-term business model. Similarly, coupon step-ups for bonds that are rated at the lower end of the investment-grade range may be requested, again to protect in the case of downgrade. Finally, restricted payment covenants for issuing entities that are owned by a highly levered holding company are desirable, in order to preserve the sustainability of the issuer.

Other asset classes

The Scheme’s approach to stewardship is less developed in private market assets although the Scheme’s long-term focus and consideration of ESG factors are an important part of stewardship in these assets. The examples for private equity, real estate, shipping and infrastructure in principle 7 show how the Scheme is thinking about stewardship in these areas. Through 2021, CPTI plans to further develop the Scheme’s approach to stewardship across private markets for discussion and agreement with the Trustee.