Bodycote UK Pension Scheme Implementation Statement

September 2021

isio.

Contents

1. Introduction

Background

The Department for Work and Pensions ('DWP') is increasing regulation to improve disclosure of financially material risks. This regulatory change recognises Environmental, Social and Governance (ESG) factors as financially material and schemes need to consider how these factors are managed as part of their fiduciary duty. The regulatory changes require that schemes detail their policies in their Statement of Investment Principles (SIP) and demonstrate adherence to these policies in an Implementation Statement, which will be updated annually.

Statement of Investment Principles (SIP)

The Trustees have updated the SIP in August 2020 to cover:

- Policies for managing financially material considerations including ESG factors and climate change.
- Policies on the stewardship of the investments.

The SIP can be found online using the following link:

Bodycote SIP

Changes to the SIP are detailed in Section 2 of this report.

Implementation Statement

This Implementation Statement documents the ways in which the Trustee follow and act on the principles outlined in the SIP. The statement covers the 12-month period to 5 April 2021 and the changes to the SIP in August 2020 and includes:

- Actions the Trustee have taken to manage financially material risks and implement the key policies in its SIP. This Section also details any changes the Trustee has made to the investment strategy in the previous 12 months and the relevance of such changes to the agreed investment policies,
- The current policy and approach with regards to ESG,
- The extent to which the Trustee has followed policies on engagement, covering engagement actions with its investment managers and in turn the engagement activity of the investment managers with the companies in the investment mandates.

Summary of key strategic changes undertaken over the Scheme reporting year

The Trustee monitors the Scheme's investments on an ongoing basis, including receiving regular reporting from the Scheme's investment adviser and the investment managers.

Reporting includes monitoring the Scheme's investment strategy versus the strategic target detailed in the SIP, reviewing the performance of the investment managers versus relevant benchmarks and/or their stated objectives, and monitoring investment risks.

The Trustee made no significant changes to the investment strategy during the year ending 5 April 2021.

Implementation Statement

This statement demonstrates that Bodycote UK Pension Scheme has adhered to its investment principles and its policies for managing financially material considerations including ESG factors and climate change.

Signed: Bodycote Pension Trustees Limited on behalf of the Bodycote UK Pension Scheme

Date: September 2021

2. Changes to the SIP

As required by new regulations effective from 1st October 2020, the Trustee's Statement of Investment Principles ("SIP") was updated over the year to 5 April to include further policies on how the Trustee will monitor and ensure the Scheme's investment managers' policies are aligned to the Scheme's policies. The additional polices added to the SIP are outlined in the table below.

Policies added to the SIP	
Date updated: August 2020	
How the investment managers are incentivised to align their investment strategy and decisions with the Trustee's policies.	• As the Scheme is invested in pooled funds, there is no scope for these funds to tailor their strategy and decisions in line with the Trustee policies. However, the Trustee invest in a portfolio of pooled funds that are aligned to the strategic objective. • The Scheme's mandate for Direct Lending is subject to a performance related fee.
How the investment managers are incentivised to make decisions based on assessments of medium to long-term financial and non-financial performance of an issuer of debt or equity and to engage with them to improve performance in the medium to long-term.	• The Trustee review the investment managers' performance relative to medium and long-term objectives as documented in the investment management agreements. • The Trustee do not incentivise the investment managers to make decisions based on non-financial performance.
How the method (and time horizon) of the evaluation of investment managers' performance and the remuneration for their services are in line with the Trustee's policies.	• The Trustee review the performance of all of the Scheme's investments on a net of cost basis to ensure a true measurement of performance versus investment objectives. • The Trustee evaluate performance over the time period stated in the investment managers' performance objective, which is typically 3 to 5 years.
The method for monitoring portfolio turnover costs incurred by investment managers and how they define and monitor targeted portfolio turnover or turnover range.	• The Trustee does not directly monitor turnover costs. However, the investment managers are incentivised to minimise costs as they are measured on a net of cost basis.

The duration of the Scheme's arrangements with the investment managers	• The duration of the arrangements is considered in the context of the type of fund the Scheme invests in.
	  ○ For closed ended funds or funds with a lock-in period the Trustee ensure the timeframe of the investment or lock-in is in line with the Trustee objectives and Scheme's liquidity requirements.
	  ○ For open ended funds, the duration is flexible, and the Trustees will from time-to-time consider the appropriateness of these investments and whether they should continue to be held.

3. Managing risks and policy actions

Risk / Policy	Definition	Policy	Actions and details on changes to policy
Interest rates and inflation	The risk of mismatch between the value of the Scheme assets and present value of liabilities from changes in interest rates and inflation expectations.	The Trustee aims to hedge this risk where it is deemed appropriate and affordable.	• To manage interest rate and inflation risk, the Scheme has an LDI mandate in place, which hedges up to funded liabilities. This mandate is monitored on an ongoing basis with a more detailed review periodically.
Liquidity	Difficulties in raising sufficient cash when required without adversely impacting the fair market value of the investment.	To maintain a sufficient allocation to liquid assets so that there is a prudent buffer to pay members benefits as they fall due (including transfer values), and to provide collateral to the LDI mandate.	• The Trustee monitors the level of liquid assets available to the LDI manager on an ongoing basis. • Sufficient liquidity was maintained over the period to ensure all cashflow requirements were met in a timely and cost-efficient manner.
Market	Experiencing losses due to factors that affect the overall performance of the financial markets.	To remain appropriately diversified to avoid over-reliance on any one asset class.	• The Trustee maintained a diversified portfolio over the year to 5 April 2021.
Credit	Default on payments due as part of a financial security contract.	To diversify this risk by investing in a range of credit markets across different geographies and sectors. To appoint investment managers who actively manage this risk by seeking to invest only in debt securities where the yield available sufficiently compensates the Scheme for the risk of default.	• The Trustee maintained a diversified portfolio of credit assets over the year to 5 April 2021. The Scheme's investment adviser meets with the Scheme's investment managers on a regular basis to monitor portfolio risk.
Environmental, Social and Governance	Exposure to Environmental, Social and Governance factors, including but not limited to climate change, which can impact the	To acknowledge Environmental, Social and Governance factors when appointing new mandates and when monitoring existing mandates.	• More details of the ESG policy and how it was implemented are presented in Section 4 of this report.

	performance of the Scheme's investments.		
Currency	The potential for adverse currency movements to have an impact on the Scheme's investments.	To largely invest in GBP share classes where possible to eliminate direct currency risk. To largely invest with managers that hedge exposure to foreign currency risk in underlying holdings, except where active currency positions are held. (1)	• The vast majority of Scheme assets were held in sterling denominated funds over the period.
Non-financial	Any factor that is not expected to have a financial impact on the Scheme's investments.	Non-financial matters, such as reputational risks, are taken into account in the selection, retention and realisation of investments where it is deemed appropriate.	• Non-financial matters are considered where appropriate on an ongoing basis.

Notes: (1) The Scheme's direct lending manager, Permira, and the Scheme's Semi-Liquid Credit manager, Apollo, may have non-GBP principal investments which are hedged back with a portion of income hedged also.

4. Current ESG policy and approach

ESG as a financially material risk

The SIP describes the Scheme's policy with regard to ESG which is recognised as a financially material risk. As outlined in the 'Investment manager arrangements' section of the SIP, all decisions about the day-to-day management of the assets have been delegated to the investment managers via a written agreement. The delegation includes decisions about:

- Selection, retention and realisation of investments including taking into account all financially material considerations, including Environmental, Social and Governance ('ESG') factors in making these decisions.
- The exercise of rights (including voting rights) attaching to the investments.
- Undertaking engagement activities with investee companies and other stakeholders, where appropriate.

The 'Investment Manager Monitoring and Engagement' section of the SIP outlines the framework the Trustee uses to monitor and engage with the investment managers on ESG matters.

Areas for engagement	Method for monitoring and engagement	Circumstances for additional monitoring and engagement
Environmental, Social and Governance factors and the exercising of rights and engagement activity	• The Trustees' investment managers provide reports on how they have engaged with issuers regarding social, environmental, and corporate governance issues.	• The manager has not acted in accordance with their policies and frameworks.

Areas of assessment

Risk Management	1. Integrating ESG factors, including climate change risk, represents an opportunity to increase the effectiveness of the overall risk management of the Scheme 2. ESG factors can be financially material and managing these risks forms part of the fiduciary duty of the Trustee
Approach / Framework	3. The Trustee should understand how asset managers make ESG decisions and will seek to understand how ESG is integrated by each asset manager. 4. ESG factors are relevant to investment decisions in all asset classes. 5. Managers investing in companies' debt, as well as equity, have a responsibility to engage with management on ESG factors.
Reporting & Monitoring	6. Ongoing monitoring and reporting of how asset managers manage ESG factors is important. 7. ESG factors are dynamic and continually evolving; therefore the Trustee will receive training as required to develop their knowledge. 8. The role of the Scheme's asset managers is prevalent in integrating ESG factors; the Trustee will, alongside the investment advisor, monitor ESG in relation to the asset managers' investment decisions.
Voting & Engagement	9. The Trustee will seek to understand each asset managers' approach to voting and engagement when reviewing the asset managers' approach. 10. Engaging is more effective in seeking to initiate change than disinvesting.
Collaboration	11. Asset managers should sign up and comply with common codes and practices such as the UNPRI & Stewardship code. If they do not sign up, they should have a valid reason why. 12. Asset managers should engage with other stakeholders and market participants to encourage best practice on various issues such as board structure, remuneration, sustainability, risk management and debtholder rights.

Appendix A - Engagement

There were no voting rights attached to the Scheme's investments over the 12-month period to 5 April 2021. The majority of the Scheme's assets are credit based where there are no voting rights attached.

The Trustee delegates the day-to-day management of the Scheme's assets to investment managers. Details of the investment managers' engagement actions, including a summary of the engagements for the 12-month period to 31 March 2021 (rather than 5 April 2021 due to availability of data), are included below.

Fund name	Engagement summary	Commentary
M&G Alpha Opportunities Fund	Total Engagements: 14 Environmental: 5 Social: 2 Governance: 7	M&G's activities are consistent with their ESG policies and they have a systematic approach around engagements in which specific objectives are outlined in advance and measured based on the outcomes from the engagements. Examples of significant engagements include: - BP – governance: M&G co-signed a letter with other major BP shareholders to support various changes to accounting assumptions, writing down the value of assets based on a lower future expected oil price viewed as consistent with a Paris-aligned world. This helped the company to make investment decisions that are more aligned with climate targets. - HSBC – environmental: spoke to the head of sustainable finance to gain further details and reasoning into HSBC's thermal coal policy and the exceptions which allowed investments in Bangladesh, Vietnam and Indonesia. M&G accepted HSBC's pledge that no new coal-fired power stations will be financed, and the exceptions were due to expire by the end of 2020. - Manchester Airport – governance: engaged with company insiders for feedback on its proposed covenant waiver request, due to the impact of COVID19. The covenant waiver request was granted post engagement, which M&G voted in favour of.

Permira PCS II	Total engagements: 3	Permira are in contact with the management teams of their portfolio companies. However, given their position as lenders, they will typically rely on the equity sponsor to report ESG-related concerns and drive ESG improvements. Investing in private companies also reduces the transparency of the information available to assess ESG risks. Examples of significant engagements include: **David Brown**: Permira engaged with the company to discuss its ESG strategy, with a focus on the company's carbon footprint, energy efficiency, and diversity/inclusion across the business. An internal team at the company is developing this strategy and approach, and an ESG committee has been formed which includes senior members of the team. The company is also planning to release an external ESG report by the end of 2021. Permira intend to continue engaging with the company as they develop and roll out the strategy. Permira's ESG team have the capabilities to be directly involved in the ESG strategy of underlying companies, however for the majority of companies in the PCS Funds, their private equity sponsors have their own capabilities to drive ESG improvements independently. David Brown's private equity sponsors did not have the required ESG expertise, requiring Permira to be more involved directly in the development and rollout of the company's ESG strategy. **Paperchase:** During the year Permira took ownership of the company, thereby increasing their engagement rights in comparison to their previous position as a lender. Management recognises that sustainability should form a key part of Paperchase's new strategy. Permira have also introduced external advisors to support the company on the development of its sustainability strategy, which is focused on sustainable sourcing and plastic reduction. This is due to be developed further in H2 2021, and Permira plan to continue engaging with the company to discuss next steps.

Apollo Total Return Fund	Total Engagements: 32 Environmental: 18 Social: 19 Governance: 17 Please note that the sum of the above categories is greater than the number of total engagements, as some engagements covered more than one ESG area.	Apollo have a clear due diligence and engagement framework. The team engages with portfolio companies through discussion with management, and these engagements have been a key driver for the production of formal company ESG reports and Key Performance Indicators. As bond investors, Apollo's voting and engagement rights are limited, making it more difficult to engage with portfolio companies in comparison to equity investors. Examples of significant engagements include: **Belron -** Apollo met with the company to discuss the introduction of an ESG 'ratchet' (a mechanism whereby investors' loan terms are altered based on their performance relative to pre-agreed ESG targets). The ESG ratchet for the company is based on the percentage of recycled glass used and greenhouse gas emissions. As a result of this engagement, the approved loan structure included an ESG ratchet whereby loan payments increase or decrease by +/- 0.075% depending on whether or not the company meets certain thresholds for using recycled glass and reducing greenhouse gas emissions. This aims to improve financial alignment of the underlying company with the ESG interests of the Fund and its investors. **Gannett Co. Inc. –** Apollo discussed the topic of diversity and inclusion with the company at the annual board meeting. As a result of the engagement, the company set a target for 50% of the workforce to be comprised of underrepresented groups by 2025. The company also set targets in relation to increasing diversity at the director level and above.
LGIM – Absolute Return Bond Fund **LGIM - Buy and Maintain Corporate Bonds Fund** **LGIM - LDI Funds**	LGIM currently do not provide details of their engagement activity on a fund-by-fund basis. Isio are working with LGIM to find ways of improving their engagement reporting.	LGIM believe in an active ownership approach. Therefore, they aim to leverage the wider capabilities of the global firm, to actively engage with companies, to create positive change and value. LGIM's Investment Stewardship team are responsible for engagement activities across all funds. LGIM share their finalised ESG scorecards with portfolio companies and the metrics on which they are based.

Where engagements are unsuccessful, the team will assess where problems arose and new approaches to be employed. LGIM engage with regulators, governments, and other industry participants to address long-term structural issues.

Examples of significant engagements include:

The Procter & Gamble Company (P&G) - LGIM engaged P&G on the use of both forest pulp and palm oil as raw materials within its household good products as Palm oil and forest pulp are considered the leading drivers of deforestation and are responsible for c.12.5% of greenhouse emissions that contribute to climate change. LGIM will continue to engage with and monitor P&G's environmental impact disclosure for improvement.

Luckin Coffee Inc. - LGIM engaged with Luckin Coffee Inc (a Chinese coffee company and coffeehouse chain) following concerns around fraudulent behaviour denied by the board. Further investigation revealed fabricated sales of approximately $300 million and led to the company being delisted from Nasdaq in June 2020. LGIM sanctioned the board for its lack of oversight, supported the removal of the board chair and voted in favour of the removal of two outside non-independent directors of the board. The outcome of this engagement was the appointment of a new combined chair and CEO, the removal of three board directors and the appointment of two new outside directors.

Toshiba Corp – LGIM engaged with Toshiba on restoring trust between its shareholders and management team following recent controversies, including allegations of abnormal practices and behaviour by the company surrounding its July 2020 AGM. As part of this engagement, LGIM supported the resolution calling for (i) the appointment of investigators to address doubts over the company's 2020 AGM (the Investigation Resolution) and (ii) mandating the company to present its strategic investment policy to a shareholder vote (the Investment Policy Resolution). While the Investigation Resolution passed, the Investment Policy

		Resolution did not. However, the vote provided a clear signal to the board and executive team that shareholders expect increased transparency and accountability.

www.isio.com