



# Engineering Employers’ Federation Staff Pension Fund ( “the Fund”)

July 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 Report

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

The Fund's SIP can be found online at the following web address:  
<https://eefstaffpensionfund.lcp.uk.com/information>

The Implementation Report details:

- Actions the Fund 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 Fund 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 reporting year

- The Trustee agreed to review the Fund's LDI mandate using updated cashflows from the 2020 Actuarial Valuation. As part of this review, the Trustee entered into an Enhanced Service Agreement ("ESA") with their LDI manager, Legal & General ("L&G"). This introduced a more efficient management of the Fund's collateral which should lead to more capital efficiency and lower governance going forward, particularly when managing cashflows.
- Due to the pace at which gilt yields rose over September, particularly as a result of the volatility post the mini-budget announcement, the Fund's interest rate and inflation hedge was reduced from c.90% to c.70% on the Technical Provisions basis. To help manage the impact of further gilt market volatility given the potential stress on the Fund's liquidity, the Trustee agreed to temporarily reduce the hedge target to 60% until the liquidity position had improved.
- Given the Fund's strong funding position and the need to improve the liquidity position, the Trustee fully redeemed from the M&G Alpha Opportunities Fund during Q4 2022 as well as the Apollo Total Return Fund in Q1 2023. The proceeds from both redemptions were invested into the L&G LDI and Absolute Return Bond ("ARB") mandates in order provide additional liquidity to support the LDI hedge.
- The Trustee also instructed the full redemption of the JP Morgan Infrastructure Investment Fund with a 31 March 2023 trade date. The proceeds landed post year-end and were invested into the L&G ARB Fund, which forms part of the collateral waterfall. This redemption was used to further increase the Fund's

interest rate and inflation hedge and add greater stability to the Fund's strong funding position.

- The Fund's Alcentra Direct Lending mandate made two drawdowns over December 2022 and March 2023, totalling c.£2.2m. The mandate ended its investment period post year-end and entered into its realisation period.
- Due to the increased frequency of LDI collateral calls, the Trustee was comfortable maintaining an overweight allocation to the L&G ARB fund. The Trustee added the following wording to the SIP to highlight their stance:
  - Throughout the gilt market volatility in September and October 2022, the Trustee made a number of investment decisions to improve liquidity and provide collateral to support the LDI mandate. This has resulted in the Fund deviating from the target allocation outlined in the IID. The Trustee is considering the longer-term strategy of the Fund and will update the IID accordingly when the strategy has been set.

#### Implementation Statement

This report demonstrates that the Fund has adhered to its investment principles and its policies for managing financially material consideration including ESG factors and climate change.

Signed

Position

Date

# Managing risks and policy actions DB

Risk / Policy	Definition	Policy	Actions and details on changes to policy
Interest rates and inflation	The risk of mismatch between the value of the Fund assets and present value of liabilities from changes in interest rates and inflation expectations.	To hedge a large amount of these risks in the Technical Provisions basis through the LDI mandate.	<p>The Trustee responded to volatile gilt market conditions to ensure the highest level of hedging was maintained throughout the year that could be supported by the Fund's liquid assets.</p> <p>This separately involved both a reduction and increase in the target hedge level over the year, as well as making redemptions from the Fund's less liquid assets to support the hedge.</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 manager.	<p>Following the period of gilt market volatility, the Trustee instructed the full redemption from the following three funds: M&amp;G Alpha Opportunities Fund, Apollo Total Return Fund and the JP Morgan Infrastructure Investment Fund. These redemptions were instructed to improve the liquidity position of the Fund and provide collateral support to the LDI mandate.</p> <p>In addition, the Trustee entered into an ESA with its LDI manager, L&amp;G. In this arrangement, L&amp;G automatically top up the LDI portfolio from the ARB fund should the collateral headroom fall below the minimum acceptable level.</p>
Market	Experiencing losses due to factors that affect the overall performance of the financial markets.	To remain appropriately diversified and hedge away any unrewarded risks, where practicable.	No action over the period.

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.	<p>The Trustee made the decision to redeem the Fund's M&amp;G Alpha Opportunities Fund and Apollo Semi-Liquid Credit Funds over the period, in favour of providing additional liquidity to the LDI mandate.</p> <p>This decision was thought to be lower risk than maintaining the Fund's credit mandates.</p>
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 Fund's investments.	<p>To appoint managers who satisfy the following criteria, unless there is a good reason why the manager does not satisfy each criterion:</p> <ol style="list-style-type: none"> <li>1. Responsible Investment ('RI') Policy / Framework</li> <li>2. Implemented via Investment Process</li> <li>3. A track record of using engagement and any voting rights to manage ESG factors</li> <li>4. ESG specific reporting</li> <li>5. UN PRI Signatory</li> </ol>	Further detail provided later in this report.
Currency	The potential for adverse currency movements to have an impact on the Fund's investments.	To invest in funds that hedge the majority of currency risk as far as practically possible	No action over the period.
Non-financial	Any factor that is not expected to have a financial impact on the Fund's investments.	Non-financial matters are not taken into account in the selection, retention or realisation of investments.	No action over the period.

# Changes to the SIP

Over the reporting period, the Trustee added reference to the Trustee's new ESG policy (which can be found on page 8 of this statement) to the Fund's SIP, along with the following change to the policy on interest rate and inflation risk:

Policy updated to say: to hedge a large amount of these risks in the Technical Provisions basis through the LDI mandate.

The Trustee also updated the Fund's Investment Implementation Document to reflect changes in the investment managers, manager fees and asset class assumptions.

In addition, at the end of the reporting period the Trustee was considering the following changes to the SIP to reflect updated guidance from the DWP and following the gilt market volatility of September 2022:

Throughout the gilt market volatility in September and October 2022, the Trustee made a number of investment decisions to improve liquidity and provide collateral to support the LDI mandate. This has resulted in the Fund deviating from the target allocation outlined in the IID. The Trustee is considering the longer-term strategy of the Fund and will update the IID accordingly when the strategy has been set.

## Policies added to the SIP

Date updated: to be updated

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 Fund'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 Fund'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 have considered are listed below.
  - Selecting and appointing asset managers – the Trustee will consider potential managers' stewardship policies and activities.
  - Asset manager engagement and monitoring – on an annual basis, the Trustee tracks the voting and engagement activity of their asset managers. The results of this analysis may feed 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 Fund's policy with regards to ESG as a financially material risk. The Trustee has agreed a more detailed ESG policy which describes how it monitors and engages with the investment managers regarding the ESG policies. This page details the Fund's ESG policy.

### 1. Introduction

The Fund's Environmental, Social and Governance ("ESG") Policy formalises the Trustee's ESG beliefs and its policy on how ESG factors should be integrated in investment decision-making.

The Trustee defines Responsible Investment ("RI") in line with the UN-backed Principle for Responsible Investing ("PRI"), which states that RI is an approach to investing that aims to incorporate ESG factors into investment decisions, to better manage risk and generate sustainable, long-term returns.

### 2. The Trustee's ESG beliefs

The Trustee has formulated a set of ESG beliefs to help underpin overall investment decision making. The Trustee's ESG beliefs have been summarised below.

#### Risk Management

1. ESG factors such as climate change are important for risk management and can be financially material. Managing these risks forms part of the fiduciary duty of the Trustee.

2. The Trustee believes that ESG integration leads to better risk adjusted outcomes and want a positive ESG tilt to the investment strategy.

#### Approach/Framework

3. The Trustee wants to understand how asset managers integrate ESG within their investment process and in their stewardship activities.

4. The Trustee believes that sectors aiming for positive social and environmental impacts may outperform as countries transition to more sustainable economies. Where possible the investment strategy will seek to allocate to these sectors.

5. The Trustee will consider the ESG values and priority areas of the stakeholders and sponsor and use these to set ESG targets.

#### Voting & Engagement

6. ESG factors are relevant to all asset classes and, whether equity or debt investments, managers have a responsibility to engage with companies on ESG factors.

7. The Trustee believes that engaging with managers is more effective to initiate change than disinvesting and so will seek to communicate key ESG actions to the managers in the first instance.

8. The Trustee wants to understand the impact of voting & engagement activity within their investment mandates.

#### Reporting & Monitoring

9. ESG factors are dynamic and continually evolving, therefore the Trustee will receive training as required to develop their knowledge.

10. The Trustee will seek to monitor key ESG metrics within their investment portfolio to understand the impact of their investments.

#### Collaboration

11. Asset managers should be actively engaging and collaborating with other market participants to raise ESG investment standards and facilitate best practices as well as sign up and comply with common codes such as UNPRI and TCFD.



# ESG summary and actions with the investment managers

Isio, as the Fund's investment consultant, engage with all of the Fund's investment managers on an ongoing basis. ESG and Engagement are specifically covered in both the initial due diligence and ongoing monitoring of funds that Isio actively monitor.

# Engagement

As the Fund invests via fund managers the managers provided details on their engagement actions including a summary of the engagements by category for the 12-month period to 31<sup>st</sup> March 2023.

Fund name	Engagement summary	Commentary
Alcentra European Direct Lending III	<p>Total Engagements: 147</p> <p>Environmental: 19</p> <p>Social: 29</p> <p>Governance: 10</p> <p>Other: 89</p>	<p>Alcentra believe that as fixed income investors, they have limited influence over engagement.</p> <p>Despite this, Alcentra do communicate on ESG issues within the positions they hold. In addition, through Alcentra having representation on the Board of Directors within some of the companies they invest in, the fund has been able to influence strategy.</p> <p>For example, Alcentra engaged with a clothing retailer to evolve their ESG strategy through supporting a number of sustainability initiatives and amending the company's Articles of Association to include commitment from the company to: "Stakeholder interests" and "Having a material positive impact on society and the environment".</p>
Partners Group Private Market Credit Strategies 2018	<p>Total Engagements: 3</p> <p>Corporate: 3</p> <p>*Note that Partners Group provide data semi-annually, and as such the engagement data shown reflects their activity over the 2022 calendar year.</p>	<p>Partners Group maintain ongoing 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.</p>

		Whilst Partners Group provided 3 examples of corporate engagements, they did not provide any examples of ESG related engagements.
Legal and General – LDI & Sterling Liquidity Fund	<p>Total Engagements: 33</p> <p>Environmental: 23</p> <p>Social: 1</p> <p>Governance: 8</p> <p>Other: 1</p>	<p>LGIM 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>LGIM 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 LGIM's proprietary ESG tools.</p>
Legal and General – Absolute Return Bond Fund	<p>Total Engagements: 170</p> <p>Environmental: 88</p> <p>Social: 30</p> <p>Governance: 44</p> <p>Other: 8</p>	<p>LGIM provide an annual update setting out the firm's approach to stewardship and activities during the year.</p> <p>LGIM's Investment Stewardship team manage the voting and engagement across all funds, leveraging all possible capital to maximise effectiveness.</p> <p>Engagement activity is recorded in a dedicated data management system. This system is also used to oversee progress and quantify engagement effectiveness.</p> <p>On a quarterly basis, LGIM provide a standalone Active Ownership ESG Impact Report detailing case studies of voting and engagement activities undertaken and/or concluded.</p>

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.