

Annual Engagement Policy Implementation Statement (to 5 April 2021)

NPL Management Limited Pension Scheme

1. Introduction

This Engagement Policy Implementation Statement ('the Statement') sets out how, and the extent to which, the Engagement Policy in the Statement of Investment Principles ('SIP') produced by the Trustees has been followed during the year to 5 April 2021. This statement has been produced in accordance with The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 and the subsequent amendment in The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019, which transposes the EU Shareholder Rights Directive (SRD II) into UK law.

Section 2 of this Statement provides detail of the actions taken by the Trustees to meet the Scheme's engagement policies set out in the SIP over the year. Section 3 describes the voting behaviour on behalf of the Trustees along with the relevant statistics over the year.

By adopting Mercer's Dynamic De-risking Solution, Mercer Limited (Mercer) in the UK has been appointed as discretionary investment manager by the Trustees. Pursuant to that appointment, Scheme monies are invested in Mercer Funds, which are collective investment vehicles, managed by Mercer Global Investments Europe Limited (MGIE).

2. Policy on ESG, Stewardship and Climate Change

The Scheme's SIP includes the Trustees' policy on Environmental, Social and Governance ('ESG') factors, stewardship and climate change. This policy sets out the Trustees' beliefs on ESG and climate change and the processes followed by the Trustees in relation to voting rights and stewardship.

In order to establish the Trustees beliefs and produce the policy in the SIP, the Trustees undertook training provided by their investment consultant, Mercer, on responsible investment which covered ESG factors, stewardship, climate change and the approach undertaken by Mercer and MGIE in July 2019.

As noted in the SIP, the Trustees believe that ESG factors may have a material impact on investment risk and return outcomes, and that good stewardship can create and preserve value for companies and markets as a whole. The Trustees also recognise that long-term sustainability issues, particularly climate change, present risks and opportunities that increasingly may require explicit consideration.

As noted above, the Trustees have appointed Mercer to act as discretionary investment manager in respect of the Scheme's assets and such assets are invested in a range of Mercer Funds managed by MGIE. Asset managers appointed to manage the Mercer Funds are expected to evaluate ESG factors, including climate change considerations, and exercise voting rights and stewardship obligations attached to the investments, in accordance with their own corporate governance policies and current best practice, including the UK Corporate Governance Code and UK Stewardship Code.

The following work was undertaken during the year relating to the Trustees' policy on ESG factors, stewardship and climate change, and sets out how the Trustees' engagement and voting policies were followed and implemented during the year.

Policy Updates

- The Trustees consider how ESG, climate change and stewardship is integrated within Mercer's, and MGIE's, investment processes and those of the underlying asset managers in the monitoring process. Mercer, and MGIE, have provided reporting to the Trustees on a regular basis.
- The Mercer [Sustainability Policy](#) is publicly available and will be considered by the Trustees from time to time. In August 2020 the Stewardship section was updated to reflect an enhanced approach to monitoring both voting and engagement as well as the Exclusions section to include the implementation of certain exclusions across passive funds from 1 October 2020. In March 2021 there was a further update in relation to sustainability-related disclosures in the financial services sector ("SFDR") implementation.
- In line with the requirements of the EU Shareholder Rights Directive II, Mercer have implemented a standalone [Engagement Policy](#) to specifically address the requirements of the directive.

Climate Change Reporting and Carbon Footprinting

- Mercer undertake climate scenario modeling and stress testing on the Mercer multi sector funds used by the Scheme on an annual basis, in line with the Task Force on Climate Related Financial Disclosures (TCFD) recommendations, with the latest review as at 31 March 2020. The results of the climate scenario modelling and carbon footprinting are within the [TCFD compliant Climate Change Management Report](#). The findings of the modelling are integrated into the asset allocation and portfolio construction decisions, with portfolios increasingly aligned with a 2°C scenario, where consistent with investment objectives and for consistency with the Paris Agreement on Climate Change.
- Carbon Footprint analysis of all equity funds is completed on a six monthly basis. From 31 December 2019 the approach was enhanced to include the top 5 carbon emitters and the top 5 contributors to the Weighted Average Carbon Intensity (WACI) to give the Mercer and MGIE investment teams additional information to drive engagement with managers.
- Since Q3 2020 carbon footprinting metrics for Mercer active equity funds have been included in the quarterly reporting reviewed by the Trustees, and a comparison of these against the metrics of their representative benchmarks. Over 2020 there has been a 15% reduction in the WACI across the Mercer discretionary equity funds and, as at 31 December 2020, 100% of the active equity funds used by the Scheme have a carbon intensity lower than the benchmark. In the Q4 report, this analysis was extended to include Mercer passive equity funds.

ESG Rating Review

- ESG ratings assigned by Mercer (and its affiliates') global manager research team, are included in the investment performance reports produced by Mercer on a quarterly basis for the Trustees. ESG ratings are reviewed by MGIE during quarterly monitoring processes, with a more comprehensive review performed

annually - which seeks evidence of positive momentum on ESG integration. Since Q3 2020 the quarterly performance report has included the Mercer funds overall ESG rating compared to the appropriate universe of strategies in Mercer's global investment manager database.

- As at 31 December 2020 the Trustees noted that 95% of Mercer Funds now have an ESG rating equal to or above their asset class universe, a 10% improvement on 2019.

Update to Exclusions

- As an overarching principle, Mercer and MGIE, as the Trustees' discretionary investment manager, prefer an approach of positive engagement rather than negative divestment. However Mercer and MGIE recognises that there are a number of cases in which investors deem it unacceptable to profit from certain areas and therefore exclusions will be appropriate.
- Controversial and civilian weapons, and tobacco are excluded from active equity and fixed income funds. From 1 October 2020, the controversial weapons screen was extended to passive equity funds. The Mercer sustainable themed funds have additional exclusions, for example covering gambling, alcohol, adult entertainment and fossil fuels.
- In addition, Mercer and MGIE monitors for high-severity breaches of the UN Global Compact (UNGC) Principles that relate to human rights, environmental and corruption issues.

Sustainably themed investments

- An allocation to Sustainable Equities is directly made by the Scheme, with the strategic allocation to Sustainable Equities within the Growth Portfolio increasing by 3.9% over the year.
- A detailed standalone sustainability monitoring report is produced for the Sustainable Global Equity funds on a semi-annual basis, including a more granular breakdown of the fund against ESG metrics, for example the UN Sustainability Development Goals, and is periodically reviewed by the Trustees.

Diversity

- From 31 December 2020 Gender diversity statistics have also been included in the quarterly reporting for the Mercer equity funds and this is being built into a broader investment policy.

3. Voting Activity

The Trustees' investments take the form of shares or units in the Mercer Funds. Any voting rights that do apply with respect to the underlying investments attached to the Mercer Funds are, ultimately, delegated to the third party investment managers appointed by MGIE. MGIE accepts that managers may have detailed knowledge of both the governance and the operations of the investee companies and has therefore enabled managers to vote based on their own proxy-voting execution policy, and taking account of current best practice including the UK Corporate Governance Code and the UK Stewardship Code. As such the Trustees do not use the direct services of a proxy voter.

The MGIE Engagement Policy outlines this framework.

Set out below is a summary of voting activity for the year to 31 March 2021 relating to the relevant Mercer Funds.

- **Voting:** As part of the monitoring of managers' approaches to voting, MGIE assesses how active managers are voting against management and seeks to obtain the rationale behind voting activities, particularly in cases where split votes may occur (where managers note in different ways for the same proposal). MGIE portfolio managers will use these results to inform their engagements with managers on their voting activities.

Voting statistics are available and are drawn from the Glass Lewis voting system (via Mercer's custodian). Across the various Mercer funds that invest in equities, over 50,000 voting proposals were considered by the underlying investment managers. Almost 10% of the votes made were against proposals. Typically, votes exercised against management can indicate a thoughtful and active approach. This is particularly visible where votes have been exercised to escalate engagement objectives. The expectation is for all shares to be voted.

Occasionally voting is recorded as "Unvoted" or "Other". "Unvoted" reflects instances where managers have not actioned a vote – these are specific areas where MGIE will follow up to ensure managers have appropriate systems in place to ensure all votes are actioned. "Other" reflects instances where managers have withheld votes in Power of Attorney markets, share blocking markets or where conflicts of interest may be present.

- **Significant Votes:** Mercer Investment Solutions has based its definition of significant votes on its Global Engagement Priorities, based on its Beliefs, Materiality and Impact ("BMI") Framework. This is summarised in the Engagement Section of the MGIE Sustainability Policy. In order to capture this in the monitoring and reporting of managers voting activities, significant votes focus on proposals covering these priority areas, with specific focus placed on shareholder proposals ("SHP") relating to these priority areas and taking into account the size of holding across funds. There are a number of examples of Significant Votes over the year, including on topics such as Climate Change and Emissions, Diversity and Executive Pay. In a number of these examples the investment managers voted against Company Management.