Annual Stewardship Report 2022/23

Pennon Group Pension Scheme

Review period 1 April 2022 – 31 March 2023

Contents

ANNUAL STEWARDSHIP REPORT 2022/23

Foreword

In recent years, we have put responsible investment and stewardship at the heart of what we do as a Trustee Board. This report talks to some of the work we have done and provides examples of the actions we have taken.

The following demonstrates some of the steps taken over recent years, and the journey we have been on:

- We have set investment and responsible investment beliefs.
- We have used our beliefs to form a responsible investment policy.
- As part of agreeing a responsible investment policy, we have considered priority areas of focus. These include climate change, pollution, working conditions, health & safety and board composition.
- We have set a target to be net zero by 2045, and to halve carbon emissions by 2030. As part of a broader net zero journey plan framework, we have set a range of targets, including targeting 25% of return seeking assets in direct climate change solutions by 2030, and investing 20% of return seeking assets in impact assets by 2030.
- We have worked with our investment advisor to design net zero journey plan reporting to monitor progress relative to the above targets.
- Through this process, we have made commitments to a renewable infrastructure fund and a timberland & farmland fund. We have also made an investment into impact equity and changed our synthetic index exposure to replicate an index selecting underlying companies scoring highly on ESG credentials.
- Our priorities have provided focus to our manager engagement and we are looking to intensify our work in this area over the coming year

Given all of the work we have undertaken, we believe that we satisfy the signatory requirements and therefore the time felt right to now apply for signatory status to the UK Stewardship Code.

Looking forward to the 2023/24 Scheme year, we will be ramping up our engagement with the Scheme's managers across our priority areas. We started this process during the recent Scheme year, but have further work to do here. We will also be allocating more capital to renewable infrastructure and timberland & farmland, as these allocations more meaningfully drawdown our committed amounts. We intend to closely monitor these allocations to ensure the positive societal benefits are manifesting as we had hoped. Finally, we have recently brought the work of our Responsible Investment Sub-Committee into the day-to-day work of the Investment Committee. We hope this will help better integrate responsible investment into overall decision making and will be monitoring this closely.

We look forward to reporting on this next year and hope you find this year's report informative.

Ken Woodier

Chair of Trustee

Section A: Purpose and governance

Principle 1: Purpose, strategy and culture

We, Pennon Pension Trustee Limited ("the Trustee"), are the trustee body for the Pennon Group Pension Scheme ("the Scheme"). The Scheme is comprised of three sections, the DB Section, Executive Section and Bournemouth Water Section. Each Section has its own set of assets and liabilities, as well as separate investment strategies. Total assets amounted to £628.2m at 31 March 2023.

Our over-riding funding principle for the Scheme is to ensure that there will be sufficient assets in the Scheme to meet benefits in full, as they fall due for payment to members. Our aim is to minimise risk across the Scheme whilst maximising the probability of achieving the over-riding funding principle. We have set a specific funding objective of being fully funded on a self-sufficient basis (defined as gilts+0.5% p.a.) by 2030.

We have agreed a strategic asset allocation for each Section of the Scheme, across growth, income and protection assets. The asset allocation for each Section is provided in the Principle 6 section. The investment strategy is designed to balance risk and expected return in order to achieve the over-riding funding principle. Each Section has a different investment strategy, reflecting the fact that each Section is at a different point in the journey to being fully funded on a self-sufficient basis by 2030.

The Scheme is a long-term investor, and the strategic asset allocation has been designed with that in mind. We monitor the asset allocation and the Scheme's funding position regularly and adjust the asset allocation, and the allocation to individual managers, if considered appropriate to do so.

We seek to act in the best interest of the members of the Scheme and so ensure appropriate individuals comprise the Trustee Board and specialist advice is received from experts to aid decision making. Whilst we rely on advisors to provide that specialist knowledge, we are the ultimate decision maker, and will often robustly challenge advice given.

Our beliefs

We have strong beliefs in relation to responsible investment (formal statement of RI beliefs below). These beliefs have been used to derive an RI policy which forms a key part of the our governance and decision-making process.

The investment strategy has been altered in recent years to reduce exposure to ESG related risks – reflecting our increased focus on the risks posed. Recent changes include the introduction of an impact equity allocation (altering the synthetic equity mandate to track an ESG tilted index) and new investment in renewable energy infrastructure and timberland/farmland. Further detail is provided later in the Principle 7 section.

Climate change has been identified as a key source of risk and we therefore prioritise this in our regular monitoring, which we spent considerable time developing with our investment advisor, Hymans Robertson. Monitoring covers progress against net-zero related objectives and aims to identify trends that we may want to escalate and explore further with the underlying managers. Examples of this are provided in the Principle 9 and 11 sections.

We developed a set of investment beliefs and responsible investment beliefs several years ago. These are reviewed regularly. The responsible investment beliefs have been strengthened over the years, reflecting our commitment to higher standards in this area. The two sets of beliefs are set out below.

Investment beliefs

The following Trustee and Company beliefs are based on a combination of economic theory and views on current markets. As a result, they may change over time.

- Movements in interest rates and inflation will alter the present value of the Scheme's liabilities and can have a significant impact on the Scheme's funding position, increasing the level of funding level volatility.

In order to reduce funding level volatility, interest rate and inflation hedging should be as high as possible subject to leverage and expected return constraints. However, there may come a point where retaining some residual interest rate and inflation exposure adds some diversification benefit and this should be explored further as hedging approaches 100%.

- Equities are expected to generate the highest level of returns relative to the liabilities and the associated risks – this is reflected in the allocation to equities;
- The risks associated with investing in equities can be reduced by diversifying across a range of different growth asset classes – this is reflected in the 20% allocation to other growth assets.
- Investment in illiquid assets offer attractive returns relative to the associate risks (due to the associated ‘illiquidity premium’) as well as offering further diversification from listed equities. This is reflected in the Scheme’s 16.5% allocation to illiquid assets.
- Passive management is more appropriate than active management where a suitable index approach is available (e.g. for equities). However, indices based on market capitalisation, or the size of each issue/security in the market, have limitations, and alternative indexation methods e.g. multi-factor equity strategies, can add value over a market cycle.
- Active management is more appropriate than passive management for most of the asset classes that the Scheme invests in because there is either no suitable index, or because investing in line with an index would be sub-optimal.
- Risk should be diversified such that no one risk is allowed to dominate. However, diversification has its limitations, and suffers from increasing governance and diminishing marginal returns as the portfolio is made more complex. Consequently, individual mandate sizes should be kept proportionate and small mandate sizes should be limited where possible.
- Shorter term tactical decisions should usually be delegated to an appropriate investment manager – this is reflected in the Scheme’s governance structure.
- The Trustee believes that ESG risks can have a material impact on the long-term performance of its investments. ESG risks are defined as the extent to which these issues are not reflected in asset prices and/or not considered in investment decision making leading to underperformance relative to expectations. The Trustee has established a separate set of responsible investment beliefs focused on this area.

Responsible investment beliefs

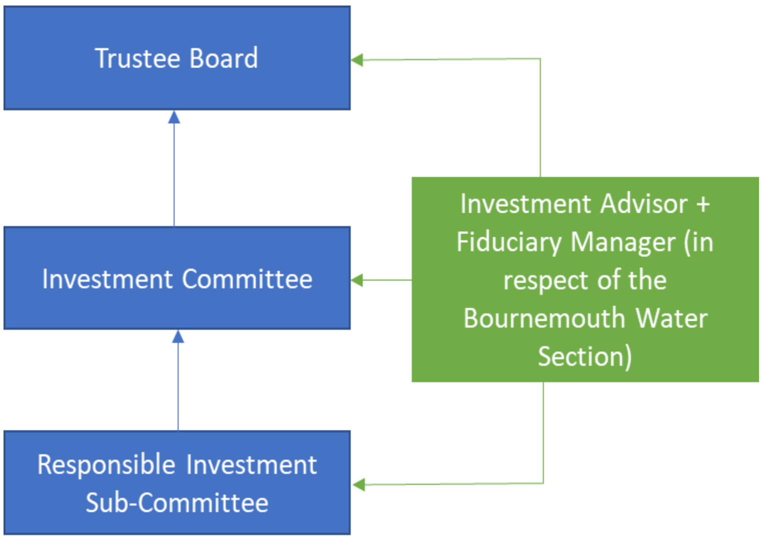
The Trustee considers that the Scheme is a long-term investor, and it believes that investment returns can be maximised for the benefit of all stakeholders by investing in a responsible and sustainable way.

- Environmental, social and corporate governance (‘ESG’) issues are likely to be one of the biggest drivers of long-term performance. Part of the Trustee’s fiduciary duty is to ensure that the Scheme is positioned to protect against related risks and seek to capture the related opportunities that are likely to arise.
- The Responsible Investment Sub-Committee (“RISC”), IC and Trustee should be aware of relevant RI considerations and developments in best practice and consider the implications of these for the way in which the Scheme invests and is managed.
- The Trustee should consider and where appropriate implement policies and procedures which align with the beliefs and approaches adopted by the Company.
- The views of individual members should be considered only if they are made known to the Trustees; it is not appropriate to actively canvas members’ views.

- RI considerations, including the potential impact of climate change, should be factored into the overall assumptions e.g. expected return and volatility metrics, made when setting the Scheme's investment strategy and asset allocation.
- There are likely to be RI related opportunities to enhance investment performance, either by increasing returns or reducing risk.
- Asset owners should embed consideration of RI issues into their investment processes and seek to engage with companies in which they invest with the aim of improving corporate governance and the sustainability of their businesses.
- The IC expects the Scheme's managers to engage with company management as a means of driving improvements to business practices. Exclusions may be appropriate if the IC believe certain industries or sectors prevent a financial, or non-financial, threat to the Scheme. Illegal activities are always prohibited.
- The impact of climate change will have a material impact on the Scheme's future investment performance. A carbon budget should be set and monitored with the aim of aligning the Fund's emissions with an Average Warming Potential and/or Implied Temperature Rise of 1.5°, and the Scheme should commit to reaching Net Zero greenhouse gas emissions by 2045.
- Companies and other investments which actively participate in and support the climate transition are likely to do better than equivalent investments which do not. Therefore, the Scheme should invest at least 25% of the portfolio in investments with exposure to climate change solutions.

Principle 2: Governance, resources and incentives

Establishing a focused sub-group



Recognising the increased emphasis placed on responsible investment matters in recent years, we established a Responsible Investment Sub-Committee ("the RISC"), reporting into the Investment Committee ("the IC"). We set a Terms of Reference for the RISC, which included developing knowledge and understanding, setting priority areas, developing reporting and using this to inform investment strategy. We recognised that to consider these matters in the required level of detail, and to build up the required level of knowledge in newer areas, the matters would have to be discussed outside of the regular Trustee and Investment Committee meetings to ensure sufficient time and resource could be dedicated.

Following the considerable work done by the RISC, we have recently trialled absorbing the RISC into regular IC matters. This reflects the higher level of understanding across responsible investment matters, and the establishment of responsible investment policies that are now reflected in the Schemes' investment strategy. Integrating the RISC into regular IC work should ensure that responsible investment is integrated into all investment decision making, though we are keen to ensure that sufficient time and resource can still be dedicated to responsible investment. We will report on how this progresses in our submission next year.

Through the work of the RISC, climate change emerged as a clear priority area, and we subsequently set a net zero target of 2045 for the Scheme's investments, with interim targets in 2030. With support from Hymans Robertson, the RISC has designed net zero journey plan reporting. This reporting has been reviewed quarterly by the RISC, and IC, and will be used as the basis for ensuring that the Scheme remains on track to deliver the targets set. If the reporting indicates that the Scheme is falling behind plan, action will be taken to correct this.

Ensuring sufficient time, resource and expertise

The RISC met to specifically discuss RI matters at least twice a year, though this has generally been on a quarterly basis over the past two years. The RISC was chaired by the Chair of Trustee, who also sits on the Accounting for Sustainability ("A4S") board and raised matters discussed at A4S meetings with the RISC as appropriate. The RISC comprised of four other Trustee directors.

Both Hymans Robertson, Investment Advisor, and SEI, Fiduciary Manager for the Bournemouth Water Section attended RISC meetings and provided support and advice. Regular training was also provided to build Trustee knowledge in this area. In previous years, training was a higher proportion of RISC time, although this had been able to reduce over time as knowledge developed.

Whenever new topics or ideas were introduced, training was initially provided. If appropriate, we invited industry specialists to provide this training. For example, after an initial introduction to impact equity, we invited a specialist impact equity manager, WHEB Asset Management, to conduct a training session on the topic. The RISC subsequently recommended that the IC conduct an impact equity manager selection exercise, with a shortlist of managers provided by Hymans Robertson.

Other recent examples of using specialist providers to conduct training sessions included an introduction to timberland and farmland investing by Manulife Investment Management and a session from Legal & General Investment Management on exercising stewardship in their role as the UK's largest asset manager (and also one of the Scheme's asset managers).

We have recently agreed to reduce the size of the Trustee Board, and also change the Board composition process from a nomination to a selection process, for member-nominated trustees. We have made these changes because we believe that a smaller, more focused Trustee Board, with a wide range of experiences will result in a more effective decision making collective. Steps are also being taken to ensure diversity is retained in a more concentrated Trustee Board. We look forward to reporting our progress on this in our submission next year.

Incentivising stakeholders

We incentivise various stakeholders to integrate stewardship into decision-making as follows:

- Hymans Robertson are set an objective to advise on the development of an investment strategy to navigate, support and benefit from the transition to a low carbon economy. Success metrics include the development of a net zero journey plan, provision of regular reporting and introduction of new strategies. We review these objectives on an annual basis and any areas not meeting expectation are raised.
- SEI are asked to report on, and demonstrate, stewardship at IC meetings (and previously RISC meetings), with specific examples provided. We have also worked with SEI to develop net zero journey plan reporting for the Bournemouth Water Section, following the work done with Hyman Robertson.
- New allocations have been introduced into the investment strategy over recent years, where the objective of these allocations covers stewardship, and climate-related goals, as well as financial performance. Examples include impact equity, timberland and farmland, ESG-tilted passive equity and renewable infrastructure. Further detail of these allocations is provided in the Principle 7 section.

Principle 3: Conflicts of interest

Trustee conflict management

We have a responsibility to act in the best interests of the membership as a whole. Recognising that conflicts of interest can arise from time to time, we have long had a conflicts of interest policy in place.

The conflicts of interest policy is treated very seriously and is reviewed on a regular basis. We did not identify any areas of the policy requiring change over the past year and therefore no updates to the policy were made over this period.

The policy applies to all Trustee Directors, and sets out the protocol in relation to potential, perceived or actual conflicts. The policy includes specific sections on the following:

- Declaration of conflicts
- General conflict management
- Anticipating and tackling conflict situations
- Managing negotiations with the sponsoring employer
- Member Nominated Director arrangements
- Trustee Directors' personal interests
- Professional advisers

The most common potential conflicts that could arise relate to cross-directorships and where a Trustee Director is employed by the sponsoring Company in a role that has implications for the pension scheme. We manage this by ensuring full disclosure of potential conflicts and applying our conflicts policy. In doing this, we require an individual to stand down if the conflict is not manageable.

An example of this being applied in practice is where one Trustee Director, who holds a senior financial position in the sponsoring Company, is required to stand down from certain discussions on the Scheme's actuarial valuation. This is because these discussions can have implications for any contributions the sponsoring Company may be asked to pay into the Scheme by the Trustee.

A register of known conflicts is included in the meeting pack for all Trustee meetings, and Trustee Directors are asked to confirm any they know of any new actual or potential conflicts. This ensures any arising conflicts are identified at an early stage and can be managed as appropriate.

Manager conflicts of interest policies

We have reviewed the stewardship specific section of our equity managers' conflicts of interest policy and have outlined the key areas included in each below:

Manager	Comment
Manager A	Manager A has a general conflicts of interest policy applying across the business. This policy outlines the approach to identifying, managing and disclosing any conflicts. Manager A also has a specific principle within their engagement policy which refers to managing actual and potential conflicts of interest in relation their engagement.
Manager B	Manager B has a detailed stewardship specific conflicts of interest policy covering all of the expected areas. The policy also includes a series of case studies demonstrating best practice for applying the policies.
Manager C	Manager C does not have a specific engagement related conflicts of interest policy but does include a section on potential conflicts within their proxy voting guidelines. The conflicts section covers areas such as disclosure of potential conflicts, appointment of a third-party to help determine conflicted voting outcomes and establishment of information barriers as required.

We plan to widen this exercise and review all managers' conflicts of interest policies in relation to stewardship in future.

Principle 4: Promoting well-functioning markets

Climate change

We have identified climate change as a key financial risk to the Scheme and have taken actions to better recognise and monitor exposure to the risk. We have also made specific changes to the Scheme's investment strategy to better position the Scheme for the global transition to a low carbon economy.

We have agreed for the Scheme to target net zero by 2045. This date was chosen in part because it aligns with the net zero target date of the sponsoring Company. It is also ahead of the 2050 timeframe that the UK government has set to become net zero, but not so far ahead that the Scheme would be forced to make changes to the investment strategy such that net zero was achieved without making much direct contribution to reducing actual emissions.

To ensure this is delivered, we have developed a net-zero journey plan. The journey plan consists of various metrics with corresponding objectives by 2045 (and interim targets by 2030). We followed the principles and framework outlined by the Institutional Investors Group on Climate Change when establishing our net-zero plan. A screenshot of this reporting is shown below, for the DB Section.

Key Takeaways

Metric	Q3 2021 Position (baseline)	Q4 2022 Position	Current Objective	12 month Objective	2030 / 2045 Objective
Proportion of assets assessed and included in carbon reporting	45.9%	77.4%	51.9%	56.6%	90% / 100%
Data quality - proportion of Scheme where carbon metrics are measured not estimated	34.2%	64.5%	41.8%	47.8%	90% / 100%
Portfolio implied temperature rise	3.48°C*	3.07°C	3.28°C	3.12°C	2.0 degrees Celsius / 1.5 degrees Celsius
Portfolio emissions intensity, tCO2e/$m sales	208.7	128.2	194.6	183.3	50% reduction / close to zero
Portfolio Emissions, tCO2e ($'000)	103.0	74.6			Total emissions from 31 March 2022 onwards consistent with 'fair share' of global emissions for a 2/3rd chance of a 1.5 degree temperature rise
Proportion of the portfolio with fossil fuel ties	12.0%	10.3%	10.6%	9.6%	<2% / 0%
Average exposure to climate change solutions within investee companies	20.0%	17.7%	20.7%	21.2%	25% / 35%
Proportion of return seeking assets with a specific ESG / climate related focus (actual allocations)	5.7%	23.3%	10.7%	12.5%	25% / 25%
Proportion of return seeking assets invested into "impact" investments (actual allocations)	0.5%	8.5%	2.7%	4.9%	20% / 20%
Proportion of investments in material sectors aligned with relevant transition pathway	Currently unknown		-		75% / 100%
Proportion of investments in material sectors that are subject to engagement action	Currently unknown		-		100% / 100%

This reporting allows us to identify if the Scheme is falling behind journey plan and consider any appropriate action.

Our monitoring has been gradually developed and enhanced over the past 18 months as data availability has increased. The reporting is intended to evolve going forward as data availability and relevant practices continues to develop.

We have taken steps to better protect the portfolio from the risk of climate change going forward. Strategy changes have been focused on reducing carbon exposure and increasing exposure to companies directly involved in the transition to a low carbon economy (and therefore most likely to benefit during and after the transition). Changes have included:

- Investing in impact equity;
- Replacing the market cap synthetic equity index with an ESG tilted index;

- Investing in renewable energy infrastructure; and
- Investing in timberland/farmland.

Altering the synthetic equity mandate reduced the Scheme's weighted average carbon intensity ("WACI") by c.35%.

Gilt market crisis

The sharp fall in gilt values in September / October became a market-wide, systemic event. Owing to the large proportion of investors in UK government bonds being pension schemes with leveraged exposure, the fall in gilt prices resulted in pension schemes having to sell gilts, creating a downward price cycle.

During this period, significant cash inflow was required to maintain the Scheme's hedging position. We arranged several emergency meetings with the Trustee Board, sub-committees and sponsoring Company. These meetings allowed the necessary decisions to made and action taken to protect the hedging position and avoid hedging exposure having to be sold.

As part of the emergency meetings, the Scheme arranged a credit facility with the sponsoring Company. The collaborative approach between Trustee and sponsoring Company allowed this credit facility to be agreed and put in place at very short notice and provide further security for the Scheme.

In total, between September and December 2022, we sold £180m worth of return seeking assets (c.33% of total Scheme assets) which were used to support the liability hedging programme. Without this action the Scheme would have been forced to unwind its hedging position, at a detriment to the funding position of the Scheme (given gilt yields fell shortly after), and further contributing to the market-wide sell-off.

We have noted that The Pensions Regulator ("TPR") has recently issued guidance to pension schemes around how to implement LDI portfolios. Following actions taken soon after the events of September / October, we expect to comply with the key recommendations made by TPR.

COVID-19 pandemic

All Trustee meetings were moved to virtual during the COVID-19 outbreak. This allowed effective governance of the Scheme to continue, and the disruption caused by the pandemic to be minimised. Virtual meetings have been retained for Committee meetings, though Trustee Board meetings have returned to face-to-face.

Direct consequences from the market distress caused by the pandemic on the Scheme's investment strategy were very limited. We did take action to rebalance the Scheme's underweight equity position, following market falls, which benefited the Scheme as markets quickly recovered, and these gains were locked in.

Principle 5: Review and assurance

We review all responsible investment related Scheme governance documentation on an annual basis. This includes the following documentation:

- Statement of Investment Principles
- Responsible Investment Policy
- Investment and responsible investment beliefs
- Responsible Investment Sub-Committee Terms of Reference (no longer required going forward)

These reviews are intended to capture any responsible investment developments over the year and reflect any change to Trustee views, allowing the documents to be kept up-to-date and relevant.

An example of updates made during the 2022 review of our responsible investment beliefs included the addition of wording to state "ESG issues are likely to be one of the biggest drivers of long-term performance" and also "the impact of climate change will have a material impact on the Scheme's future investment performance". These changes were made to reflect the strengthening of our belief in this area, and importance of considering how these risks might impact the Scheme's investments.

External criteria assessment

Following an initial assessment, by our investment consultant, of the Scheme's approach across a range of RI related areas, and assignment of "core", "active" or "leader" in each area, we agreed to seek assessment against an external body's criteria. The external criteria used was that established by the Accounting for Sustainability ("A4S") group and involved a red, amber or green assessment being placed on a variety of RI related areas.

Initial assessment across both frameworks highlighted several gaps and areas for improvement, informing future RISC agenda items. In particular, the following areas were targeted for improvement (in order of Trustee priority at the time):

- Asset allocation. Adjusting the asset allocation and redistributing some of the Scheme's capital to better reflect our investment and responsible investment beliefs was prioritised as this was deemed to have the most material immediate impact.
- Net-zero journey planning and associated reporting. We focussed on establishing a net-zero journey plan and developing the reporting against this. This helped us identify key areas of risk and inform ongoing engagement.
- Stewardship priority areas. Our stewardship priority areas were then established to better inform our ongoing stewardship and support a more robust engagement framework.

A more recent assessment has confirmed significant improvement against the A4S assessment framework and Hymans Robertson have confirmed that the Scheme's net-zero journey framework is now ahead of the majority of private sector pension schemes across their client base. Our approach to engagement remains an area that we will look to bolster and focus on over the coming year.

External Assurance

Investment Consultant assessment

All of the investment managers appointed to manage the Scheme's assets are independently assessed from an RI perspective by our investment advisor. This covers a range of areas that inform an RI rating that Hymans Robertson sets for funds.

This independent assessment has resulted in us challenging the Scheme's managers in certain areas. Examples include challenging managers on their reasoning for not becoming signatories to the UK stewardship code, or UN Principles of Responsible Investment. We also challenged a manager previously who was initially unable to give sufficient assurance that they were fully integrating climate risk into their asset pricing models. They subsequently provided a much more robust response to demonstrate that it was factored in.

We have made it clear to Hymans Robertson that we expect them to raise any concerns or shortcomings across the Scheme's managers. Any managers that receive a rating below our expectation, or any manager that is downgraded, will be challenged by the Trustee. If a suitable response is not received, the allocation may be reduced or removed.

Stewardship reporting

We review and assess all voting and engagement of the Scheme's underlying equity managers on at least an annual basis, particularly focusing on the priority areas that we deem to be of greatest importance. Hymans Robertson input into this process by providing their assessment of the quality of manager responses, drawing upon their experience across many different investment managers and pension schemes.

We have challenged the managers on activity which has fallen below expectation, and an example of this is given in the Principle 9 section.

Net zero reporting

Our net zero journey plan reporting is provided by Hymans Robertson, who derive data sourced from MSCI where possible. This provides a consistent source of data independent to individual manager estimates. The reporting highlights any areas that may be falling behind minimum required levels to deliver the journey plan. This then informs our ongoing stewardship and ultimately investment strategy.

Section B: Investment approach

Principle 6: Client and beneficiary needs

Our vision and objectives

We have set a long-term funding target for the Scheme to be fully funded on a gilts+0.5% basis by 2030. Various metrics (including value at risk and probability of achieving this target) are monitored on a quarterly basis and action taken to adjust the level of risk/return targeted by the Scheme if experience moves sufficiently behind or ahead of the required level to achieve the long-term funding target.

We have agreed that upon reaching the full funding on a gilts+0.5% basis target, the investment strategy will be immediately de-risked to target an expected return of gilts+1.25%. At this point, the Scheme's investment strategy will be significantly de-risked. This trigger is in place to protect the high level of funding once achieved.

We consider this funding target to be appropriate, as by this point the membership is expected to be at least 57% pensioners (the DB Section pensioner proportion as at the 31 March 2022 valuation) and therefore reasonably mature. It is therefore important that by this point the risk in the Scheme's investment strategy is low.

We have considered canvasing member views on investment strategy and wider approach, however, thus far have opted not to given the disparate views across the membership. A general update on responsible investment related activity is published on an annual basis, available for all members to view, via the Implementation Statement.

Scheme information

The Scheme is an occupational, defined benefit pension scheme consisting of three sections with separate investment strategies and liability profiles. These are the DB Section, the Bournemouth Water Section and the Executive Section. The Bournemouth Water Section employs SEI as fiduciary manager.

Information on the membership for each of the sections is set out below.

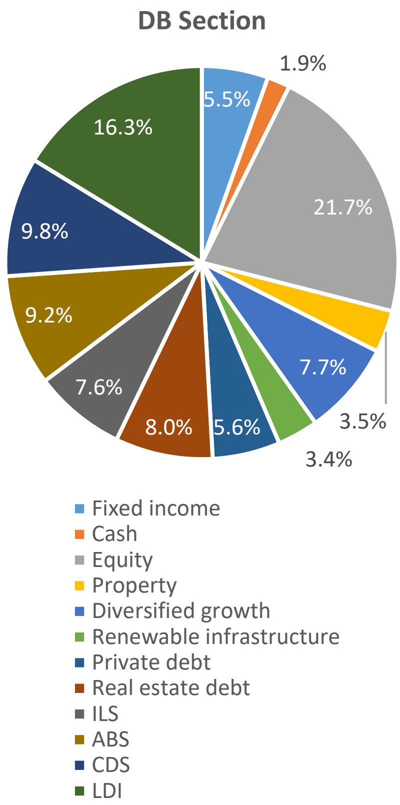
Membership profile

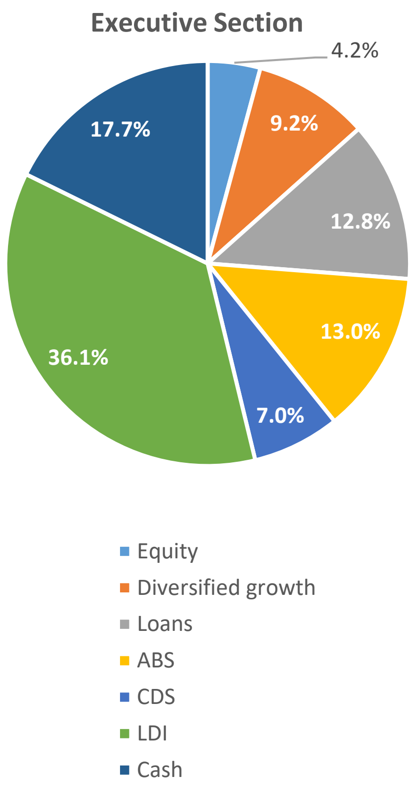
Number of members	Deferred	Pensioner	Total
Scheme	1,888	2,679	4,537

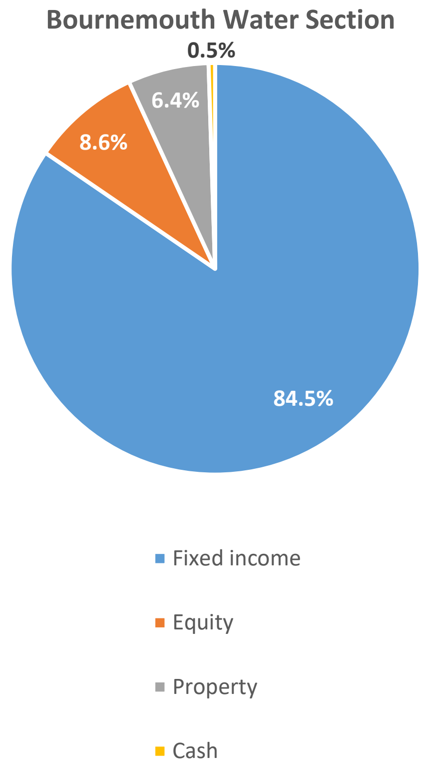
* As at 31 March 2022. Includes all Sections of the Scheme. Source: Scheme Report and Accounts

Asset class breakdown at 31 March 23

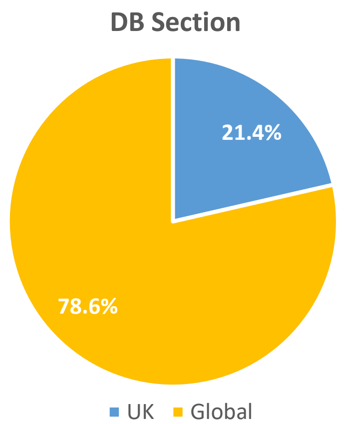
The asset class breakdown for each section of the Scheme is detailed below:

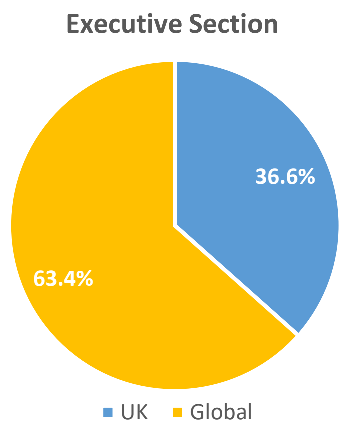


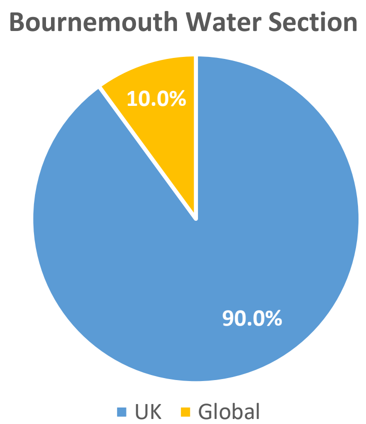




Regional breakdown at 31 March 23







Principle 7: Stewardship, investment and ESG integration

Engagement priority areas

We have developed an RI policy and a set of RI beliefs which help provide a framework around stewardship and ESG integration. Further, we have identified a set of priority areas for engaging with underlying managers and monitoring stewardship activity. These priority areas are as follows:

- Climate change
- Pollution
- Working conditions
- Health and safety

- Board structure (with a focus on diversity)

Climate change has been an area of focus for the Trustee for several years and as such the majority of RI related work has been focused on this area to date. Initially, our focus was on asset exposures. More recently, this has shifted to a focus on manager engagement across the funds in place.

We widened our priority areas in 2022 to include the other areas listed above. An example of this engagement is shown in the Principle 9 section.

Recent manager appointments

We placed significant emphasis on RI credentials in recent years when making manager appointments and changes to investment strategy. Recent examples are outlined in the following table:

Manager appointment	Proportion of Scheme assets	Comment
Transferring synthetic equity exposure to an RI focused index	15.0%	There are no physical holdings in this allocation, and so the changes made here were focussed on risk management. We chose to switch index exposure to an index that selected the top ESG scoring companies in a global market capitalisation index. As part of the index selection process, we ensured that the index chosen also had a large reduction in carbon emissions, relative to global market cap. The selected index also upweighted companies with strong environmental, social and governance practices. We believe this will improve risk-adjusted performance.
Investment in a timberland and farmland product	8.0%	One of the Scheme's illiquid allocations was in the process of winding down, and there was an opportunity to reallocate the sales proceeds to a new allocation. Timberland was identified as an asset class that could fill this role and play a key role in the delivery of our 2045 net zero objective (timberland can exhibit negative emissions through the carbon sequestration process). As part of the initial due diligence process we questioned the manager on the working conditions of the staff that would be involved in the timberland/farmland production, reflecting our focus in this area. Sufficient accreditation from independent bodies was provided by the manager that gave us comfort that a process was in place to ensure staff working conditions were maintained at a sufficiently high level.
Investment in renewable energy infrastructure	4.5%	We expect this investment to deliver high returns, due to the increasingly high demand for renewable energy. This allocation will also benefit wider society through the carbon emissions avoided by using clean energy. In the coming year, we expect to reflect this within our ongoing monitoring.
Investment in impact equity	4.0%	We replaced a passive mandate with an active impact equity allocation, on both expected return grounds, but also recognising the wider societal benefits the underlying companies bring. Whilst going through the manager selection process, we disregarded managers focussing solely on environmental impact, preferring products with positive social and environmental factors. This

		reflected our shift to include social aspects as part of its wider RI approach. We recognise that listed equity investment does not represent "new money". However, the allocation of capital to sustainable-focused products contributes to wider market signals.

Climate risk reporting

Our climate risk reporting has been developed to assess the underlying sector performance of the Scheme's portfolios against our net-zero target. This process has been used to highlight the sectors least aligned with our net-zero target and has allowed us to engage with the underlying managers on their exposure to these sectors. An example of this within our equity exposure is provided in the Principle 9 section.

We focus engagement on the areas of the strategy most at risk of climate change. For example, more focus has been placed on the equity mandates, which are expected to form part of the strategy for the foreseeable future and invest on a long-term basis, than an opportunistic credit allocation, where the underlying companies are expected to only be held for a 3-6 month period.

Principle 8: Monitoring managers and service providers

Monitoring of Hymans Robertson

We have set Hymans Robertson the following objective:

"Put in place and maintain an investment strategy that is able to navigate, support and (where appropriate) benefit from the transition to a low carbon economy."

Success measures for this include:

- A journey plan to a net zero investment strategy is developed.
- Regular reporting of climate metrics is provided.
- New strategies, consistent with the net zero journey plan, are considered and implemented where appropriate.

Objectives are reviewed on an annual basis and feedback is provided to Hymans Robertson. The objectives set are also evolved over time as the Scheme's circumstances and priorities change.

Monitoring of SEI

The Trustees have a documented set of long-term objectives for SEI in their role as the Fiduciary Manager to the Bournemouth Water Section. SEI's performance against the objectives is reviewed at least annually. The objectives are reviewed (and where appropriate revised) at least triennially.

On a quarterly basis, SEI reports back to the trustees on

1. Investment performance and key drivers of performance
2. Environmental and social governance metrics of the portfolio
3. Stewardship activities including engagement activities, engagement milestones achieved and proxy voting

Monitoring of investment managers

This takes place on a quarterly basis with input from both Hymans Robertson (in respect of the DB and Executive Sections) and SEI (in respect of the Bournemouth Water Section), covering both core performance and responsible-investment related matters.

As mentioned in previous sections, we have typically reviewed net zero journey plan reporting on a quarterly basis. This has been used to inform subsequent engagement with managers. A couple of case studies of this process in action have been included below.

Case Study 1: Replacement of fund

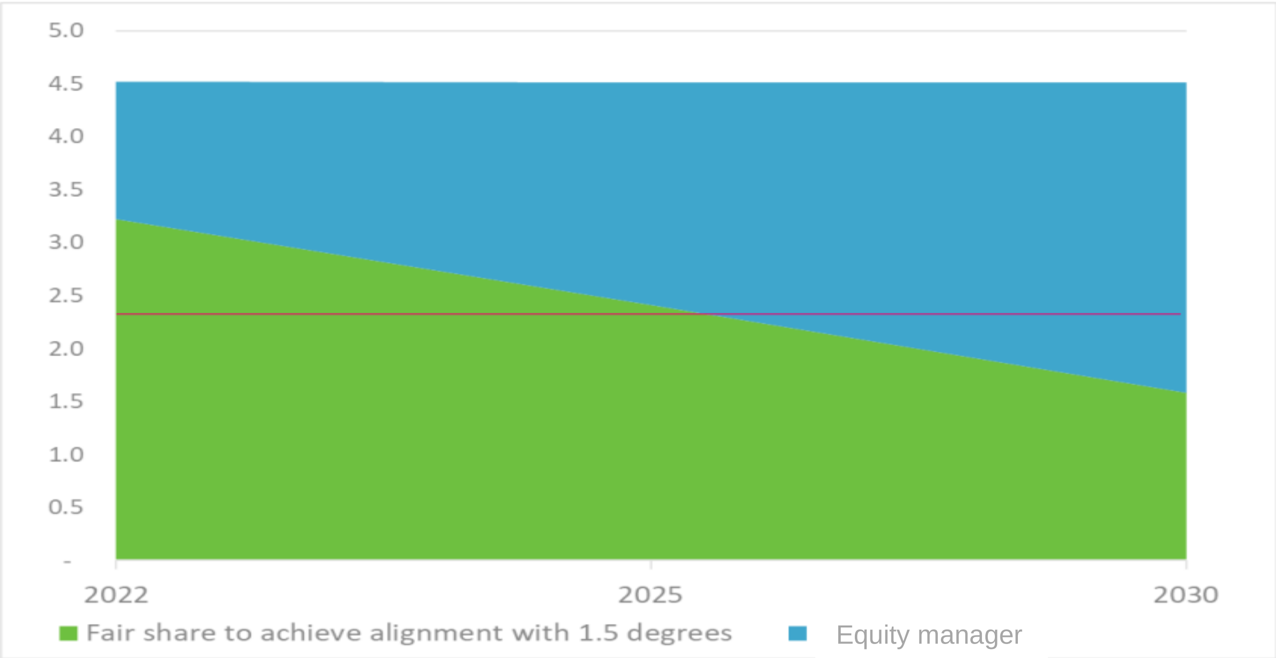
We recently carried out a review of an individual allocation within the investment strategy. As part of the review process, we considered the carbon exposure of the investment and factored this into the overall decision making process. We ultimately agreed to replace the allocation, partly due to concerns over the carbon emissions of the fund.

Case Study 2: Engagement with investment manager on emissions projection

As part of our net-zero journey plan monitoring, we investigated the expected future emissions projection of our equity mandates and compared these with their ‘fair share’ emissions level in order to limit global warming to 1.5 degrees. The fair share emissions projection is based on the underlying sector exposures within each equity mandate.

The projection for one of the equity funds is illustrated below. The fund’s expected emissions projection is in blue, with the fair share amount in green. As can be seen, the blue portion is significantly above the green portion, indicating that the fund is not currently aligned with limiting global warming to 1.5 degrees.

Absolute Emissions (KtCO2) to 2030



Based on these results, we initiated an engagement process with the relevant investment manager to better understand the factors driving these results and investigate the carbon targets of the underlying companies. The manager provided assurance that 92% of the fund was already invested in companies committed to achieving net-zero by 2050.

Further, the manager’s target is for 100% of the fund to be invested in companies that are ‘transition aligned’ or ‘transition aligning’ by 2030, based on the following definitions used by the managers.

- *“Aligned: Companies with climate resilient and transition-aligned climate management and processes, which includes appropriate risk pricing, robust climate target-setting (such as SBTi-approved GHG reduction targets, long-term value chain Net Zero targets) and climate reporting (such as TCFD aligned, leading CDP Climate Change reporting). This corresponds to the highest scoring tiers for climate transition risk pillar discussed above in the Impax proprietary methodology for Fundamental ESG Analysis.*

- *Aligning: Companies with climate management and processes that have been initiated but have not been fully developed. This equates to the middle scoring tier for climate transition risk in the Impax proprietary methodology for Fundamental ESG Analysis.*

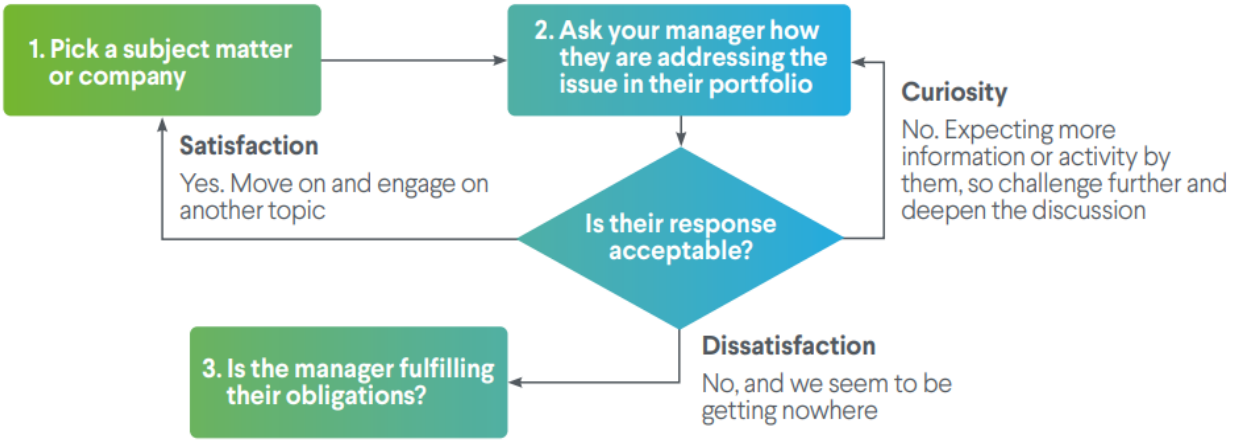
- *Non-aligned: Companies with very weak or non-existent climate management and processes. This equates to the lower scoring tiers for climate transition risk in the Impax proprietary methodology for Fundamental ESG Analysis.”*

We take comfort from the commitments already in place from the manager and will continue to closely monitor the position.

Section C: Engagement

Principle 9: Engagement

Our engagement process is outlined below:



Your questioning will get an answer which should lead you down one of three courses of action:

- **Satisfaction**, in which case you can move on to another issue to engage on.
- **Curiosity**, in which case you can deepen the discussion and challenge to gain further insight.
- **Dissatisfaction**, in which case you can pose deeper questions as to your relationship with your manager.

As set out under principle 7, we have agreed on a range of engagement priority areas covering environmental, social and governance issues. The primary rationale behind agreeing each priority area is outlined below.

Priority area	Reasoning
Climate change	Long-standing priority area for the Trustee given the direct and very important impact of climate change on investment outcomes
Pollution	Closely linked to the industry of the sponsoring Company and Trustees (water utility company)
Working conditions	Chosen with a view to what can be practically measured and monitored, as well as what can be influenced by asset owners, covering "social" and "governance" areas.
Health and safety	
Board structure (with a focus on diversity)	We believe that diversity within board structure is a key requirement for a well-functioning management board.

Speciality chemicals sector example

When reviewing the net zero journey plan monitoring in late-2022, we identified that the speciality chemicals sector was the sector least aligned with our net-zero target. We therefore agreed to engage with the Scheme's equity managers that had exposure to companies in this sector. At this time, we also engaged with our underlying equity managers across some of our priority areas, still focusing on companies within the speciality chemicals sector. The aim of this engagement was to better understand how our managers understood the risks associated with the sector and seek reassurance that this was factored into the portfolio construction process and ongoing company engagement.

An anonymised summary of the quality of manager responses is set out in the table below.

Manager – Response Quality	Climate Emissions	Pollution	Board Composition
Manager A	Strong	Strong	Strong
Manager B	Good	Weak	Strong
Manager C	Good	Strong	Strong

We were satisfied with the majority of the responses received, but identified the following areas to delve deeper on:

- Manager B's response in relation to pollution. In particular, we are keen to encourage stronger commitment to this area and make our expectations clear.
- More information from Manager B regarding the consequences of one of the underlying companies failing to meet minimum criteria on their climate pledge requirements
- More information from Manager C on the specific engagement with one of the underlying companies to better understand the being work carried out to support their transition to a low carbon economy

At the time of writing, we are awaiting responses from the underlying managers on the follow-up engagement. If we receive insufficient comfort through this round of engagement, further escalation will likely involve the manager being invited to attend a Trustee meeting to discuss remaining issues, with reducing the allocation or fully removing the manager from the Scheme's strategy a potential final outcome.

Manager engagement on behalf of the Trustee

Case study: Increased board diversity example

Impax, one of our equity managers, are currently engaging with Kubota Corporation ("Kubota"), a Japanese agricultural machinery manufacturer. The aims of the engagement have been to:

- Raise awareness and provide education on the importance of good governance and diversity
- Establish diversity policies and targets
- Improve board diversity

Engagement with Kubota has resulted in the first appointment of a female director to the Board, increase in the proportion of independent board executives and the appointment of a US citizen as Executive Officer.

Impax will continue to engage with Kubota to improve governance standards and further increase diversity on the board.

Case study: Climate

Another one of our equity managers, Nordea, invest in Air Liquide, a company producing solutions and services based on gases and essential molecules. Some of the solutions produced by Air Liquide improve energy and industrial efficiency and Nordea therefore see the company as having an important role to play in the transition to a low carbon economy. However, given the high carbon emissions associated with Air Liquide's operations, Nordea also recognise the importance in taking action to bring down the emissions where possible.

In early 2022, Nordea decided to increase the level of engagement with Air Liquide by stepping into a co-lead role within the Climate Action 100+ (CA100+) initiative. During the second quarter of 2022, Nordea had several calls with the company to better understand their emission target setting and encourage the company to further enhance its commitments and practices. In particular, discussion focused on the company's strategic direction of travel, the current state of its Science Based Target (SBTi) approval and how achieving its climate commitments will impact its return profile.

Nordea believe the engagement has been well received by Air Liquide and has resulted in more stretching short-term carbon reduction targets being set.

Principle 10: Collaboration

We were supportive of the pressure being placed on Governments by the Institutional Investors Group on Climate Change ("IIGCC") via their Global Investor Statement to Governments on the Climate Crisis. We publicly demonstrated this support by becoming a signatory to the 2021 statement. The statement set out five actions governments needed to urgently undertake related to the climate crisis and we were keen to add our name to the weight of asset owners supporting the statement.

The Chair of Trustee sits on the Accounting for Sustainability ("A4S") board and feeds back relevant discussion from A4S meetings to the Trustee as required. In 2021, we agreed to sign up to the A4S Pension Fund Chair Net Zero Statement of Support, which entailed committing to the following within 12 months:

- Committing to set net zero targets to align our investment strategy with a 1.5°C pathway.
- Expecting our direct service providers to support this ambition.
- Being an active shareholder across all relevant asset classes we invest in.
- Collaborating with our peers to innovate ways to bring influence to bear in the interest of our members.
- Attempting to understand climate risk in a holistic manner and to manage these risk factors within our investment portfolios, including physical and transition risks.

We see the above commitments as being aligned with our investment and responsible investment beliefs and consistent with the wider work being undertaken across the Scheme.

Principle 11: Escalation

Trustee escalation with investment managers

As discussed in previous principles, we have engaged with some of our equity managers on the areas least aligned with our net-zero journey plan. As part of this engagement process, we submitted initial queries to each manager regarding relevant underlying companies and assessed the quality of response received. Where the response was deemed to fall below expectation, we increased our engagement with the relevant managers.

So far, this has consisted of highlighting the areas falling below expectation, making clear what our expectation was in each instance and seeking manager justification for the approach taken. An example being one of the manager's approach to engaging on pollution issues and making clear that our expectation be that pollution issues form a greater part of the engagement process.

Should we remain dissatisfied with the manager's approach, we will likely escalate this by requesting the manager attend a Trustee meeting and justify their position to us. If we continue to see no progress, this could lead to the manager being replaced.

Investment manager escalation on behalf of the Trustee

During periodic meetings with each investment manager, we have discussed engagement activity, including where escalation action has been required.

Relevant examples linked to our priority areas are outlined below:

Case study: Carbon reduction example

One our equity managers, Nordea, is invested in one of the largest waste management companies in North America, Waste Management Inc ("Waste Management"). Nordea has been in regular dialogue with Waste Management since 2019, given the significant carbon emitting sector it operates within.

Engagement to date has resulted in Waste Management starting to report climate and environmental data to Carbon Disclosure Project ("CDP") Climate Change and publicly disclosing TCFD aligned reporting.

However, Waste Management have recently adopted a carbon reduction target that Nordea does not believe to be significant enough to be aligned with a 2 degree warming scenario. Nordea met with the Waste Management's Sustainability & Policy Director to escalate the engagement and highlight the insufficient carbon reduction target.

Engagement with Waste Management has resulted in the appointment of an external consultant to set a 1.5 degree aligned carbon reduction plan with explicit scope 1 and 2 reduction targets to be included.

Case study: Working conditions, health and safety and diversity example
Nordea have been a long-term investor in Chinese technology company Alibaba. Following a series of human rights and workplace diversity issues, Nordea escalated their level of engagement with the company and arranged an onsite meeting at the company's headquarters.

During this meeting, recent issues were discussed, and Nordea outlined their expectation with regard to human rights and diversity. In particular, health and safety was discussed, and current practice which put employees at risk (such as discouraging delivery drivers from taking breaks) were highlighted.

Since the meeting, Alibaba have introduced a range of measures to improve working conditions and workplace safety such as:

- Altering the delivery algorithm to shift emphasis away from short-term KPIs which put a lot of pressure on avoiding individual deliveries being late (with severe punishments if missed even by minutes) and towards longer-term overall ratings
- Introducing mandatory rest periods for delivery drivers
- Rolling out road safety training for over 5 million delivery drivers
- Introducing monitoring systems to discourage drivers from using mobile phones whilst driving

Further, the gender split at Alibaba has improved significantly and is now comfortably ahead of other global technology companies, including Apple and Amazon.

Section D: Exercising rights and responsibilities

Principle 12: Exercising rights and responsibilities

Voting Policy

We have delegated voting activity in respect of the underlying assets to the Scheme's investment managers, the monitoring of which is undertaken by us on at least an annual basis in conjunction with the Scheme's investment advisor, Hymans Robertson. We may use this information as a basis for discussion with our investment managers, and where we deem it appropriate, any issues of concern are raised with respective managers for further explanation. We believe it is important that our investment managers take an active role in the supervision of the companies in which they invest, both by voting at shareholder meetings and engaging with the management on issues which affect a company's financial performance. We have made it clear to our managers that we expect them to vote in all resolutions where they are able to do so.

We monitor compliance with our voting policy on at least an annual basis.

Voting activity

We seek to ensure that our investment managers are excising voting rights and, where appropriate, monitor managers' voting patterns.

We hold physical equity assets with Impax Asset Management ("Impax") and Nordea Asset Management ("Nordea"). Both managers have reported on how votes were cast in each of these mandates as set out in the table below. Nordea invest across a range of asset classes. The proportion of Scheme assets referenced in the table below corresponds to the look-through allocation to physical equities, as estimated by Hymans Robertson.

The data in the following table refers to the 12-month period to 31 March 2022 (due to data availability at the time of writing in order to meet the report submission). The Scheme invested with Nordea for this full period but only invested with Impax from 23 March 2022.

Manager	Impax	Nordea
Proportion of Scheme assets (as at 31 March 2022)	4.9%	8.4%
No. of meetings eligible to vote at during the year	38	199
No. of resolutions eligible to vote on during the year	544	2,348
% of resolutions voted	100.0%	99.9%
% of resolutions voted with management	93.0%	88.0%
% of resolutions voted against management	5.2%	11.3%
% of resolutions abstained	1.3%	0.6%*
% of meetings with at least one vote against management	65.8%	66.3%
% of resolutions voted against recommendation of proxy adviser (if applicable)	4.2%	8.3%

*Includes 0.4% of votes withheld

Whilst a summary of the voting activity for the Scheme's managers is useful to refer to, we note that one should be careful to draw conclusions on a manager's voting policy by comparing headline figures. For example, the

Impax fund has an explicit sustainable focus and therefore we may expect to see greater alignment with management and fewer votes against management. This in isolation does not mean that the manager should be viewed as being any better or worse on voting and engagement.

We are satisfied that a high proportion of the eligible resolutions have been voted on behalf of the Scheme. In particular, Nordea has shown significant improvement from the previous 12month period, voting on 99.9% compared to 45% in 12 months to 31 March 2021 (a figure that we challenged in 2021 and made clear our expectation that the proportion voted should be significantly higher).

Significant votes

Key votes in relation to our engagement priority areas are:

Example 1

Republic Services, 21 May 2021 vote for a report on Integration of ESG Metrics into Executive Compensation Program. Resolution was not approved.

Nordea voted for this shareholder resolution that proposed that the Board should issue a report describing how Republic Services' compensation program is linked to ESG criteria. Nordea believe this is important since the company has several ESG-related controversies, and several peers have started integrating ESG metrics into executive compensation programs. They will continue to support shareholder proposals on this issue as long as it is needed.

Example 2

Autozone, 15 December 2021 vote for a report on the Annual Climate Transition. Resolution was approved.

Autozone's current targets for greenhouse gas emissions includes short-term Scope 1 and 2 targets for operations in the United States. Thus, the emission targets have not been formulated in line with the Paris Agreement as they do not cover the entire Group and Scope 3 emissions. Nordea voted for the shareholder proposed resolution as the requested report would allow investors to better assess how the company is managing climate-related risks.

Use of a proxy advisor

The below table details where investment managers have appointed a proxy advisor to advise on voting and/or conduct company engagement.

Manager	Proxy Advisor used
Impax	Glass Lewis
Nordea	ISS ProxyExchange & Nordic Investor Services

The managers take on board voting recommendations provided by the proxy advisors but retain the discretion to vote however they see fit. Both managers voted against their proxy advisers on less than 10% of occasions over the period considered.