XPS Investment

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UK Stewardship Code Submission 2022

April 2023

This report provides details of XPS Investment's application of the **6 Principles of the UK Stewardship Code 2020** during the period 1 January 2022 to 31 December 2022.

Executive summary of key activities in the year

255	34	6%	7	1
Funds rated on ESG with feedback provided to all managers	Sustainable funds (15 new in 2022)	Of AUA in funds with a sustainable objective	Sustainability related thought leadership pieces	Firm-level net zero strategy

Principle 1: Purpose, strategy and culture

Our purpose, services, culture, values and strategy

XPS Investment sits within XPS Pensions Group, a leading pension consulting and administration business fully focussed on UK pension schemes. XPS combines expertise, insight and technology to address the needs of over 1,500 pension schemes and their sponsoring employers on an ongoing and project basis. We undertake pensions administration for over one million members and provide advisory services to schemes and corporate sponsors in respect of schemes of all sizes, including 51 with assets over £1bn.

Our business strategy is best summarised with reference to our mission, vision, and purpose:

- **Our Purpose:** We exist to shape and support safe, robust, and well-understood pension funds for the benefit of people and society.
- **Mission Statement:** We strive to be leaders in pensions, investment consulting and administration, with brilliant people and leading technology delivering better outcomes for pension fund members and rewarding careers for our people.
- **Our Vision:** We will constantly challenge the pensions industry to improve and achieve better outcomes for members.

XPS Investment is a fast-moving, exciting business, with a **team of 89 people across 8 locations** exclusively focused on the UK market. We advise DB and DC pension schemes on all aspects of investment, from objectives and strategy to fund selection and monitoring. We do not provide fiduciary management services as we believe it would create a conflict of interest for us to do so, but we do provide fiduciary management oversight services to clients.

We take pride in delivering great service in our clients' best interests. In *Principle 5 and 6* we provide more detail on the feedback we receive from clients and other parties as part of assessing our effectiveness, and how we use that to inform our progress and development of our approach.

Our culture and values

As a progressive company we acknowledge our responsibility to shareholders, clients, suppliers, our employees and the wider community in which we operate, to work responsibly. Our approach to corporate responsibility helps us manage our business more efficiently, mitigates risk and supports the communities in which we operate, for the benefit of all our stakeholders.

Our values are as follows:

- **We are ambitious** – We're aiming high to achieve our purpose of benefiting people and society. We have ambitious goals for our clients, our industry and ourselves. This means leading our industry in thought, action and opinion. It means we are progressive and think differently about pensions.
- **We are agile** – We're forward-thinking, innovative and quick-moving. When we see a better and more sustainable way to do something, we make change happen. We don't just follow the way things have always been done in our industry.
- **We are helpful** – We are one firm who build and sustain great relationships with our clients and with each other. This means we're always ready and willing to help out – clients and colleagues know they can trust us. We work hard together, we support each other, we listen and we are helpful.
- **We are expert** – We know our stuff and we each bring something special to our collective knowledge. We make a point of cultivating our individual expertise and diversity of thought – and we use it, share it and support each other for the benefit of our clients and colleagues every single day.
- **We do the right thing** – We're inclusive, approachable, honest and fair; both with our clients and each other. We value everyone's unique contribution, recognising and rewarding hard work. We act with integrity and honesty, speaking up if something doesn't meet our standards.

Our culture, driven by our values, has yielded benefits for our staff and clients alike. Our core values are at the heart of our commitment to our people. As a good example of this, in 2022 all staff below senior grades were given an out-of-cycle £2,000 salary increase to assist with the rising cost of living. We received overwhelmingly positive messages from the staff. In our 2022 employee survey, **98%** thought XPS was a good place to work (2021, 95%).

Commitment to inclusion, equality and diversity

We are committed to a culture of 'Belonging' at XPS. One where differences are valued and respected, where all staff can be their true selves at work and where we can all contribute to, and be recognised for, creating the best possible XPS.

Our Board has clearly and regularly expressed its support for inclusion, equality and diversity (IED) in the workplace. It is the responsibility of everyone to make XPS a great place to work, where colleagues feel able to share their ideas, views and concerns and are supported, trusted, valued and respected.

Our IED strategy has 4 main pillars:

1	2	3	4
Our culture	**Fair processes**	**Attraction and retention**	**Diversity & Inclusion within society**

We have an **Inclusion and Diversity Framework**, which was created with input from colleagues from our Diversity Working Group, our Employee Engagement Group and our Employee Networks. Working with our inclusion specialists, the 'Inclusive Group', and colleagues, we identified what was important to colleagues, clients and other stakeholders, where we could make a difference and what we should prioritise.

We have asked and trained our managers to set clear expectations, to lead by example and uphold the highest of standards and to ensure decisions are fair and free from bias. **All line managers had a 2-hour mandatory inclusion workshop** and we provided tools and knowledge on topics such as terminology, micro-behaviours, and inclusive language to support employees and engage them.

A key initiative for us has been to run **unconscious bias training** for all 1,600 employees, and new staff as part of their onboarding. In addition, we provide mandatory 'Respectful behaviours' training. Our training scored an average of 8/10 for engagement and usefulness.

In our Staff Survey, October 2022, **95% of staff said they felt like they 'belong' at XPS.** We are using this as a baseline for measuring the impact of our IED activities.

XPS has been **part of the Actuarial Mentoring Programme (AMP) since 2017**, and we have been **members of the 30% Club for the last four years**, both of which support senior representation of women. Additionally, XPS has internal mentoring to help develop gender equality.

We now have 5 employee networks, which play a key role in encouraging and supporting all employees to bring their whole self to work. Networks greatly contribute to creating inclusive environments and building a sense of community. Throughout the year we run a full calendar of **21 internal firm wide webinars** hosted by multiple networks working together to bring about a more inclusive culture at XPS.

XPS Menopause Network

XPS Women's Network

XPS Disability Network

XPS LGBTQ+ Network

XPS Multicultural Network

XPS prides itself on being an inclusive company that cares about employees which is demonstrated by the results of our **employee survey.** The **Employee Net Promoter Score** question in our survey, which asked 'How likely are you to recommend working here to a friend or relative?', which we use as a measure of levels of engagement was +33. (2021 survey:+5) (The creators of the metric, Bain & Company, state that a score above 0 is good, and above 20 is great.)

98% **of employees said XPS was a good company to work for**

Health and wellbeing

We want to ensure the best welfare for our employees. As such, we have developed a **wellbeing programme that focuses on mental, physical and financial wellbeing.** It aims to help our colleagues to stay well and to support them when they're not. We have partnered with Mental Health at Work to help us reduce stigma and discrimination about mental health in the workplace, with a growing Mental Health Ally Network and an Employee Voice 24/7 programme. Part of XPS's activity around mental health is a frequent XPS Wellness Hour to encourage employees to use allocated time to focus on an activity that will support their wellbeing, with a different theme each month

Business ethics

All XPS employees have access to our **Business Code of Ethics**, which is based on laws and values that we expect all our employees to adhere to in relation to areas including harassment and bullying, treating customers fairly, diversity and inclusion, financial crime and dealing with vulnerable customers.

We have a zero-tolerance approach to bribery and corruption. The Board has responsibility for oversight of the Group's anti-bribery and financial crime policies and carries out a review of their adequacy annually.

Actions to ensure our strategy and culture enable effective stewardship

Our culture and values described above set the platform for us to promote effective stewardship for our clients.

ESG integration and stewardship are embedded throughout our processes and interactions at a firm level, with investment managers and with clients in the following ways:

As a firm

Commitment to zero carbon

In 2021 XPS Pensions Group pledged to become carbon neutral by offsetting carbon emissions across our value chain, as part of our journey to limit the business's environmental impact while helping clients and stakeholders also move towards a more sustainable future.

In 2022 we have made progress with our carbon reduction strategy, committing to source 100% renewable energy by 2030 (halving scope 1 and 2 emissions). We completed our second annual carbon offset, covering all our emissions including scope 3. We are clear that we only source the highest quality offsets, and our investment in carbon markets helps deliver an improved ecosystem for all. The Group's investment this year supports a long-term biodiversity & reforestation project in Panama and a clean energy installation in India.

We are clear that offsets can only be part of the solution in solving the climate crisis, which is why we're committed to undertaking multiple initiatives to continue to reduce our absolute carbon footprint directly.

Sustainability Committee

We have firm level commitment through our **Sustainability Committee.** The Committee was created in 2021 to support the XPS Board with driving ESG initiatives that have a material impact on business strategy, business performance and the long-term sustainability of the Company. It is chaired by one of XPS's non-executive directors. It has oversight of the views and interests relating to sustainability of the internal and external stakeholders of the Company, with activities revolving around our 5 sustainability pillars (governance, employees, clients, communities, and environment).

We summarise below the key activities under the remit of the Committee in 2022:

- **7 of 18 sites** on certified renewable energy supply, with an additional 2 sites supplied by uncertified zero carbon tariffs.
- Overseeing progress against governance ambitions around Board diversity – now **43%** of the Board (target 47% by 2027), and **26%** of senior management (target 30% by 2027) are Female.
- Updated our **supplier code of conduct** to include ESG related expectations.
- Commenced a nationwide volunteering programme, including partnering with **Business in the Community** on their Clicksilver Programme, which helps older UK residents use technology to gain confidence and improve their digital skills.
- Our **Scams Protection Service** has now helped protect over 8,500 members, covering over £1.85bn of transfers.

Wider industry initiatives

We demonstrate our commitment through active participation in various industry initiatives. Under *Principle 4* we provide more detail on our contribution to the broader industry effort around stewardship and sustainability.

Our investment research that underpins client advice

Our philosophy is captured within our stated Principles and Preferences. Our six Principles underpin all our advice, and our six Preferences reflect how we steer clients in the absence of them having a strong view. In particular we have embedded integration of ESG and consideration of Sustainable outcomes as follows:

- Our investment Principle 5 embeds the importance of robust stewardship (in addition to ESG integration) in effective risk management.
- We are clear on our belief that sustainable investment will improve long term outcomes under our investment Preference 6.

Principles

1. **Clear objectives and strategic direction.** Objectives taking into account liabilities are a vital requirement for setting the strategic asset allocation - which is the most important investment decision.
2. **Remove undesirable risks, diversify desirable risks.** Unwanted or undesirable risks offer no benefit to a pension scheme and should be reduced as far as practically possible. Diversification can be a powerful way to manage risk within limits. Investors should understand and ensure strategies will deliver in a range of economic environments.
3. **Avoid short term tactical positions.** They are difficult to get right consistently and the temptation to second guess markets should be resisted.
4. **Cost control.** Costs can have a significant drag on returns and all costs should be fully understood and tightly managed.
5. **ESG and strong stewardship are fundamental elements of risk management.** Investment managers should incorporate ESG considerations into day to day investment management to drive better practices in underlying investee companies.
6. **Clear accountability.** Advice should be accountable and set with reference to clear objectives. It should be independent, minimising conflicts and putting the clients' interests first.

Preferences

1. **Simple is good.** Portfolios should be pragmatic and free of unnecessary complexity. Excessive numbers of managers and funds should be avoided.
2. **Passive management where appropriate.** It is very difficult for active managers to consistently outperform the market over the long-term after the deduction of additional charges.
3. **Active management to access new markets.** Active should be used where passive management isn't viable or as a means of allocating between mainstream and specialist asset classes to improve governance and diversification.
4. **Illiquidity presents opportunity.** For long-term investors it is an important source of risk reduction, diversification and return enhancement.
5. **Leverage is a powerful tool.** It can reduce risk or enhance returns but needs to be carefully managed.
6. **Sustainable approaches improve outcomes.** Allows for the pursuit of wider sustainability objectives and the management of risks such as climate risk, whilst not coming at the cost of lower expected returns.

We fully incorporate ESG criteria within our research and require that the funds we recommend to our clients demonstrate an appropriate minimum level of ESG integration and stewardship – we will not recommend funds which fail to meet our minimum requirements on our ESG scoring system. Furthermore, we encourage clients to set high expectations of fund managers in this regard.

We believe ESG is a critical and fundamental component of investment decision making and that investor engagement should not be seen as optional for investors. Our proprietary ESG research framework has been developed using the UN PRI principles as a foundation and aims to assess the genuine commitment of managers to ESG and stewardship activity. We continue to evolve this framework to reflect best practice, as detailed in *Principle 5*.

We annually review ESG integration and in particular stewardship across all asset classes and provide feedback to managers – as described further under *Principles 4 and 5*. This feedback on ratings is fundamental to our engagement effort with managers and helps to raise the bar across the industry on ESG and sustainability. We consider this to be key in promoting effective stewardship across asset classes.

We review our ESG framework annually and have described the changes made in 2022 in *Principle 5*.

Helping our clients

We have a clear framework for helping our clients with their approach – rooted in establishing their own beliefs on ESG and climate change, including the importance of engagement with their managers and underlying holdings.

To support this we've invested in ensuring our people are constantly building their knowledge by conducting internal training and through ongoing engagement with investment managers to understand evolving best practice in this developing landscape.

We are committed to educating clients on ESG and stewardship-related topics through training programs, webinars and conferences.

We help our clients monitor and engage with their investment managers in respect of their ESG integration and stewardship practices.

We support our clients in meeting regulatory requirements such as preparing annual Implementation Statements that disclose voting and engagement activity over the accounting year.

Assessment of our effectiveness in serving our clients' best interests

We believe that our culture, values, business model and strategy are completely aligned to serving the best interests of our clients.

Through ongoing feedback, for example through the Greenwich Associates survey where we received 15 evaluations in the year and our client survey with 219 responses, we get insight into how effectively we are meeting our clients' needs. Our senior leadership review the results and we look to continually develop our approach to ensure we continue to serve their best interests. Our strong client feedback indicates that our clients feel their interests are served well.

We continue to evolve the ESG ratings process and the extent of our client reporting, recognising how important ESG factors and effective stewardship are for our clients' long-term interests. As described in *Principle 5* the changes we have made in 2022 to the ESG questionnaire ensure that it continues to provide a robust assessment of a managers' approach.

We've also continued to focus our research on sustainable funds (*see Principle 5*). These allow our clients to express stronger beliefs and preferences around ESG and climate change in their investments and seek to support the direction of travel in the industry towards targeting sustainable outcomes alongside financial returns. We believe the work we have done in this area now provides our clients with a comprehensive range of solutions for them to express their preference with how their money is invested.

Looking forward, we recognise that the field of ESG and sustainability is moving rapidly. Therefore, our priority for 2023 will be to revisit our sustainable funds to identify any areas where we could update our list to reflect best practice, or areas of emerging importance such as social impact and biodiversity.

Principle 2: Governance, resources and incentives

We continuously strive to improve our capabilities and our structure allows for challenge from various different stakeholders, ensuring we are keeping up to date with the wider evolution and changing needs of the investment industry and risk landscape. This continuous challenge from everyone in the team is exactly what we want as it pushes us to continue developing and progressing, which is our desired outcome.

Our governance structure, processes, and appropriate resourcing of responsible investment and stewardship

Our approach to responsible investing is led by **Alex Quant, Head of ESG Research**, and overseen by **Faye Clark, Head of Manager Research**, and **Simeon Willis, Chief Investment Officer (CIO).** The role of various teams involved in our approach to effective stewardship and wider responsible investing are described below:

Investment Committee

The Committee is comprised of 16 people, the most senior members of the investment team and led by **Ben Gold, Head of Investment at XPS and a Director of XPS Investment Limited.** This group is not static and had three joiners in 2022. The Committee has oversight of the overall XPS Investment approach. This includes ensuring how ESG and stewardship are embedded in our advice to clients. All fund recommendations are reviewed by our CIO and Head of Manager Research, Faye Clark, and ratified by our Investment Committee. This ensures consistent application of our approach.

ESG research team

The ESG research team continues to grow and is comprised of **15 individuals** from across the team (2021: 12 members), including three of our Investment Committee, and led by Alex Quant. It is focussed on implementing and evolving our ESG research approach and framework to assess ESG and stewardship practices of investment managers, and producing client materials.

Our Investment Database 'ID'

ESG information is shared across the team along with huge amounts of other information using **ID** (our online database which captures: all aspects of our clients' investments; quarterly performance monitoring; team responsibilities; as well as fund and manager research including a record of meetings held with managers), giving all team members ready access to all ESG information on specific funds. We have invested heavily in building ID over the last 4 years and it is central to the efficient management of our clients and our advice.

We routinely utilise ID to monitor compliance and wider exercises to ensure complete accuracy and coverage across the full client base. ID permits detailed information/actions which are relevant to all clients to be centrally monitored, notably when communication has taken place and when confirmation has been received that a task has been completed.

We keep a central log of our clients' adherence to key regulatory requirements.

Asset class research teams

Specialist asset class teams which incorporate the ESG framework as an explicit stage within their respective investment manager research. This is tailored to the characteristics of the specific asset classes. The ESG research team will also always be involved to input their expertise in this area too.

In 2022 **Faye Clark joined as Head of Manager Research**, overseeing all research teams. This will further ensure the consistency of application of our ESG framework across all asset classes.

In 2022 we also split our Real Assets asset class team into two teams covering **Property** and **Alternatives** (Infrastructure and Diversified Private Markets).

Ensuring quality and accuracy of services

We recognise that clients can only act on the information and advice received. Therefore, the overarching way we promote effective stewardship is by providing detailed and tailored reporting on our clients' investments. For the majority this is in the form of quarterly investment reports covering valuations, performance, risk analysis and other key matters which may include ESG issues. We also provide specific annual reporting on ESG integration and climate change risk within our clients' portfolios (described further in *Principle 4 and 5*) as well as supporting with implementation statement reporting. This reporting enables clients to really understand the approach and outcomes of their managers and whether these are in line with their intentions and policies. Clients can therefore react accordingly, for example by engaging with their managers on issues identified, which we actively encourage.

We ensure that our teams have the appropriate level of expertise to provide this reporting and advice in the following ways:

- Across XPS Investment we encourage everyone to take professional exams to help build their knowledge. We currently have **18 qualified actuaries** and **6 CFA charterholders.** Additionally, we currently have **45** people actively studying for one of these qualifications. **Alex Quant** holds the **CFA Certificate in ESG Investing.**
- All aspects of ESG form an integral part of our graduate training programme. We provide ongoing training to our consultants around responsible investing through our quarterly cycle of training sessions. During the year we held **3 team-wide ESG training sessions**, one on ESG factors and specific sessions on climate change and biodiversity considerations . We also encourage all consultants to attend seminars hosted by fund managers to raise awareness of the different approaches taken across the industry alongside achieving relevant professional qualifications.

Our consultants are incentivised through their individual performance ratings and remuneration to provide high quality tailored advice to our clients and conduct themselves in a manner that is in keeping with our values. This relates to the full range of aspects of their advice to clients, including the importance of ESG matters. All consultants are expected to understand ESG matters and advise clients appropriately. Through our annual performance development process, each consultants' end of year rating, which informs their bonus, is linked to performance against each of our values and based on doing a great job for clients, which is everyone's number one objective. Line managers hold their people to account in terms of proactively bringing ESG and climate change advice to their clients.

Ensuring appropriateness of fees

One of our Principles is Cost control. We help clients understand the sources of cost within their portfolio in terms of both explicit costs, such as fund management charges and expenses, and implicit costs, such as turnover costs. During 2022 we rolled out a client-wide campaign to produce a report detailing the key sources of cost for our clients, including a comparison against peer pension schemes, in line with the Cost Transparency Initiative by working with an independent firm to supply this data.

We also follow a pricing matrix for our fees to ensure fairness and consistency across our clients. The appropriateness of this is reviewed in detail each year and on an ad-hoc basis as required. Through participating in many tender processes and the associated feedback we receive, whether successful or not, we are confident our fees are fair and competitive versus our peers. Given client circumstances can be unique and complex, where pricing is to deviate from the pricing policy this needs to be agreed with a member of the Investment Committee to ensure it is appropriate.

Effectiveness of our governance structure and processes

Over the year our proactive and thorough approach has supported all our clients in meeting their regulatory requirements and achieving appropriately high standards in terms of their investment arrangements through tailored advice and attention to their specific needs.

We feel that the structure of our research and consulting teams combined with our use of precise technology is effective to support robust stewardship for and on behalf of our clients.

Our proprietary database **ID** is a powerful tool in supporting our clients with the provision of robust information on all aspects of their investments including ESG, and also supports our internal recording of engagement with managers and progression of their approach. We are constantly upgrading the database capabilities to improve the usefulness of the data stored.

We will continue to develop new propositions (e.g. roll out of **Responsible Investment Framework**) and services (e.g. expanding our lists of recommended sustainable-rated funds, and providing enhanced reporting climate change risks using our new data provider – *see Principle 5*) to help our clients get greater sight of stewardship within their current investments and how they can incorporate even more effective stewardship.

We are clear on the need to continue to educate our staff on ESG and the importance of stewardship, and this will permeate through our advice to clients. Outside the ESG Research team we feel that ongoing training, including for example by offering the **CFA Certificate in ESG Investing** to more of our client facing consultants, will increase knowledge of the pertinent issues more broadly and therefore the quality of our advice, and we feel that the training we have provided has been effective.

We recognise the importance of the ESG research team in supporting all asset class teams and our consultants, and to improve its effectiveness will continue to grow this team. We have invested in a **new Head of Manager Research** to support our total research effort, recognising our growing client base and the importance of effectively resourcing robust research.

Principle 3: Conflicts of interest

Our focus is on doing a brilliant job for our clients. We know that we will maximise our success if we build long-term relationships with clients on mutual trust rather than trying to maximise short-term profits by abusing our position of influence. We have built a great company with a highly regarded brand doing just this, and we are proud and very protective of that. So, it is in our DNA to avoid or carefully manage any perceived conflict of interest. We've seen examples in our industry of clear conflicts of interest that have damaged firms' reputations and the industry as a whole.

How we identify and manage conflicts of interest

We have a **Conflicts of Interest policy** which outlines how we manage confidentiality and conflicts of interest. This outlines that XPS will always act in the best interests of our clients and treat them fairly in line with one of our values '**We Do the Right Thing**'.

We have included our *Conflicts of Interest Policy in Appendix 1.*

In our capacity as a service provider, XPS neither owns its own funds nor does it take the role of a fiduciary manager.

A conflict does not automatically mean that XPS will cease to act. We always disclose actual conflicts to conflicted clients in writing, together with details of the risks and the actions taken to manage the conflict.

Our staff undergo regular training on managing conflicts of interest and our bribery and gifts policy, which is particularly relevant for our relationship with managers. We have a clear policy in relation to receiving gifts from managers to ensure our advice and recommendations to clients remain fully independent.

We have a policy on being fair to all clients. This is particularly relevant when communicating a rating downgrade to Red for a fund as it leads to sale of assets and potential for first mover advantage. We address this by coordinating in such a way that all clients are notified of the news at the same time, so no single client is advantaged or disadvantaged.

To demonstrate our approach we have set out a selection of examples of our identification and effective management of conflicts in the year:

(i) Communicating ratings changes of LDI managers

During 2022, we undertook a review of all of our LDI investment managers, resulting in some of the managers being downgraded. We issued an update to 139 clients, holding a team briefing on the day of the update and organising the communications using our tool ID, so that all our clients were informed at the same time, in keeping with our policy.

(ii) Governance model advice

When refreshing the investment beliefs of a trustee group, all the trustees answered that they "wish to retain control of investment decisions", however the sponsor leant towards "I wish to delegate those decisions". We were clear that it would not be appropriate for us to advise on models of governance, and the trustees commissioned independent advice.

(iii) Focusing on our client's best interests.

A large DC scheme was going through a selection exercise for an investment platform where one of the trustees was a senior company employee and had a strong existing relationship with one of the providers. The individual requested repeated analysis and for us to amend our analysis, which at times felt like they were steering the case for appointing the provider with whom he had the existing relationship. We recognised the conflict and clarified with all parties that our client was the trustee group, and ensured that we delivered our analysis appropriately for their needs.

(iv) Potentially conflicted Chair of Trustees

Small client with an independent Chair of Trustees. Through corporate activity involving XPS purchasing the company for which the independent Chair had worked, XPS could now be seen to be advising a Trustee board whose Chair was an XPS employee. Recognising the conflict, XPS created a new arrangement with the Trustees such that where any investment advice might be deemed to cover an area of conflict (including pricing/billing arrangements) the chair would be removed from any decision that needed making.

Assessment of our approach to managing conflicts

Our approach to managing conflicts means that clients of XPS can be confident they are receiving the high-quality independent advice they should expect from a professional financial services organisation.

Through the decisions we've taken as to what we will and won't do, i.e. no Fiduciary Management, and no fund management, potential conflicts are quite limited.

Where we have identified conflicts, we believe these have been managed in a clear and robust way.

Principle 4: Promoting well-functioning markets

In our capacity as a service provider, our role is to deliver clear, independent advice to pension scheme trustees to enable them to make appropriate investment decisions for their scheme's assets.

Identifying and responding to systemic risks and promoting well-functioning markets

Market-wide risk management

Our second Principle within our Principles and Preferences is to 'Remove undesirable risks and diversify desirable risks'. We help clients understand their exposure to interest rate, inflation and currency risks, and in the main encourage them to hedge these risks as far as is practical whilst still achieving their return target. We also encourage clients to diversify by geographic region, investor base, underlying entity and sector, whilst also ensuring portfolios have enough liquidity to meet short, medium and long-term liabilities and cash requirements.

Case study

Supporting clients through the LDI crisis

Background: During September and October 2022, the pensions industry experienced perhaps its greatest ever stress event – in terms of the level and speed of action that was required by trustees, sponsors, and advisers. Our focus was on providing bespoke advice to help our clients understand what was happening, the impact on them, and the actions they could take to best navigate the crisis as quickly and effectively as possible.

Action: Specific actions that we took to help our clients through this challenging period included:

- Emailing all our clients (on 26 September, the next working day after the mini-budget) with a summary of the situation and areas that they may be affected. This was followed up on 28 September with an **11 point action plan** with all the aspects to be considered, with follow ups organised on a client by client basis to agree which aspects required immediate focus, so that an action plan could be agreed within the two week "window" when the Gilt market was being supported;
- Setting up a webinar for 3 October which had over **800 registrations**, which clients found invaluable to understand the impact of the crisis and the longer term issues that could arise;
- Creating a new liquidity "headroom" tool centrally to allow clients simply and quickly to assess their hedge headroom to deal with future rises in interest rates, so that they could assess whether further work was needed longer term on their broad strategy; and
- Using our online funding monitoring tool, '**Radar**' to assess whether there was scope to reduce growth assets to maintain the hedge due to funding level improvements.

After the crisis we undertook a comprehensive, market leading review of all LDI managers, assessing their performance over the period, providing feeding back to our clients, and also transparent feedback to the managers which we know has informed changes to the approach by certain managers.

Outcome: Using these approaches and tools, we were able to be innovative in our method of advising clients – with no time for detailed reports, we could use our tools and short papers to advise with speed and accuracy.

This episode demonstrated our proactivity in engagement and commitment to ensuring good outcomes for our clients and their members – key hallmarks of stewardship - as well as our effectiveness in engaging with managers to improve their approach. We received excellent feedback from a number of clients on our response through the crisis.

> *I have been very impressed with both the timely & quality of information which has been forthcoming from XPS given the testing circumstances.*
>
> **Chair of Trustees**

Risk modelling

We use proprietary software to design solutions that can be used to mitigate interest rate, inflation and longevity risk. This is done alongside asset/liability modelling software with forward-looking views of investment returns, risk parameters and correlations to help our clients implement an investment strategy to help meet their target investment return and risk objectives. We also use scenario analysis and stress testing routinely as part of our modelling to ensure, as far as is possible, that the investment strategy is resilient against future market shocks. We have an embedded version of our user-friendly scenario modelling tool to our website, available to all clients and prospects free of charge together with our latest scenarios to help promote the importance of this analysis. Our approach to advice is tailored and does not employ house views. This reduces the scope for central decisions and policies to have a systematic effect across all of our clients. We trust our consultants to apply the principles of our approach to each client's specific circumstances.

Climate change

We recognise climate change to be a systemic risk that needs to be assessed, managed and mitigated. This is reflected in how we engage with our clients and investment managers on climate change and ESG issues.

We have an internal **Climate and Environment solutions team** covering all aspects of our pension scheme advisory services. The team is focussed on helping clients meet climate related regulatory requirements both from an investment, actuarial and covenant review perspective. The key activities undertaken in the year were:

- Expanded our team to 13 people, by adding new members from different areas of the business to enhance expertise and knowledge and ensure our research and development is integrated across all areas of the business.
- Developed our client advisory capabilities on climate risk.
- Developed our market-leading quantitative forward-looking scenario modelling of the impact of **climate-related risks on the longevity** of pension scheme members, and advised the first clients on the impact on their members' longevity of climate scenarios, providing four £1bn+ pension schemes with liability scenario modelling that will be incorporated into their TCFD reports.
- Developed our consultants' internal knowledge by running training sessions on the requirements of **TCFD** reporting, including background on climate risks, actuarial requirements and through publication of internal technical briefings and gathering training and content on a dedicated intranet site on Climate & Environment.
- Continued to support client knowledge and understanding of climate risks through publication of a number of XPS Insights briefing notes on climate legislation and developments (more detail provided in *Principle 5*), and development of an area on **XPS Arena** (*see below*) covering climate and ESG risks in relation to pension schemes.

We have continued to refine our **climate change risk dashboard**, which provides our clients with a clear insight into their climate change risk exposure. In 2022 we added further detail to our standard reporting on a broader range of sustainability risk exposures. We have also appointed a **market leading climate change data provider**, to enhance the climate change risk analysis and reporting we are able to provide. More detail is provided under *Principle 5*.

In-depth manager research

We have a highly structured and disciplined approach to manager research at XPS. All members of our team have both research and client responsibilities and so are able to have informed conversations about our approach outlined below.

Our approach is deliberately designed to balance the broad and deep research our scale enables. Our process is focussed on assessing investment managers against eight key factors, which we call the '**7Ps and ESG**', to ascertain their ability to manage market and systemic risk. These consist of:

- **Parent** – ownership of the business.
- **People** – leadership/team managing the strategy and client service.
- **Product** – key features of the investment and the role it performs in a portfolio.
- **Process** – philosophy and approach to selecting underlying investments including operational risk management and systems.
- **Positioning** – current and historical asset allocation of the fund.
- **Performance** – past performance and track record.
- **Pricing** – full details of underlying cost structure.
- **ESG** – consistency and extent to which ESG analysis is incorporated into the process of selecting underlying investments (more detail on our approach to assessing managers on ESG on behalf of our clients is provided under *Principle 5*).

Raising industry standards

A key aspect of our manager research is providing detailed bespoke feedback to managers on areas for improvement across the areas above, including ESG, so as to drive improvements in their processes and practices. This happens as part of new market searches but also on an ongoing basis during quarterly catchups with research teams. We are also asked to feed into discussions around development of new products, drawing on best practice we observe around the market. Our transparency and openness is often pinpointed as a differentiator to our peers by investment managers.

In 2022 we provided **bespoke feedback to 60 managers** involved in the ESG ratings review and held face-to-face meetings with **8 managers** who either received a red rating or requested further detail in relation to this project.
The meetings help them understand our position and expectations with regards to the rating and provide a platform for future engagement to track progress.

> *XPS' feedback and structure on ESG manager evaluation is in my view market leading, especially in flagging future expectations. This feedback has been very instructive for us over the years and is again this year.*

Investment Manager – August 2022

In 2022, we published the results of our third **annual ESG fund rating review.** This transparency to the market is important for helping investment managers understand where their ratings sit relative to others as well as highlighting the broader market areas for improvement that they can act upon. Further detail on the results and comparison against 2021 is set out under *Principle 5*. A link to the full report can be found here.

Engagement

In addition to providing direct feedback to managers regarding the outcome of our research view, we facilitate engagement between our clients and their investment managers in relation to ESG and stewardship.

For example, where the fund manager rating is not satisfactory, we will have a discussion with our clients regarding the next steps which may include; engagement/discussion with the manager, providing alternative fund recommendations or other appropriate steps which are all considered in the context of the wider scheme circumstances and objectives. Where an incumbent fund manager was assessed to be unsatisfactory in ESG terms, but good quality in other respects, we typically provided advice that engagement with the investment manager be the initial action, with a clear time period over which improvement be evidenced, typically 2 years. For those clients invested in funds rated Red on ESG we have been clear that this engagement with the manager is happening and will report back on progress observed through the 2023 ESG ratings exercise.

Case study

Large client engaging with managers on ESG Ratings and carbon emissions

Background: Recognising the importance of the ESG rating as an indicator of robust risk management, and in line with a strong Sponsor position on sustainability, one of our large clients has implemented a bespoke Responsible Investment Policy, which includes targets for the proportion of assets under management which are rated Green on XPS' ESG Ratings over time. The scheme also has an ambition to see the carbon emissions of the funds held reduce over time.

Action: Using XPS ESG Ratings report and carbon dashboard, the scheme monitors the ESG rating and carbon footprint annually. Following the review in 2022 and setting of the policy, the scheme communicated the ratings target to all their managers – in coordination with XPS feedback to the managers on their current rating.

For one manager, the trustees flagged the relatively high carbon emissions as noteworthy, and asked the manager to comment, and provide detail on any particular holdings driving the high emissions.

Outcome: The managers are now clear that the assessment on ratings has direct link to their ongoing retention of the mandate. This creates another channel for engagement between XPS, the client and the manager to understand what actions are being taken to further integrate ESG,

For the manager challenged on emissions, they provided explanation that they had reduced their exposure to certain high emitting sectors, and noted some other holdings where they felt they were being rewarded appropriately for the associated risks, so that where there were higher carbon names there was a reason to do so. This will remain under ongoing review by the scheme.

Avoiding speculative holdings

Given the long-term time horizon of our investors, we avoid advising schemes to take tactical asset allocation positions as we believe market timing is notoriously difficult to get right and getting it wrong can have significant financial implications for our clients. We do note some managers will take positions under their objectives, but we have full sight of these and assess their credibility to do so in our manager research.

Highlighting systematic market events: Through our free monthly market updates, combined with timely ad hoc briefing notes on developments, we keep clients abreast of current issues and action they should be considering, for example rising inflation rates affecting liability hedge accuracy. More details are included under *Principle 5*.

Use of technology

We recognise that there may be situations which require swift action and using our proprietary software, Radar, we are able to provide our clients real time information on their scheme's funding position and risk based on market movements. This enables us to be proactive in helping our clients navigate periods of market stress and staying on track to achieve their long-term objectives.

Cost control

We avoid high turnover solutions and focus on providing cost transparency to our clients. This involves close scrutiny of fee arrangements of funds that we research, combined with a targeted approach of seeking justification for any and all fees charged by fund managers, as well as applying competitive tension into discussion around fund manager costs on behalf of our clients. We supplement this with assessment of turnover and transaction costs as an integral part of our research, as set out in *Principle 2*.

Thought leadership

Our investment team provide a breadth of research covering the key issues. We produce a series of bulletins and host seminars and conferences that capture the latest investment market developments and technical issues. In 2022 this included pieces on the new UK Sustainability Disclosure requirements and fund labelling regime, and an update on TCFD reporting to date. Please see *Principle 5* for further detail on our ESG thought pieces in the year.

Working with wider stakeholders and industry collaboration

We actively participate in the wider industry efforts to advance effective stewardship. This is demonstrated through the following channels:

Investment Consultants Sustainability Working Group

In our role as a member of the Investment Consultants Sustainability Working Group (ICSWG), our Head of ESG research attends the Steering Committee and is a member of the Asset Owners workstream. In 2022 we completed a self-assessment against the ICSWG climate change competency framework, which confirmed that we have the tools and capability to meet the criteria therein. We have communicated our credentials against the criteria to a number of clients as part of their governance framework to ensure climate change is appropriately considered by all their advisers.

In 2022 we agreed to join the **Net Zero Investment Consultant Initiative**, a group which requires us to meet nine principles, concerning the way we advise and support our clients with improving climate change risk management, and one principle in relation to our Firm level climate strategy. At the time of writing our membership is in the process of being finalised, and we will self-assess against the nine principles going forward. We are confident that our Responsible Investment Policy and Firm level net zero strategy is consistent with the aims of the Initiative.

In Feb 2023 a **sub-working group of the ICSWG** was set up to review and form a collective view on reporting carbon emissions for sovereign bonds, which our Head of ESG leads.

We recognise the benefit of collective action in making progress in this rapidly evolving space and are committed to contributing more to this group.

UN PRI

We are a signatory to the **UN PRI**. Due to issues with the PRI's reporting system, we did not submit an annual submission in 2022, but our responsible investment policy and ESG research framework reflect the 6 principles.

Pensions for Purpose

Pensions for Purpose exists as a bridge between asset managers, pension funds and their professional advisers, to encourage the flow of capital towards impact investment.

We participate in the **Paris Alignment Forum** and **Impact Forum**, attending sessions and contributing to the debate on how investors can align their portfolio to successful delivery of the **Paris Agreement** and incorporate real world impact alongside financial returns. The learnings from these sessions feed into our research and client advice.

During the year we have published our thought leadership on their dashboard:

- Carbon offset credits – what are they and should pension schemes invest in them?
- ESG Fund rating review 2022.
- Carbon reduction pathways – how your pension scheme investments can become net zero aligned now.

Impact Investing Institute

The Impact Investing Institute has developed principles to accelerate the growth and improve the effectiveness of the impact investing market. In July 2022 we completed our first self-assessment against their new framework. We are waiting to hear back on the results of this assessment however in summary our self-assessment covered the following:

- Our governance structure (described in *Principle 1*) ensures impact is routinely included as a key topic for consideration in our advice and research framework. Our framework for advising clients (including our beliefs survey) ensure schemes understand where impact investing sits on the spectrum of investment capital, and how schemes can have impact when investing. Our range of sustainable funds offer solutions to those schemes looking to have impact (for example on climate change or against the SDGs).
- Our ESG and carbon dashboard reporting (described in detail in *Principle 5*) help clients review the ESG impacts of their portfolio, from a process and outcome perspective. We annually undertake ESG research in relation to over 300 clients, collecting data on carbon emissions and other sustainability indicators and provide this to clients in a cost effective way.
- We reported 8 clients who had implemented a bespoke Responsible Investment Policy, and 4 which had an explicit net zero target. We provided examples of schemes where we had helped to embed impact into investment strategy reviews, including:
  - Working with a scheme who had strong beliefs around impact to implement funds with specific ESG tilts and high allocation to sustainable infrastructure projects and also a social impact allocation, where the funds are able to report on specific impact metrics such as renewable energy usage; and
  - Updating the investment mandates of a large scheme to deliver market-leading climate change alignment, resulting in clear parameters around carbon emissions reduction alongside the financial objectives of the funds.

Promoting awareness of the UK Stewardship Code

At each announcement date (April and Sept 2022) we notified clients on whether their managers had successfully become signatories or not. As part of our Responsible Investment framework issued to all clients, we also raised the potential for clients to sign up to the Code themselves.

We contacted those managers who were not successful to understand why and reiterated the importance of being a signatory of the Code as part of our ESG ratings process. We introduced a threshold that those managers who are not signatories to the 2020 Code cannot be given our sustainable designation.

In 2021 we had removed the Sustainable Designation from two managers (in respect of three funds) because they did not achieve UK Stewardship Code status. One of these managers was successful in Sept 2022 and therefore we reinstated their Sustainable Designation. We are in discussions with the other manager and understand they are due to apply to the Stewardship Code in 2023 – we believe our engagement on this has contributed to their internal decision to apply.

Consultations

We actively participate in consultations in the interest of supporting our clients and wider stakeholders. During the reporting period XPS Investment actively participated in **32 consultations** in total, demonstrating our commitment to supporting well-functioning markets, including the **following focussing on ESG and stewardship:**

- **IIGCC** call for input on Proposals for Climate Resilience Investment Framework.
- **FCA** consultation on Sustainability Disclosure Requirements (SDR) and investment labels (CP22/20).

Assessment of our risk management and contribution to well-functioning markets

We are clear that our priority is to **encourage our clients to focus on longer term outcomes** rather than knee jerk reactions – this is suitable in the vast majority of cases, and was critical at the start of the year given extreme market volatility as a result of the invasion of Ukraine. The gilt and liquidity crisis in September 2022, however, required us to demonstrate flexibility and speed in our reaction to ensure the best outcome for our clients.

We're confident that our **expert research teams supported by market leading technology** and collaboration with wider stakeholders gives us a clear picture of systemic risks so that we are able to effectively address these in our clients' best interests.

Our **feedback process to managers** on their ratings, bolstered by our publication of a summary report of all ratings, seeks to drive an improvement in policies and practices across the market.

By evaluating the overall trend in ratings from year to year we can form a view on the effectiveness of our feedback to managers. From 2021 to 2022 we saw a slight **increase in overall Green ESG ratings, up from 23% to 24%.** There was improvement in some areas but stagnation in others. This was also in part due to the fact that we had raised the bar on our ESG assessment so that all other things equal we would have expected lower average ratings. Whilst the scores did not improve as much as in previous years, we believe that our ratings framework and the feedback we provide is effective for both our clients and investment managers we engage with. We did see **numerous examples for specific managers of improvement in overall rating or sub-rating** – we are encouraged by this and believe that our ongoing efforts to assess managers and engage with feedback will drive further improvements across the board,

As explained further in *Principle 5* we have received good feedback from managers on our research approach, including comments that our breadth and depth of granular feedback is ahead of the market – in this way we remain confident that our process adds value to the industry and ultimately our clients who benefit from the higher standards this generates.

Through being proactive with items such as our **Responsible Investment Framework**, we are being helpful in identifying where clients can improve their approach, with solutions on hand for those clients who wish to improve. We will continue to look for innovative, cost-effective and scalable ways of helping our clients like this.

We recognise the importance of wider industry collaboration as a means of driving improved outcomes across the industry, and continually look for appropriate ways we can engage. Since the reporting year-end, **Alex Quant** now leads an ICSWG sub-working group providing another channel for us to provide our views and bring best thinking around addressing climate risk to our clients and the wider industry.

Principle 5: Supporting client's integration of stewardship and investment

Our overall client base totals approximately **£96bn of Assets Under Advice** as at 31 December 2022. All clients are institutional and are UK based.

Investment client base breakdown by service

Service	
UK DB Trustee	253
UK DB Corporate	21
UK DC	47
UK FM Oversight	19

How our services best support clients' stewardship

Helping clients develop their approach

ESG and stewardship are an integral component of investment decision-making and therefore a core part of our advice to clients.

We work with our clients to understand their specific beliefs and priorities to help develop a tailored approach using our **Responsible Investing framework.** This provides trustees with practical steps they can take to meet their responsible investing objectives aligned with generating long term sustainable returns for their members. To support this, we have undertaken numerous training sessions with trustee boards on ESG and stewardship issues, helping them understand the risk management and upside opportunities that effective stewardship can offer.

We continue to use an **online questionnaire tool** to collate and summarise views of the individual trustees on a trustee board around ESG and sustainability. The output is an anonymised summary for each client, indicating areas of strong consensus and areas for further discussion. Given the use of technology to provide scale we offer this service at no charge to both clients and non-clients.

This has been well received by clients, help them better understand their collective views on ESG and sustainability and providing a powerful tool for aiding a productive discussion and unearthing views from the whole trustee board.

The table below sets out a summary of the results of the beliefs survey across 2021 and 2022. The number of respondents naturally fell in 2022 as the majority of our client base had undertaken the review in 2021. However, the results continue to indicate that the vast majority believe ESG and climate change represent material financial risks, but that their current policies do not reflect this. By establishing ESG beliefs in this way clients are able to develop bespoke ESG and stewardship policies, covering their approach towards ESG integration, managing climate change risk, and stewardship.

	2021	2022
Number of survey responses	299	43
Agree ESG and climate change represented material financial risks	84%	72%
Agree current approach reflects beliefs	43%	30%

We anticipate running this survey for each client every 2 or 3 years, aligned to wider investment strategy review discussions, at which point the results will present a true like for like comparison and we can assess whether more clients feel their approach is aligned to their beliefs.

Thought leadership and webinars

Taking advantage of our scale and the commonality of issues across the pension industry, we routinely provide clients with ongoing tailored pieces of advice on topical matters at no extra charge. During 2022 we provided 6 pieces of such advice including on the **implications of the Russia invasion of Ukraine**, and the **Responsible Investment Framework.**

We issued **30 investment briefing notes and reports** to help pension scheme trustees and sponsors, over **40% more** than in 2021. Within this, we produced **7 thought leadership papers specifically on ESG** matters including:

- Update on changes to climate change disclosures (July 2022).
- Carbon reduction pathway – how your scheme can become net zero aligned now (July 2022).
- Fiduciary Manager ESG Integration survey (July 2022).
- Fund ESG ratings review 2022 (Sept 2022).
- What can schemes learn from first wave of TCFD reports (Nov 2022).
- FCA proposal on UK SDR and fund labelling regime (Nov 2022).
- COP27 – Key outcomes and implications for schemes (Dec 2022).

This was alongside our **12 monthly investment market updates** with corresponding videos. We issued many others on wider topics, all aimed at supporting our clients understand various issues affecting the security of their schemes.

We hosted **27 other webinars** during the year on a range of topics, with over **6,000 registrations** (an increase of 39% on the previous year). Feedback was consistently very high; All our investment events have achieved a delegate rating of at least 4.3 out of 5.

In 2022 we participated in numerous external events specifically focused on sustainability, including the following:

- Presentation to Association of Consulting Actuaries conference on climate change reporting for pension schemes.
- Investment manager webinar titled ‘How ESG and climate policy can improve the DB outlook’.
- Roundtable between investment consultants and investment managers on sustainable equity funds and how they can help schemes deliver impact.

Research approach

We assess investment managers using detailed ESG questionnaires that comprises **77** targeted questions covering **5** key ESG aspects, alongside face-to-face meetings as required. The 5 key aspects are:

- **Philosophy** – Firm level philosophy relating to ESG, stewardship and broader sustainability issues.
- **Integration** – Implementation of the firm’s ESG philosophy at individual fund level through robust processes.
- **Climate Change** – Explicit climate change considerations within the investment processes and stewardship.
- **Stewardship** – Approach to voting and engagement including being a UK Stewardship Code signatory.
- **Reporting** – Transparent communication of activity to stakeholders.

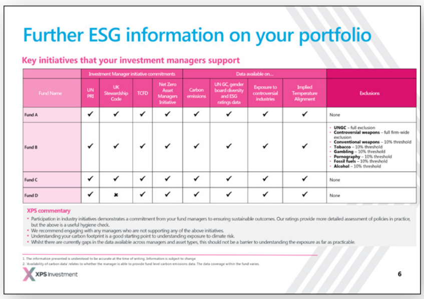
Our assessment in each of the areas described above hinges on outcome-based evidence in each of the key areas. We ask for detailed examples to support claims.

Our due diligence results in an overall ESG rating of Green, Amber or Red as well as individual ratings for each of the 5 key aspects.

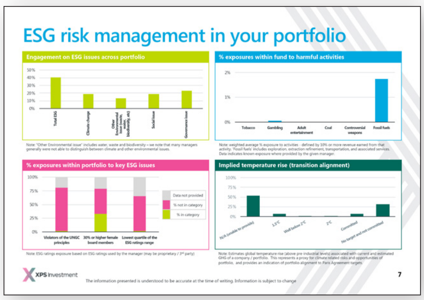
We have a clear minimum threshold with regards to ESG to the extent that a fund that is rated ‘Red’ on ESG will not be recommended to our clients.

Our ESG monitoring process

In addition to our established approach to researching new funds, which has been in place since 2018, we conduct a comprehensive review of our clients existing holdings from an ESG perspective each year. Investment managers’ policies and practices are evolving rapidly in this space and this annual review ensures we will continue to provide assessment of suitability along with assessment of improvement relative to prior years. We encourage all our clients to participate in this review, and our ESG ratings report provides a clear summary of the strengths and weaknesses of their managers.



The **key changes we made to our questionnaire in 2022** included asking for additional examples on engagement across discrete E, S and G issues, as well as asking for the % of the fund which was engaged with. This is to truly understand the commitment of the manager to engaging with holdings at each strategy level. We also added specific questions on firm-level inclusion and diversity commitments, and how their engagement with underlying companies serves to improve inclusion and diversity outcomes.

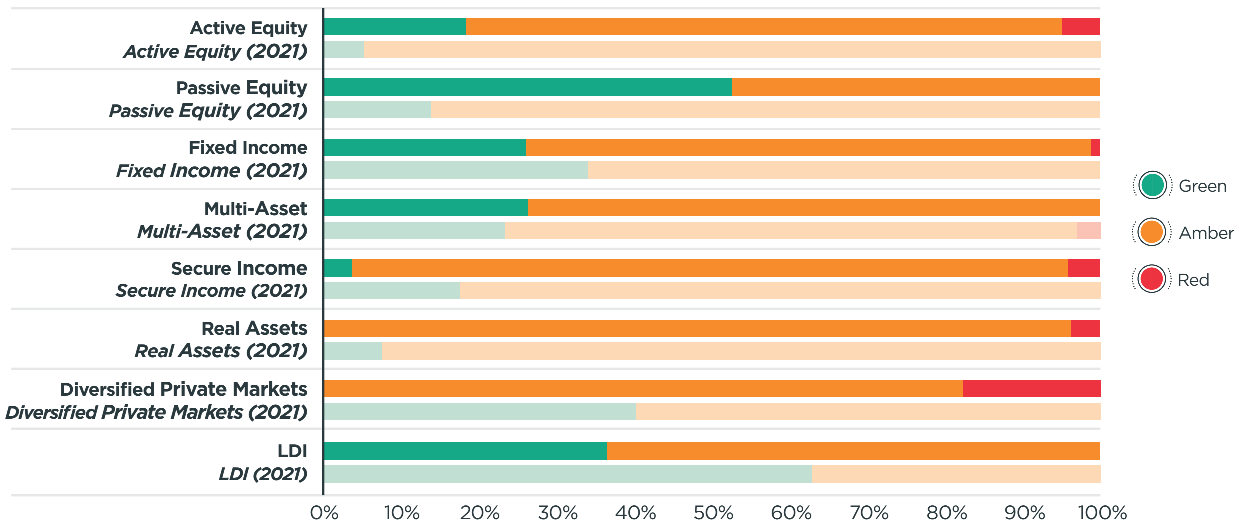


Overall, the changes made increase the importance of robust stewardship in the rating, and we raised the minimum score required for acceptable ESG approach (i.e. an Amber score) overall.

In 2022 we **assessed 255 individual funds** across **63 different investment managers** that our clients were invested with. Our analysis indicates a similar picture to previous years – the vast majority of managers were able to demonstrate some consideration of ESG factors in relation to their investments (24% overall greens vs 23% in 2021). The majority of ratings receive Amber, which indicates acceptable integration of ESG but where more could be done across the sub-areas – we're clear that Green ratings should be reserved for only the most comprehensive and robust managers in this space.

The chart below summarises the overall ESG ratings grouped by asset class:

Overall XPS ESG ratings for 2022 by asset class (compared with 2021)



Source: XPS Investment

This year we introduced a specific sub rating on reporting, with **36% funds rated Red** on this element, causing several funds to be downgraded overall. Reporting is becoming increasingly important to meet disclosure regulations and for investors to obtain to evidence of robust and consistent consideration of ESG and stewardship across a given portfolio.

The full summary of our ESG ratings report for 2022 can be found here.

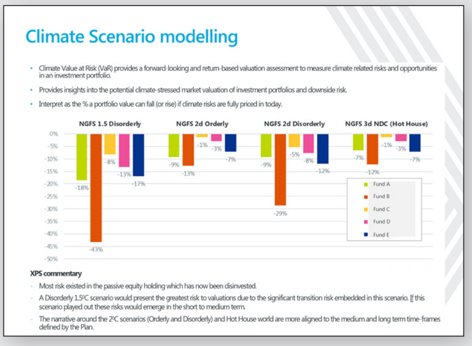
Carbon footprint monitoring and developing climate strategy

We collect carbon data where it is available across the 255 funds analysed in our ESG ratings exercise and provide our **carbon dashboard** annually to clients along with our ESG ratings report. The dashboard provides a summary of exposure to climate change risk within the current investments vs peer group of funds and fund benchmarks. We have found this to be a useful tool in prompting discussion with investment managers around plans to reduce emissions or increase their investment in companies with well-defined climate transition plans. **In 2022 we enhanced the dashboard** to include further detail on a broader range of sustainability issues, such as exposure to sin industries, exposure to positive ESG indicators (such as proportion of women on Boards), and engagement by managers on ESG issues.

We found the availability of carbon data varied significantly by asset class, with listed equity and credit indicating the highest ability to report – however disappointingly this was down slightly on the previous year (e.g. 86% of active equity funds able to report carbon data versus 91% in 2021). We reported last year on the wo rk needed to improve availability of carbon data. The results indicate that there has been progress in diversified private markets in particular, where last year no managers could provide this data. This is still an issue given the role this sector has to play in supporting a successful transition. Full details of our analysis of climate risk reporting capability of fund managers can be found in our ESG Fund Rating Review 2022.

This is an area where we continue to have a dialogue with the fund managers to seek improvement driven by TCFD recommendations and UK SDR reporting requirements.

We have recently appointed a **market leading data provider to enhance our client reporting on climate change risks.** We can provide comprehensive reporting on carbon emissions, as well as forward looking climate transition alignment indicators such as implied temperature rise, exposure to physical risk, and green technology within a given portfolio. The tool also allows us to stress test portfolios to understand resilience to future climate scenarios. We are encouraging all or clients to undertake this sophisticated climate analysis, with particular focus on those clients undertaking TCFD climate reporting. A key benefit of this analysis is providing our clients a platform to engage with their managers on key sources of risk and opportunity. The scope of the reporting available is growing all the time, with metrics on biodiversity impact recently added, so our clients will benefit from this evolution.



Linked to the growing work we are doing helping clients understand their climate risk exposure, we are helping a number of clients set climate policies, including carbon reduction targets aligned with Net Zero by 2050.

Case study

Developing a market leading climate strategy

Background: A client with a significant UK profile and links to the UK government had the desire to be market-leading in their commitment to climate change. Whilst the client had strong ambitions to net zero, their targets and policies were loosely defined.

Action: XPS helped design a comprehensive framework for implementing the net zero strategy which considers the nuances of the client's mandates and their managers' capabilities, sets clear parameters for achieving the objectives and is aligned to the Institutional Investors Group on Climate Change Net Zero Investment Framework. The framework included an overall ambition to reach net zero by 2050, with interim targets to reduce emissions by 50% by 2030 with a 7% year-on-year absolute reduction.

Outcome: The client now has an established net zero strategy which is soon to be implemented and will allow the client to effectively monitor and review progress against their goals as well as initiating effective ongoing engagement with their investment managers. The strategy is successful in aligning the ambition of the client with the Sponsor and the UK's national goals. XPS recommended that the framework and policies be frequently reviewed to ensure it reflects future enhancements in capability and understanding.

XPS Sustainable designation and promoting sustainability

In 2019 we recognised there was a lack of clear definition of sustainable funds. In response to this XPS developed our own **Sustainable designation** that we would award to funds that met our criteria. In addition to meeting our 7Ps and ESG criteria these funds also need to:

- Involve portfolio construction tilted towards sustainable practices and/or away from unsustainable practices, which may include an explicit sustainable objective.
- High degree of ESG integration into decision making reflected in an XPS Green rating for ESG.
- Strong active ownership – including a minimum requirement to be a signatory of the 2020 UK Stewardship Code.
- UNPRI fund score of at least A+.
- Exclude UN recognised unacceptable practices.

We have a central ambition to see take up of sustainable solutions increase. The key ways we look to achieve this are through ongoing training and education and by ensuring we have solutions available to deliver a client's broader objectives as well as providing positive sustainability outcomes.

In 2022 we continued with our whole-of-market searches on sustainable funds concluding our search for sustainable real assets (diversified private markets, infrastructure and real estate) and beginning sustainable investment grade corporate bonds (this search has been completed since reporting year-end). Overall we increased the number of sustainable funds by 15 during the year and now have a total of **34 sustainable funds** across all major asset classes.

We are committed to taking these sustainable options to our clients when they undertake manager selection exercises. The table below indicates the extent to which we have taken sustainable funds to our clients in manager selection exercises, and the proportion where a sustainable fund was ultimately selected by the trustee.

	2021	2022
% manager selection exercises where a sustainable fund was included	9%	26%
% manager selection exercises where a sustainable fund was selected	7%	22%

Case study

Sustainable strategy to align with values of charity client

Background: During 2022, a charity client had the desire to align their investment portfolio more closely to their sustainable and ethical investment principles across its entire asset base, while still achieving their financial objectives.

Action: XPS provided the Trustees access to our free, proprietary investment beliefs and ESG beliefs questionnaire to gather the views of the Trustees across a range of areas. After discussing the results and establishing the views of the group, XPS provided extensive training on ESG and sustainability to educate the group on key areas.

Following this, XPS carried out a full ESG and sustainability review of the client's existing managers/funds against key sustainability metrics and both the Trustees' and Sponsor's goals. This highlighted that the current strategy was not aligned to their goals. XPS then initiated a bespoke selection process focused on reviewing responsible, charity focussed funds which have a focus on Sustainable Development Goal (SDG) alignment.

Outcome: The selection process was successful and the Trustees implemented a new investment strategy which is aligned to the Sponsor's sustainability goals and ethical views. As a result, the client is able to report positively to wider stakeholders on ESG and climate change benefits of their investments vs non-ESG alternatives.

Integration of sustainability within XPS' Mastertrust, NPT

We reported last year on the integration of a sustainable equity fund into the **National Pension Trust (NPT)** default arrangement. In 2022, NPT completed the transition of the entire default structure into sustainable funds across all asset classes.

The NPT regular reporting now also includes detail on sustainability and impact outcomes, with the intention of driving member engagement with their pensions.

Methods and frequency of communication with clients

Our business model is moulded around a culture of personal relationships and making ourselves available to clients, either face-to-face or via video or conference calls. We also provide in-depth reporting and written advice on various different aspects. Our reports are flexible and will be tailored to client's specific needs.

We engage with clients on ESG and stewardship issues through the following channels:

- **Quarterly investment meetings:** Our consultants meet with the majority of our trustee boards on a quarterly basis. Increasingly ESG is a standing agenda item, which may be to discuss the ESG ratings report, an ESG training session, deeper discussion on the development of a bespoke RI policy or implementation of a sustainable fund. We do recognise (in line with the feedback we have received from clients as described below) that clients have varying degrees of interest in these issues, and therefore the same approach cannot be taken for all schemes.

  In this forum we increasingly include standard agenda items for all our clients on ESG matters, including the Responsible Investment Framework this year, as a prompt to all our clients for them to consider enhancing their approach.
- **ESG ratings reports and carbon dashboard:** Provided to trustee meetings usually on an annual basis in line with the annual review of fund ESG ratings. Ratings are then discussed through the year and of course any changes during the year will be flagged. We believe that communicating formal ratings on an annual basis is appropriate to reflect the pace of change in policies and practices.
- **Ad hoc meetings with investment managers:** As a matter of good stewardship we actively encourage trustees to speak to managers about ESG and other investment issues. These meetings are very effective and bring ESG and climate change issues to life for trustee groups – particularly as an opportunity to challenge managers on examples to substantiate the approaches they describe. For the most part this happens on an ad hoc basis at the moment, but we believe engagement will become more frequent and regular.

We have summarised how integral ESG and sustainability were to the conversations:

	2021	2022
Total number of meetings held with asset managers	288	334
Meetings which directly noted a focus on ESG or sustainability	60	62

- **XPS Arena:** New portal launched in 2021 for any trustee to use anytime which provides access to training and other market updates. We have a standalone ESG section on the platform. This is an effective way of driving engagement in ESG and climate change issues outside of the above approaches. In 2022 we launched a new inflation module on XPS Arena to help clients understand inflation and its potential implication on pension schemes. This includes two dedicated videos and has over 650 unique views.

Case study

Facilitating engagement on voting between a large client and their manager

Background: One of our large DC clients has a clear commitment around sustainability across both their DB and DC sections. As part of ongoing monitoring XPS review the voting statistics of their DC managers twice a year.

Action: We have been asking and encouraging the client to ask the manager why they are not voting at 100% of votes to which they're eligible. The scores are generally in the high 90%s, but we're supporting the client in the discussion on whether high 90%s is good enough.

Outcome: We have seen a general increase in the proportion of eligible votes used over 2022 and this remains an ongoing area of review. We continue to proactively monitor the voting outcomes and encourage engagement with the managers to see if the increase is part of a prolonged change in voting behaviour.

Feedback from our clients

We're clear in our commitment to deliver tailored advice bespoke to our clients' circumstances. This requires building great relationships built on trust and open dialogue. We seek to understand their views and discuss where their views differ to ours.

By establishing an open and honest relationship, we encourage an environment in which informal feedback on our services and people is commonplace. We conduct annual reviews with our clients where we consider the year past and plan the year ahead.

We have sought feedback from clients on our approach to ESG. A common thread was that some clients (typically smaller) were most focused on minimum compliance whilst others (typically larger) were focused on doing as much as they could to improve ESG governance within their remit. We have factored this feedback into our approach, avoiding a 'one size fits all' approach to engaging with our clients.

XPS Group also undertake a periodic **Client Satisfaction Survey**, covering aspects such as timeliness, competence, clarity of communication, helpfulness and pro-activity. **Over 219 clients** responded and overall the feedback was very positive. In particular we noted over **75% of clients** were '**very satisfied**' or better with our services, and **24%** indicated they had in increased focus on 'responsible investing and ESG factors in decision making'.

We collate detailed feedback via the **Greenwich Associates survey**. This year we received evaluations from **15 clients** and the assessment is given particular focus at the Investment Committee level. We proactively encourage clients to participate in this survey with a charitable donation offered in exchange for their participation.

Our clients are required by the Competition and Markets Authority to set us **investment adviser objectives** against which we will be assessed on an annual basis. Whilst not a strict requirement we actively encourage clients to assess us annually, which we support by providing a template scorecard based on the TPR guide which includes an evaluation on ESG and stewardship and how we have helped our clients achieve their wider objectives.

How we have taken this feedback into account in provision of services

We review feedback on a case by case basis but also look at trends across the client base. This includes our advice, and the feedback also drives development of our tools, policies and activities in pursuit of supporting clients' effective stewardship that we think they will find valuable.

Based on direct feedback from the Satisfaction Survey (24% wanting more focus on ESG) and also our view of the shifting sentiment from our clients on areas of focus for them, specific developments in the year included:

- Appointing a dedicated specialist climate data provider to ensure we can deliver market leading climate change resiliency risk analysis (this helps support them with regulatory TCFD requirements, but certain clients have indicated an appetite for this outside of a regulatory need).
- Production of widely distributed Responsible Investment Framework taken to all clients, in response to many clients indicating a desire to see more proactivity from us in relation to ESG.

Effectiveness of how we have supported clients with stewardship

Our minimum ESG criteria within our fund ratings continues to ensure ESG integration and stewardship are embedded in all of our advice. There is a clear direction of travel now towards sustainable funds, which pursue long term sustainable investments, including climate transition alignment, supported by strong active ownership.

The changes made to our ESG ratings questionnaire in 2022 were very useful; by asking managers additional questions on the proportion of the underlying holdings engaged with at a fund level, we identified several managers who described a seemingly comprehensive approach to engagement, but in practice were not engaging with a significant portion of their investments. This is something we can now monitor going forward as an extra test of managers' actions in practice.

We believe the constant evolution we've shown in terms of enhancing our carbon dashboard over time, and the recent appointment of a specialist climate data provider demonstrates commitment to ensuring our clients have a good understanding of their investments from ESG and sustainability perspective. Furthermore, the proactivity we have demonstrated in terms of bringing items such as the Responsible Investment Framework, and thought leadership on setting carbon reduction pathways, or on regulatory updates around SDR and fund labelling, helps our clients ensure robust stewardship of their investments.

We have seen an increase in the proportion of fund selection exercises where a sustainable fund has been included, and our focus going forward will be on continued education and support for our clients to bring solutions to them which enhance long term outcomes for their members.

We have seen an increase in the proportion of fund selection exercises where a sustainable fund has been included. Our focus going forward will be on continued education and support for our clients to bring solutions to them which enhance long term outcomes for their members. The table below summarises the effect on our overall client holdings:

	31 March 2022	31 Dec 2022
% Assets under Advice in sustainable funds (DB and DC Trustee only)	3%	6%
Number of clients in sustainable funds	19	23
Average weighting of sustainable funds in portfolios (weighted by assets)	28%	34%

Principle 6: Review and assurance

Internal and external review and assurance of our policies and activities

Internal assurance

We believe it's critical to constantly challenge ourselves and evaluate our approach to improve our processes and ultimately deliver better advice and outcomes for our clients.

Our research function is overseen by our **CIO**, our **Head of Manager Research** and **Investment Committee**, which comprises the most senior members of our investment practice.

The ESG research team has monthly meetings to discuss ongoing tasks and market developments and it is these meetings which prompt production of new materials such as thought leadership or ideas around new funds to research.

We feel the combination of these review processes is appropriate and enables our policies and processes to develop at the pace required.

In terms of assuring wider credibility of our people providing these and other services to clients, XPS Investment certifies 31 staff to carry out FCA regulated work covering **Investment**, **Group Risk**, and **Risk Transfer** work. As part of that certification XPS Investment carries out annual, comprehensive checks on staff fitness and propriety, staff competency, and provides training on the **Senior Management and Certification Regime (SMCR)**, including **Conduct Rules** and **non-financial misconduct.**

This training is in addition to the mandatory training for all XPS Group employees that covers subjects such as data protection, bribery and gifts, fraud and other topics. Completion of this annual cycle of training is monitored closely.

As part of their professional qualifications all qualified staff are required to complete **Continued Professional Development (CPD)**, which ensures ongoing education to support their client service.

In terms of our advice and services, our **Risk & Compliance team** do spot checks of certain advice. Furthermore, various aspects of our policies and procedures are audited annually to ensure they're robust and represent best practice. In 2022 there was no specific need for change highlighted. XPS also employs **PwC** to provide internal audit assurance on various aspects of our internal processes. This review highlighted that we need to automate more of our transition processes and additional functionality in **ID** was rolled out in Q2 2022 to address this review.

This stewardship submission was drafted by **Alex Quant**, reviewed by **Simeon Willis (CIO)** and peer reviewed by **Ben Gold (Head of the Investment business)** to ensure it represents a fair and balanced reflection of our approach.

Client feedback

As set out in *Principle 5*, we seek feedback from clients through the Client Satisfaction Survey and the Greenwich Associates survey, and through the CMA objectives. We have explained under *Principle 5* how this feedback has informed our progress and development of tools.

3rd Party Feedback

We submitted our first report to the **UN PRI** during the reporting period and are waiting for the results of the assessment, which we will receive in 2022. This will provide an objective assessment of our processes and regular milestone for our review as part of our continuous improvement.

Whilst we did not receive bespoke feedback from the FRC in respect of our submission in April 2022, we have considered the summary report of all submissions from the FRC outlining best practice indicators and sought to enhance our approach accordingly. The resulting actions and development of our approach in response is reflected in this submission, noting that we pursue continual improvement.

We have participated in numerous round table discussions and forums to promote improving market practices.

Our participation of the **Investment Consultants Sustainable Working Group** provides a peer group comparison of our activities to help us benchmark our offering. With our participation, this group has subsequently established a set of criteria that consultants and clients alike can use as a framework to assess the effectiveness of their approach.

We also support the Impact Institute Principles for Investment and consider our policies and practices against the 4 principles on an ongoing basis. We have not received specific feedback on our first self-assessment against the 4 principles in 2022, but a broader piece of feedback was provided by the institute to investment consultants generally. Our ambition to meet the principles in a more compelling way supported the decision to appoint and commission an expert climate change data provider.

Fund Manager Feedback

We seek annual feedback from investment managers on their assessment of our research approach and suggestions on how we can work with them more successfully. This reflects XPS's commitment to working in partnership with the fund management industry for the benefit of our mutual clients. This review covered 4 key aspects of our overall research and ESG.

We show a summary of the feedback in relation to our overall research and ESG below:

	Overall				
	Quality of our research capability	**Technical understanding**	**Professionalism**	**Clarity of communication**	**ESG**
Average	7.9	8.1	8.4	8.3	**8.1**
Number of respondents	38	40	49	47	**28**

Additional detailed comments were provided by **33 respondents on ESG.** All feedback was reviewed by our **CIO** and **Head of Manager Research** who responded to all managers and collated a short list of actions in response.

Outside of our usual research agenda, we have scheduled **calls with all 49 respondents** to our survey. This call will be 45 minutes long and will be attended by our **CIO** and **Head of Manager Research.**

The agenda for the calls has been open. Discussion has varied between new investment ideas and funds (this has tended to be the focus), wider business updates, asking questions about our research process and the manager's specific ratings, ESG priorities and also D&I agendas. We have taken action from the calls including clarifying aspects of our rating assigned to that manager and reviewing white paper research papers on topics discussed. For all calls an internal note has been published on XPS ID for the benefit of the wider team too.

Driven by a desire to be more transparent, as in previous years, in Q1 2023 we securely **emailed 70 fund managers across 310 funds** with information about XPS's ratings of their funds (including overall rating, ESG rating, sustainable designation and whether the fund is actively promoted to clients).

How the feedback received ensures continuous progress

We believe this combination of internal and external review provides a comprehensive assessment of our policies and practices. Our client feedback indicated that **over 75% of schemes** were '**very satisfied**', and our feedback from managers (average 7.9 score overall) is strong. Off the back of these results, we have conversations with our clients and managers, and use input from the industry groups we're part of in order to continue to enhance the approach we take. On balance, we believe our approach towards stewardship is fair, balanced and understandable.

Signed:

Print name: Simeon Willis, Chief Investment Officer

Date: 30 April 2023

Appendix 1

Conflicts of Interest Policy

Conflicts of Interest

1. Background

1.1 This document summarises the XPS Pensions Group plc (XPS) policy to handling conflicts of interest. It is for external use with clients and supports Compliance policy 08 which provides detailed actions for conflict management.

2. Why is this important?

2.1 There are a number of reasons why we have a conflicts policy, including professional body requirements and regulatory expectations.

2.2 A conflict could impair our objectivity when providing services and also create an unfair competitive advantage. A client may also have a perception of a conflict that we need to recognise.

3. What's our policy on conflicts?

3.1 We will always act in the best interests of our clients and treat them fairly. Our values incorporate how we should act: **we do the right thing**.

3.2 That means we'll take all reasonable steps to prevent conflicts occurring or mitigate/manage any conflicts we identify.

3.3 All staff must follow our detailed conflicts policy and, if they become aware of situations which may give rise to a conflict, must report it to their line manager or the Lead Consultant who will then consider what action to take.

4. What's a conflict of interest?

4.1 Whilst it's not possible to list all types of conflict, they can be generally defined as where our responsibility to a client conflicts, or could be seen to conflict, with the interests of a staff member (**personal conflict**), XPS (**employer conflict**) or another XPS client's interests (**client conflict**).

4.2 There are many different types of conflict that can arise and our policy is regularly reviewed and updated for current types of conflicts and issues. These include where we are asked to work on projects for an existing client, working for a listed client, providing a range of services that could in themselves lead to a conflict and personal conflicts (for example when acting as an appointed Scheme Actuary).

4.3 Where conflicts cannot be managed in a proportionate manner even after discussion with our client we will consider ceasing to provide services. In this instance, support and guidance can be obtained from the Compliance team.

5. Conflict checks

5.1 Conflict checks are carried out either when a new business lead is received or as part of our client take on process.

5.2 We also carry out a fresh conflict check if something significant changes such as a material change in the services we provide, M&A activity or changes in corporate structures.

5.3 The process for carrying out a conflict check is detailed in our Compliance policy.

6. Actuarial conflicts

6.1 Our conflicts policy also details the professional requirements for members of the Institute & Faculty of Actuaries (IFoA) and includes guidance on implementing a Conflicts Management Plan" (in line with the term used in the new APS P1). Guidance is also provided by our Professionalism Committee and our Compliance team.

7. Conflicts management

7.1 A conflict does not automatically mean we must cease to act. Our conflicts policy details examples of the actions that could be taken although these will depend on the nature and extent of the conflict.

7.2 We always disclose actual conflicts to conflicted clients in writing, together with details of the risks and the actions taken to manage the conflict. Our explanation is always in enough detail to allow clients to make an informed decision. Clients must consent in writing to our controls.

7.3 Any XPS staff working on conflicted clients should be made aware of the agreed measures in writing and should confirm they will comply with those measures.

8. Other instances where conflicts can arise

8.1 These are covered by other policies and hence not covered here but they are available to all staff on the intranet. These include:

> Insider trading
> Financial crime
> Bribery and gifts
> Signing authorities

9. Records

9.1 We must keep records for at least five years from the event in question.

About us

XPS Pensions Group is a leading pensions consulting and administration business fully focussed on UK pension schemes. XPS combines expertise, insight and technology to address the needs of over 1,500 pension schemes and their sponsoring employers on an ongoing and project basis. We undertake pensions administration for over one million members and provide advisory services to schemes and corporate sponsors in respect of schemes of all sizes, including 51 with assets over £1bn.

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Award winning

Pensions advisory

Professional Pensions UK Pensions Awards 2022 — WINNER — Actuarial/Pensions Consultancy of the Year — XPS Pensions Group
Professional Pensions UK Pensions Awards 2021 — WINNER — Actuarial/Pensions Consultancy of the Year — XPS Pensions Group
Professional Pensions UK Pensions Awards 2019 — WINNER — Actuarial/Pensions Consultancy of the Year

Administration

Professional Pensions UK Pensions Awards 2022 — WINNER — Third-Party Administrator of the Year — XPS Pensions Group
Professional Pensions UK Pensions Awards 2020 — WINNER — Third-Party Administrator of the Year — XPS Pensions Group
Professional Pensions UK Pensions Awards 2019 — WINNER — Third Party Administrator of the Year

Investment consulting

Professional Pensions UK Pensions Awards 2022 — WINNER — Investment Consultancy of the Year — XPS Pensions Group
Professional Pensions UK Pensions Awards 2021 — WINNER — Investment Consultancy of the Year — XPS Pensions Group

Technology

Professional Pensions UK Pensions Awards 2022 — HIGHLY COMMENDED — Technology Innovation of the Year — XPS Pensions Group
Pensions expert Pension and Investment Provider Awards 2020 — Winner — Technology Services of the Year — XPS Pensions Group

Culture and Sustainability

Business Culture Awards 2020 — Gold Overall Winner
UK Employee Experience Awards 2020 — Gold Award Winner — Employee Engagement
UK Employee Experience Awards 2020 — Silver Award Winner — Employee-centric Company
UK Stewardship Code

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