



Bodycote UK Pension Scheme Implementation Statement

September 2023

Background and Implementation Statement

Background

The regulatory landscape continues to evolve as ESG becomes increasingly important to regulators and society. The Department for Work and Pensions ('DWP') has increased the focus around ESG policies and stewardship activities by issuing further regulatory guidance relating to voting and engagement policies and activities. These regulatory changes recognise the importance of managing ESG factors as part of a Trustee's fiduciary duty.

Implementation Statement

This implementation statement is to provide evidence that the Trustee continues to follow and act on the principles outlined in the Statement of Investment Principles ("SIP").

The SIP can be found online at the web address:

[Bodycote UK Pension Scheme Statement of Investment Principles](#)

Changes to the SIP are detailed on the following page.

The Implementation Report details:

- actions the Trustee has taken to manage financially material risks and implement the key policies in its SIP
- the current policy and approach with regards to ESG and the actions taken with managers on managing ESG risks
- the extent to which the Trustee has followed policies on engagement covering engagement actions with its fund managers and in turn the engagement activity of the fund managers with the companies in the investment mandate

Summary of key actions 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.

Due to significant market volatility impacting gilt yields, the LDI portfolio remains under review. The automatic collateral waterfall allows funds to be drawn from the L&G Cash Fund and L&G Absolute Return Bond Fund automatically in the event of an LDI capital call.

In H2 2022, the Scheme redeemed assets from the M&G Alpha Opportunities Fund and Apollo Total Return Fund. The M&G redemption proceeds were invested into the L&G Cash Fund to provide collateral for the LDI mandate. The Apollo redemption proceeds were invested into the L&G Absolute Return Bond Fund as a second tier of collateral in the event that the Cash Fund is exhausted.

In light of liquidity concerns, the Scheme transferred the holding in the M&G Alpha Opportunities Fund to the M&G Total Return Credit Investment ('TRCI') Fund. This

was completed as a stock 'in-specie,' moving the fund from a previously monthly dealt fund to a daily dealt fund to allow for more flexibility for collateral purposes and ongoing cashflow requirements.

The SIP has been updated to reflect a new interim strategic benchmark and an updated version of the SIP will be available online following Trustee sign-off.

Implementation Statement

This report demonstrates that the 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 2023

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.	<p>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. At present the hedging levels are below target following the events of Q4 2022. However, the LDI hedging is currently being reviewed in order to increase these back to target.</p> <p>The automatic collateral waterfall has been reinstated in Q1 2023 whereby the L&G Cash Fund and Absolute Return Bond Fund would be used automatically in the event of an LDI capital call.</p>
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.	<p>The Trustee monitors the level of liquid assets available to the LDI manager on an ongoing basis.</p> <p>Sufficient liquidity was maintained over the period to ensure cashflow requirements were met in a timely and cost-efficient manner in line with strategy.</p>
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 2023.
Credit	Default on payments due as part of a financial security contract.	<p>To diversify this risk by investing in a range of credit markets across different geographies and sectors.</p> <p>To appoint investment managers who actively manage this risk by seeking to invest only in debt securities where the yield available</p>	The Trustee maintained a diversified portfolio of credit assets over the year to 5 April 2023. The Scheme's investment adviser meets with the Scheme's investment managers on a regular basis to monitor portfolio risk.

		sufficiently compensates the Scheme for the risk of default.	
Environmental, Social and Governance	Exposure to Environmental, Social and Governance factors, including but not limited to climate change, which can impact the performance of the Scheme's investments.	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 pages 7 and 8 of this report.
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.

Changes to the SIP

Over the reporting period to 5 April 2023, no updates were made to the Scheme's SIP. Post reporting period, the SIP was updated to reflect changes to the recent regulatory requirements.

Policies added to the SIP

Date updated: April 2023

Voting Policy - How the Trustee expects investment managers to vote on their behalf

- The Trustee has acknowledged responsibility for the voting policies that are implemented by the Scheme's investment managers on their behalf.

Engagement Policy - How the Trustee will engage with investment managers, direct assets and others about 'relevant matters'

- The Trustee has acknowledged responsibility for the engagement policies that are implemented by the Scheme's investment managers on their behalf.
- The Trustee, via their investment advisers, will engage with managers about 'relevant matters' at least annually.
- Example stewardship activities that the Trustee has considered are listed below.
 - Selecting and appointing asset and fiduciary managers – the Trustee will consider potential managers' stewardship policies and activities
 - Asset manager engagement and monitoring – on an annual basis, the Trustee assesses the voting and engagement activity of their asset managers. The results of this analysis feeds into the Trustee's investment decision making
- Collaborative investor initiatives – the Trustee will consider joining/ supporting collaborative investor initiatives

Current ESG policy and approach

ESG as a financially material risk

The SIP describes the Scheme's policy with regards to ESG 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	<ul style="list-style-type: none">• The Trustee's investment managers provide reports on how they have engaged with issuers regarding social, environmental, and corporate governance issues.	<ul style="list-style-type: none">• The manager has not acted in accordance with their policies and frameworks.

Areas of assessment

Risk Management	<ol style="list-style-type: none">1. Integrating ESG factors, including climate change risk, represents an opportunity to increase the effectiveness of the overall risk management of the Scheme2. ESG factors can be financially material and managing these risks forms part of the fiduciary duty of the Trustee
Approach / Framework	<ol style="list-style-type: none">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	<ol style="list-style-type: none">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	<ol style="list-style-type: none">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	<ol style="list-style-type: none">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.

Engagement

As the Scheme invests via fund managers, the Trustee delegates the day-to-day management of the Scheme's assets to investment managers. The managers provided details on their engagement actions including a summary of the engagements by category for the 12-month period to 31 March 2023, (rather than 5 April 2023 due to availability of data). Details of the investment managers' engagement actions are included below.

There were no voting rights attached to the Scheme's investments over the 12-month period to 5 April 2023. The majority of the Scheme's assets are credit based where there are no voting rights attached.

Please note that the Scheme completed the transition from M&G AOF to M&G TRCI close to the end of the reporting period. As M&G AOF was held through majority of the reporting period, M&G TRCI will be included in next year's report instead.

Fund name	Engagement summary	Commentary
Apollo Total Return Fund	Total engagement: 48 Environment: 45 Social: 24 Governance: 10	<p>Apollo's credit team identifies and addresses ESG risks and opportunities through its engagement with issuers. Apollo has an active approach towards engagement with portfolio companies and where possible incorporates ESG targets in the loan deal structures or financing options. The manager also integrates ESG through the use of an ESG scorecard when making investment decisions. Regular visits to the portfolio companies' sites are carried out by members of ESG and Apollo Portfolio Performance Solutions (APPS) teams to view their operations, provide recommendations, and help formulate improvement plans.</p> <p>Examples of a significant engagement includes: Moss Creek Resources Holdings, Inc.</p> <p>Apollo engaged with Moss Creek (an independent oil and gas company focused on exploration) on the Company's environmental and governance risk. Following Apollo's engagement to mitigate its environmental impact, Moss Creek shared plans to reduce emissions within its operations by reducing flaring (the burning of natural gas associated with oil extraction) and the plan to build a water infrastructure and recycling system which will reduce the need for truck driving and freshwater extraction.</p> <p>Moss Creek have also taken steps to improve its governance structure by creating a Corporate Responsibility Team and engaging with a third-party consultant to gather stakeholder feedback. Moss Creek's US assets are ringfenced from the parent entity, mitigating governance risks. Apollo continue to engage and monitor the changes being implemented in response to this engagement and the effect of such changes.</p>

M&G Alpha Opportunities Fund	<p>Total engagements: 11</p> <p>Environmental: 5</p> <p>Social: 4</p> <p>Governance: 2</p>	<p>M&G’s engagement activities remain consistent with firm wide ESG policies, utilising a systematic approach to engagement, whereby specific objectives are outlined in advance and measured based on the outcomes from the engagements. M&G monitor the success of engagements by assessing whether they have met their objective and log this on a central system.</p> <p>Examples of a significant engagement includes: Duke Energy</p> <p>Duke Energy is a North American electric power and natural gas holding company. As part of the ongoing M&G Coal Engagements, Duke Energy was asked to disclose a phase out plan to exit coal by 2030 (currently 2035).</p> <p>The company confirmed that the plan for an orderly transition out of coal by 2035 is in place, ensuring that replacement generation is in-service prior to retirement to ensure reliability of the network and affordability of energy for clients.</p> <p>The company continues to demonstrate positive progress however, the 2030 target is unlikely to be achieved. As such, the Coal Appeals Committee will decide the next steps at the next committee meeting.</p>
Permira PCS II	<p>Total engagement: NA</p> <p>No fund specific engagement data was provided.</p>	<p>Permira engages with its portfolio companies, primarily focusing on the company’s strategy regarding sustainability. The PCS funds typically invest in non-listed companies where ESG engagement is on a case-by-case basis.</p> <p>Examples of a significant engagement includes: Sportscape</p> <p>Permira engaged with Sportscape on their ESG approach/strategy and ways Permira could support future improvements.</p> <p>Engagement included discussing the option of embedding an ESG margin ratchet in Sportscape’s loan documentation, to tie a reduction in the margin with Sportscape achieving ESG metrics. Permira Credit advised Sportscape on which of their environmental, social and governance initiatives would be most appropriate and meaningful to apply, noting the conditions agreed need to show a commitment to improving the company’s ESG measures. The key metrics discussed have been the reduction of GHG emissions, increasing the proportion of their products that are classified as having ‘Eco Credentials’ (as mapped to 3rd party verifications), and achieving a strong score on the ‘Gender Equality Index’ (as per French law definition). Conversations remain ongoing, with strong engagement from the company. In H2 2023, Isabelle Young, Permira Credit’s ESG Lead, will be presenting at a Sportscape company-wide meeting on the topic of ESG, to further embed awareness and engagement on ESG across the company as a whole.</p>
L&G Absolute Return Bond Fund	<p>Total engagement: 133</p> <p>Environment: 64</p> <p>Social: 22</p> <p>Governance: 40</p> <p>Other: 7</p>	<p>L&G do not consider engagement on a fund-by-fund basis but do actively approach ESG at a firm level. As such, L&G do not employ a formal framework for measuring the success of an engagement, as they believe success is difficult to measure and is best reflected in the overall market value of an asset.</p> <p>Examples of a significant engagement include: Sumitomo Mitsui Financial Group</p> <p>L&G engaged with Sumitomo Mistui on climate change decisions at the company. This included disclosing the company’s business strategy to align investments with the goals of the Paris Agreement Resolution and the measures to be taken to ensure the company’s lending and underwriting are not used for expansion of fossil fuel supply or associated infrastructure. Shareholders resolutions were proposed and L&G supported both resolutions which did not pass. L&G continue to engage with the company to monitor actions and to aid in their approach to net zero.</p>

L&G Buy and Maintain Corporate Bonds Fund	<p>L&G currently do not provide details of their engagement activities at Fund level, however, the firm is considering how such information can be provided going forward. Isio will work with L&G on the development of the firm's engagement reporting</p>	<p>L&G regularly monitor their portfolio holdings and where engagements are unsuccessful, the team will assess where problems arose and new approaches to be employed. L&G engage with regulators, governments, and other industry participants to address long-term structural issues.</p> <p>L&G were unable to provide examples of significant engagement.</p>
L&G LDI Fund	<p>L&G currently do not provide details of engagement activity within the LDI portfolio. Isio are working with L&G to find ways of improving their engagement reporting.</p>	<p>L&G view ESG as an essential component to LDI and integrate ESG into their LDI approach on a top-down and bottom-up basis.</p> <p>L&G engage with regulators, governments, and other industry participants to address long-term structural issues, alongside, analysing ESG-related criteria in the assessment of counterparties through L&G's proprietary ESG tools.</p> <p>L&G were unable to provide examples of significant engagement.</p>

