Engagement Policy Implementation Statement

Durham University Pension Scheme

This paper has been produced for the Durham University Pension Scheme ("the Scheme"), as the Trustees of the Scheme ("the Trustees") prepare their Engagement Policy Implementation Statement ("EPIS").

At a glance…

The first part of this document, provides guidance to the Trustees of the Scheme in relation to the preparation of the EPIS, including information regarding the regulatory background, data gathered, significant votes and next steps.

The remainder of the document includes the draft EPIS that has been prepared for the Trustees to review.

Regulatory background

On 6 June 2019, the Government published the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 (the "Regulations"). The Regulations amongst other things require that from 1 October 2020, the pension scheme trustees of defined benefit schemes outline how they have ensured that the stewardship policies and objectives set out in the Scheme's Statement of Investment Principles ("SIP") have been adhered to, by preparing an EPIS. The EPIS must:

- Explain how and the extent to which pension scheme trustees have followed their engagement policy, which is outlined in the SIP.
- Describe the voting behaviour by, or on behalf of the trustees (including the most significant votes cast by trustees or on their behalf) during the scheme year and state any use of the services of a proxy voter during that year.

Why bring you this paper?

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

Next steps

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

Prepared for: The Trustees
Prepared by: Aon
Date: 29 September 2021

Pension scheme trustees must publish the EPIS online, before 1 October 2021. Pension scheme trustees are also required to include the EPIS in the annual scheme report and accounts.

Preparing the EPIS

Data

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

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

Significant votes

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

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

Materiality considerations

This statement does not disclose stewardship information on any investments in gilts, liability driven investments (LDI) or cash due to the limited materiality of stewardship to those asset classes.

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

Next steps

The Trustees should review the document to ensure that they are comfortable with the statements being made on their behalf. Once the Trustees have reviewed, they should agree and finalise the EPIS.

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

Engagement Policy Implementation Statement ("EPIS")

Introduction

On 6 June 2019, the Government published the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 (the "Regulations"). The Regulations amongst other things require that pension scheme trustees produce an annual implementation statement which outlines the following:

- Explain how and the extent to which they have followed their engagement policy, which is outlined in the SIP.
- Describe the voting behaviour by, or on behalf of the pension scheme trustees (including the most significant votes cast by the pension scheme trustees or on their behalf) during the scheme year and state any use of the services of a proxy voter during that year.

This document sets out the details, as outlined above. This EPIS for the Durham University Pension Scheme ("the Scheme") has been prepared by the Trustees of the Scheme ("the Trustees") and covers the Scheme year 1 April 2020 to 31 March 2021.

Scheme Stewardship Policy Summary

The below bullet points summarise the Scheme Stewardship Policy in force over the majority of the reporting year to 31 March 2021. The full SIP can be found here and also includes the Trustees' wider policies in respect of the arrangements with asset managers, wider environmental social and governance considerations and monitoring investment costs. https://www.durham.ac.uk/about-us/professional-services/finance-service/durham-university-pension-scheme-dups/.

- The Trustees recognise the importance of their role as stewards of capital and the need to ensure the highest standards of governance and promoting corporate responsibility in the underlying companies in which the Scheme's investments reside. The Trustees recognise that ultimately this protects the financial interests of the Scheme and its beneficiaries.
- The Trustees:
  - regularly review the continuing suitability of the appointed fund managers, including consideration of broader stewardship matters and the exercise of voting rights by the appointed fund managers;
  - expect the Scheme's fund managers to use their influence as major institutional investors to exercise the Scheme's rights and duties as a shareholder including voting, along with — where relevant and appropriate — engagement with underlying investee companies;
  - will engage with their fund managers as necessary for more information to ensure that robust active ownership behaviours, reflective of their active ownership policies, are being actioned by means of an annual review;
  - expect the Scheme's appointed fund managers to comply with the United Nations Global Compact and to be signatories to the United Nations Principles for Responsible Investment;
  - expect the Scheme's appointed managers to offer transparency on voting and engagement carried out on the Trustees behalf, including escalation procedures and rationale for activity;
  - will engage with fund managers that are found to be falling short of the standards set by the Trustees in order to seek a more sustainable position, though they may ultimately replace the fund manager if such a position cannot be reached; and

– may engage on matters concerning an issuer of debt or equity (either directly or via a fund manager), including their performance, strategy, risks, social and environmental impact and corporate governance, the capital structure, and management of actual or potential conflicts of interest.

Scheme stewardship activity over the year

Responsible Investment Policy and updated Stewardship Policy

Over the year, the Trustees created a dedicated Responsible Investment Policy which sets out the Trustees' responsible investment beliefs and principles, recognising that ESG factors and risks are an important part of the identification of investment opportunities and the management of financial risks.

The Trustees created this policy following training sessions with their investment advisor and after collating and discussing the views of individual Trustees. During the training sessions and throughout the year, the Trustees have also been proactive to ensure they appropriately updated the Stewardship Policy in the SIP.

In line with regulatory requirements, to expand the SIP for policies such as costs transparency and incentivising managers, the Trustees expanded the Stewardship Policy in September 2020. The updated wording in the SIP illustrates how the Trustees recognise the importance of their role as a steward of capital, as well as indicating how the Trustees would review the suitability of the Scheme's investment managers.

Ongoing Monitoring

Investment monitoring takes place on a quarterly basis with monitoring reports being provided to the Trustees by Aon. The reports include ESG ratings and highlight any areas of concern, or where action is required. The ESG rating system is for buy rated investment strategies and is designed to assess whether investment managers integrate responsible investment and more specifically ESG considerations into their investment decision making process. The ESG ratings are based on a variety of qualitative factors, starting with a proprietary due diligence questionnaire, which is completed by the fund manager. Aon’s researchers also conduct a review of the managers' responsible investment related policies and procedures, including a review of their Responsible Investment Policy (if they have one), active ownership, proxy voting and/or stewardship policies. After a thorough review of the available materials, data and policies, as well as conversation with the fund manager, the lead researcher will award an ESG rating, which is subject to peer review using an agreed reference framework. Ratings will be updated to reflect any changes in a fund's level of ESG integration or broader responsible investment developments. The Aon ESG ratings correct at the time of writing, for the Scheme’s investments (where applicable) are shown later in this statement.

In addition to the above, in September 2020, Aon provided the Trustees with an overall assessment of the Scheme's investment managers' Responsible Investment Policies. The aim of the in-depth review was to help flag to the Trustees areas of concern and to strengthen ongoing monitoring and reporting, so that the activities of the investment managers could be further aligned to the Trustees' Responsible Investment Policy.

Manager Appointments

The Trustees consider ESG credentials of fund managers when considering changes to the Scheme’s portfolio and are aiming for consistency over the entire investment strategy over time. Over the year, the Trustees have introduced a dedicated ESG equity portfolio managed by Cantab alongside a factor based equity investment managed by LGIM which explicitly excludes investments in controversial sectors and has a reduced carbon footprint compared to a standard market index. Additionally, as part of a new illiquid credit manager selection, in January 2021, the managers' ESG credentials were actively considered by the Trustees to ensure they were aligned with the Scheme's policies. For example, one of the key factors for considering an investment into the CVC Credit European Direct Lending SMA was because of the integration of ESG clauses on the senior secured loans to drive borrower behaviour. This is the first manager to explicitly incorporate ESG in this manner in this space.

Voting and Engagement activity

The Scheme invests in a range of pooled funds. The Trustees have delegated voting and engagement activity for all funds to the appointed fund managers. Information on the voting and engagement carried out on behalf of the Trustees by the managers of these funds over the year to 31 March 2021 is laid out below.

Equity

The Scheme invests in the following equity-based funds:

Manager	Fund Name
Legal & General Investment Management	Developed Balanced Factor Equity Index Fund
Cantab Asset Management	Global (ex UK) Equity (Main Portfolio)
Cantab Asset Management	Global (ex UK) Equity (ESG Portfolio)

Legal & General Investment Management ("LGIM")

Aon ESG rating

The LGIM Fund has been assigned an "Advanced" ESG rating. This is the highest ESG rating awarded by Aon. This means that the fund management team demonstrates an advanced awareness of potential ESG risks in the investment strategy. The fund management team can demonstrate advanced processes to identify, evaluate and potentially mitigate these risks across the entire portfolio.

Voting policy

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

Voting statistics

Key voting statistics over the year to 31 March 2021	LGIM Developed Balanced Factor Equity Fund
Number of resolutions eligible to vote on over the year	15,664
% resolutions voted on for which the fund was eligible	99.90%
% that were voted against management	17.99%
% that were abstained from	0.23%

Voting example

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

This was 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 distinct items, and felt forced to accept a less-than-ideal remuneration structure for the new CEO.

LGIM spoke with the chair of the Pearson board earlier in 2020, on the board's succession plans and progress for the new CEO. LGIM also discussed the shortcomings of the company's current remuneration policy.

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

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

Engagement policy

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

1. Identify the most material ESG issues,
2. Formulate the engagement strategy,
3. Enhancing the power of engagement,
4. Public Policy and collaborative engagement,
5. Voting, and
6. Reporting to stakeholders on activity.

More information can be found on LGIM's engagement policy here: https://www.lgim.com/landg-assets/lgim/_document-library/capabilities/lgim-engagement-policy.pdf

Engagement example

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

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

Through this round of engagements, LGIM decided to support this resolution as although P&G has introduced a number of objectives and targets to ensure their business does not impact deforestation, LGIM felt it was not doing as much as it could. LGIM has asked P&G to respond to the Carbon Disclosure Project Forests Disclosure and continue to engage on the topic and push other companies to ensure more of their pulp and wood is from Forest Stewardship Council certified sources. More detail on this engagement can be found here: https://www.lgim.com/landg-assets/lgim/_document-library/capabilities/cg-quarterly-report.pdf

Cantab Asset Management ("Cantab")

The Scheme was invested in two Equity mandates managed by Cantab (Global Equity and ESG), which whilst are segregated mandates, comprise a range of underlying pooled equity strategies. Set out below is the voting and engagement information for three of the largest fund holdings within the Cantab mandates.

Baillie Gifford Positive Change Fund

Voting policy

Baillie Gifford's Governance and Sustainability team oversees its voting analysis and execution in conjunction with its investment managers. It uses research from proxy advisers (ISS and Glass Lewis) for information purposes only and does not delegate or outsource any of their stewardship activities, follow or rely upon proxy advisers' recommendations when deciding how to vote on its clients' shares. All client voting decisions are made in-house in line with its in-house policy and not with the proxy voting providers' policies. Baillie Gifford also has specialist proxy advisors in the Chinese and Indian markets to provide it with more nuanced market specific information.

Baillie Gifford analyses all meetings in-house in line with their Governance & Sustainability Principles and Guidelines. It believes that voting should be investment led, because how it votes is an important part of the long-term investment process. Baillie Gifford endeavour to vote every one of its clients' holdings in all markets.

Voting statistics

Key voting statistics over the year to 31 March 2021	Baillie Gifford Positive Change Fund
Number of resolutions eligible to vote on over the year	376
% resolutions voted on for which the fund was eligible	95.21%
% that were voted against management	2.39%
% that were abstained from	0.53%

Voting example

Baillie Gifford voted for a shareholder resolution at Tesla's annual general meeting on September 2020 to eliminate supermajority voting requirements from Tesla Inc's bylaws and to adopt a simple majority voting standard. It voted in favour of this resolution as it believed it was in the shareholder's best interest. This resolution was deemed significant because it was submitted by shareholders and received greater than 20% support. The resolution was passed.

Engagement policy

According to its 2020 Governance and Sustainability Principles and Guidelines, Baillie Gifford focus on stewardship through long-term value creation, board effectiveness, sustainable remuneration targets, fair treatment of stakeholders and longevity of business practices. It states that the UN Sustainable Development Goals have been central to benchmarking its progress in pursuing ESG considerations.

Baillie Gifford integrate governance and sustainability into its investment process through researching individual companies on their long-term prospects and negative screening/positive selection processes.

As active managers, Baillie Gifford engage through regular meetings with management and board members to monitor performance, with many of these meetings being attended by its Governance and Sustainability team. Baillie Gifford then set objectives when engaging with these companies and state that their strategy to steer change is through active encouragement and engagement rather than immediate disinvestment. This may take the form of approaching the company with its concerns, meetings with management, or voting against management. It states that disinvestment or a reduction in holdings may occur if the company continues to fall short of ESG friendly practices and goals.

Engagement example

In March 2021, the team at Baillie Gifford engaged with DexCom Inc. and met the CEO, Kevin Sayer. Baillie Gifford remains encouraged by the vast opportunity for the company to roll out its glucose monitoring devices to assist more diabetes patients, as well as other population cohorts. Despite the benefits that Dexcom is already bringing to its users and society at large, Baillie Gifford was left with some question marks about company culture - notably on what it perceived as undue focus on short-term share price and an aversion to experimenting on new ideas, which would be far removed from a diligent, patient-centric culture. Therefore, Baillie Gifford offered its support for Dexcom to experiment and acknowledged that inevitably this may lead to some failures along the way. Baillie Gifford will continue to monitor and learn more about these cultural aspects in future interactions, and remains excited about the company's long-term growth prospects and societal benefits.

Vanguard S&P 500 UCITS ETF

Voting and Engagement policy

Vanguard believes that a long-term perspective is central to stewardship and creating value for long-term investors. Vanguard vote its funds' proxies in support of good governance. Its voting is based on:

- A thoughtful, considerate process that is used across the global portfolio of funds.
- Internal policies and guidelines informed by research.
- Knowledge and experience of senior team leaders and analysts.

Vanguard's Investment Stewardship team plays various roles in the proxy voting process for Vanguard funds across the globe. Generally, the Investment Stewardship team is responsible for administering proxy votes on behalf of Vanguard's internally managed funds and ETFs. For externally managed funds, external managers have full proxy voting responsibilities for the portions of the funds they manage, enabling Vanguard to integrate proxy voting activities and company engagement into investment strategies.

In 2019, the boards of trustees of Vanguard's externally managed funds delegated full proxy voting responsibilities to those funds' external managers. Vanguard was not able to provide voting statistics for this fund, however, a summary of all votes taken for the fund can be found here: https://about.vanguard.com/investment-stewardship/how-our-funds-voted/

Cantab Sustainable Global Equity Fund

Voting and Engagement policy

Cantab's ESG portfolios employ overarching investment principles, with a bias towards active management and achieving diversification through geography and asset class. Cantab believes actively managed funds are better able to align its portfolios with investor's interests than passive alternatives. Fund managers can oversee clearly defined mandates, exercising oversight on focused portfolios of companies that are continually reviewed to ensure they are in line with the ESG mandate of the fund.

Cantab has confirmed that the fund did not engage in any voting over the year to 31 March 2021, which effectively covers the fund's first year of operation. Cantab has decided to do its own proxy research in-house for the time being. The Fund, through its custodian, is now set up with Broadridge's ProxyEdge service for voting and recording of voting, and on an ongoing basis is in a position to provide full disclosure of the Manager's voting.

Engagement examples

Examples include a Swiss luxury goods company and an Australasian soft-drinks manufacturer.

A small position was held in the Swiss luxury goods company. The company was not flagged for armaments on third party platforms; however, after engaging with the company, the manager found that c.0.1% of revenues were generated from a division of the company that manufactures recreational shooting apparel. The position in the company was exited.

In contrast, the Australasian drinks company was not held within the fund; however, Cantab considered adding it to the portfolio as part of the selection process. During Cantab's engagement with the company, it was established that it had exposure to alcoholic beverages in its portfolio, which prevented the addition of this stock to the portfolio.

Engagement activity – Fixed Income and Real Estate

The Scheme also invests in fixed income, real estate and a liability driven investment (LDI) portfolio.

The use of voting rights is most likely to be financially material in the Scheme's investments where physical equities are held. The Trustees acknowledge that with certain investment, for example the Scheme's LDI portfolio, stewardship and engagement is very limited. This is because the LDI portfolio primarily invests in UK government bonds, where there is very limited scope for the Trustees to influence the behaviour of the UK government. However, managers investing in other asset classes (such as corporate fixed income and property) are increasingly influential in their ability to encourage positive change. Additionally, the Trustees acknowledge that the Scheme's investment managers, as large institutional asset managers, hold important positions of influence as major investors. As such the Trustees expect their managers to engage with the companies they invest in, in general to enhance the value of assets in economy.

The following examples demonstrate some of the engagement activity being carried out on behalf of the Scheme over the year from two of the Scheme's investment managers.

PIMCO – Diversified Fixed Income Duration Hedged

As stewards of capital, PIMCO believes its size, scale and history as a premier fixed income manager gives it a special platform to engage with issuers, help lead the industry and drive positive change. Engagement is an essential tool for delivering impact for investors, markets and society, by partnering with issuers that already demonstrate a deeply unified approach to sustainability commitments, but also those with less advanced sustainability practices. This can be a direct way for PIMCO to influence positive changes that may benefit all stakeholders, including investors, employees, society and the environment.

PIMCO aims to have an industry-leading engagement program among fixed income asset managers. By investing across a diverse asset class and group of issuers – including corporates, municipalities, sovereigns and others – PIMCO believes that it is ideally positioned to drive meaningful change.

PIMCO's credit research analysts engage regularly with the issuers that it covers, discussing topics with company management teams related to corporate strategy, leverage and balance sheet management, as well as sustainability-related topics such as climate change targets and environmental plans, human capital management, and board qualifications and composition.

Further detail on PIMCO's policy can be found here: https://www.pimco.co.uk/en-gb/our-firm/policy-statements

Aon ESG rating

The PIMCO Fund has been assigned an "Advanced" ESG rating. This is the highest ESG rating awarded by Aon. This means that the fund management team demonstrates an advanced awareness of potential ESG risks in the investment strategy. The fund management team can demonstrate advanced processes to identify, evaluate and potentially mitigate these risks across the entire portfolio.

Engagement example

In 2020 PIMCO engaged with Dell Inc regarding supply chain management. This engagement activity was undertaken solely by PIMCO and led by its engagement specialist and credit team. PIMCO engaged with Dell on the labour rights issues in their supply chain, including compliance on working hours and response and investigation on forced labour disputes. PIMCO encouraged the company to disclose supplier audit coverage and assurance progress for conflict mineral sourcing, including sub-tier suppliers, and make public commitments to 100% Responsible Minerals Assurance Process (RMAP) for conflict mineral sourcing.

As an outcome, Dell confirmed that audits cover much of its supply chain. Dell also updated disclosure on RMAP-conformant supplier list to maintain transparency. Dell is working to achieve 100% RMAP conformance for conflict minerals such as tin, tantalum, tungsten, gold and cobalt in 2021. PIMCO will continue to engage with Dell on supply chain transparency and traceability.

Threadneedle Asset Management – Property Fund

Threadneedle focuses its engagement efforts on the more material or contentious issues and the issuers in which it has large holdings – based on either monetary value or the percentage of outstanding shares. Threadneedle has ongoing engagements with many companies, as well as a number that it speaks to on an ad hoc basis, as issues arise.

Threadneedle actively participates in several investor networks, which complement its approach to engagement. Along with other investors, Threadneedle raises market and issuer-specific environmental, social and governance issues, share insights and best practice.

Threadneedle continues to engage with companies to better understand their management of financial and non-financial risks and how they generate sustainable long-term returns. Companies' response to and management of Covid-19 will be a core part of this analysis going forward.

In summary

Based on the activity over the year by the Trustees and their service providers, the Trustees are of the opinion that the stewardship policy has been implemented effectively in practice. The Trustees note that most of their applicable asset managers were able to disclose strong evidence of voting and engagement activity.

The Trustees expect improvements in disclosures like this over time in line with the increasing expectations on asset managers and their significant influence to generate positive outcomes for the Scheme through considered voting and engagement.

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