December 2021

XPS Responsible Investment Policy

Summary

Our purpose: To shape and support safe, robust, and well-understood pension funds for the benefit of people and society.

We do the right thing: Our corporate values make it clear that doing the right is embedded into our interactions with all our stakeholders.

We recognise that investors have a role to play in making the future world a place where our investment returns will have value

Therefore, ESG integration and stewardship are embedded throughout our processes and interactions with our clients, investment managers, and at Firm level.

Our Responsible Investment Policy captures the following key ideas:

Deep understanding of the risk issues at play and how they can materially affect outcomes for pension schemes and society at large.

Strong beliefs around how ESG integration and sustainability should be incorporated into pension scheme investment strategy – as captured in our Principles and Preferences which underpin all of our advice:

- ESG and strong stewardship are fundamental elements of risk management
- Sustainable approaches improve outcomes

Raising the bar for the industry – We expect investment managers to integrate ESG into their processes and set a minimum standard for all funds we will recommend to our clients. We review our clients' funds annually and engage with managers to improve processes and practices.

We have developed our own Sustainable designation that we award to funds that demonstrate high degrees of ESG integration and strong active ownership, alongside additional incorporation of sustainable objectives.

XPS are a signatory of the UN Principles of Responsible Investing and a recognised signatory of the 2020 UK Stewardship Code. We are also early adopters of the Impact Investing Principles of Good Governance, Pensions for Purpose, and participate in the Investment Consultants Sustainable Working Group.

Helping our clients – We have a clear framework to help our clients develop and implement bespoke strategies capturing their specific beliefs around ESG integration and sustainability. One size does not fit all when it comes to ESG.

XPS Responsible Investment Policy

At XPS our vision is to constantly challenge the pensions industry to improve and achieve better outcomes for members. Our Purpose is that we exist to shape and support safe, robust, and well-understood pension funds for the benefit of people and society.

Against this context this document sets out our approach in relation to Responsible Investment in the development and delivery of our advice.

This policy will be reviewed annually.

XPS beliefs around responsible investment

Delivering the best outcomes for our clients goes hand-in-hand with our core values as a firm. Our Corporate Values also make it clear that doing the right thing is embedded into our interactions with all our stakeholders, whose interests shape our decision making and business model. All of our employees aim to act in the best interests of our clients, including how we charge our clients and treat them fairly, in line with one of our values 'We Do the Right Thing'.

Therefore, ESG integration and stewardship are embedded throughout our processes and interactions with our clients, investment managers and at firm level.

Understanding key risk areas

ESG factors

We think of ESG issues as being traditionally non-financial in nature, but which present financially material risks to a company's ability to generate sustainable long-term returns. These risks may not be captured through traditional financial analysis.

E **Environmental** considers how a corporation's environmental exposure affects future profitability. i.e. how will the corporation thrive in an increasingly green world.

S **Social** considers a corporation's engagement with key stakeholders and how it contributes/detracts from society.

G **Governance** relates to the structures and policies governing a corporation.

ESG considerations are no longer a 'nice to have' for a company, as they present financially material risks to its ability to generate sustainable long-term returns. Asset owners such as pension schemes and other institutional investors have an important role to play in driving improvement.

Climate change

Climate change in increasingly seen as an investment risk factor to consider in its own right in additional to ESG issues.

It is well understood that climate change presents a systemic risk to the planet and that the financial markets have a role to play in mitigating the long-term impacts of climate change. It is also acknowledged that climate change presents financial risks to companies (and therefore for pension schemes), which typically arise in the following ways:

- Transition Risk: The impact on sectors and companies of the fundamental shift in regulation and societal preferences arising as a result of to a green (low carbon) economy.
- Physical Risk: The impact of extreme weather events on a given company's operations, e.g. direct damage to assets or indirectly via the increased price of raw materials/inputs.

We also recognise that there are opportunities associated with the transition to a low carbon economy.

It is therefore critical for us and our clients to consider exposure to climate change and the above risks and opportunities in the investment decision making process.

Incorporating ESG and Sustainability

There has been rapid development in the market around different approaches that can be taken towards incorporating ESG into investment products, which adds choice but can add confusion for pension schemes when making decisions. Whilst the lines do blur between various categories, we have sought to clearly define how we think about ESG integration.

Approach	XPS view
Traditional	
- Investment decision making based on fundamental analysis of company accounts, sales growth and other financial data. - Looks to build a clear picture of a company's commercial opportunities and differentiators	Fundamental traditional analysis is no longer sufficient as it does not paint the full picture of all the risks. A fund manager that employs purely a traditional approach with no consideration of ESG will not be recommended to our clients.
Responsible	
- Consider material ESG risks within a company to provide a more complete understanding of future risks and opportunities. - Voting and engaging with companies is key to drive responsible practices.	Risks relating to ESG are fundamental and should not be overlooked. As a minimum XPS requires all funds it recommends to clients to employ a responsible investment approach.
Sustainable	
- Incorporates steer towards companies and sectors that are demonstrating good or improving ESG behaviours and away from areas that are demonstrating bad or static practices	Sustainable investing focusses on longer term outcomes – Pursuing deployment of capital that meets the needs of the present without compromising the ability of future generations to meet their own needs. We are committed to bringing sustainable solutions to our clients and believe that in many cases taking a responsible approach is not enough, as this can still involve unacceptable exposure to ESG risks. Furthermore, in some cases there may be upside potential available for investors by pursuing long term sustainable themes associated with the transition to a low carbon economy (such as renewable energy, electrification).
Impact	
- Specifically targets, measures and reports on non-financial outcomes in addition to pursuing financial returns	This involves setting clear non-financial objectives. Monitoring and reporting on progress is critical. Impact investing does not necessarily mean lower returns or more risk, although certain impact fund types do span into philanthropy. Having a good understanding of any trade-offs between a fund's pursuit of financial and non-financial goals is therefore required, but impact to moderate degree can still be achieved without materially compromising risk or return targets.

XPS research and integration of ESG factors into our investment advice

- Our philosophy is captured within our stated Principles and Preferences. Our six Principles underpin all our advice and six Preferences reflect how we steer clients in absence of them having a strong view.
- Overall, we recognise that investors have a role to play in making the future world a place where our investment returns will have value.

Principles

- Clear objectives and strategic direction
- Remove undesirable risks, diversify desirable risks
- Avoid short term tactical positions
- Cost control
- ESG and strong stewardship are fundamental elements of risk management
- Clear accountability

Preferences

- Simple is good
- Passive management where appropriate
- Active management to access new markets
- Illiquidity presents opportunity
- Leverage is a powerful tool
- Sustainable approaches improve outcomes

Research

- 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 score lowest on our ESG scoring system.
- Further we actively encourage clients to set high expectations of fund managers in this regard and challenge managers where they are not demonstrating the appropriate minimum standard.
- Our proprietary ESG 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 believe that, irrespective of any ethical views held, ESG aspects are an essential element of the overall assessment of an investment opportunity.
- Our research process is tailored to the asset class being assessed.

We assess investment managers using detailed ESG questionnaires covering 5 key ESG aspects

- **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.
- **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.

In addition to capturing detailed ESG assessment when researching new funds, we undertake an annual review of our assessment of investment managers' ESG integration and stewardship practices and provide detailed feedback to our clients' managers thereby working to raise industry standards.

We will continually look to evolve our research and assessment approach to capture emerging important themes as well as to challenge fund managers to continue to improve their policies and practices in relation to ESG.

Sustainability

- In 2019 we recognised there was a lack of clear definition of Sustainable funds. In response to this we 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 demonstrate higher calibre of base line ESG integration (strong active ownership) and additional incorporation of a sustainable objective.
- We are establishing a comprehensive range of sustainable funds across all asset classes.
- In many cases we feel taking a responsible approach is not good enough and there is no reason not to be taking a sustainable approach – where similar financial objectives can be achieved but with improved outcomes in terms of ESG and climate change.

Helping our clients

- We are committed to embedding responsible investment ideas across all of our client advice, and where available, pro-actively considering sustainable approaches.
- We recognise that one size does not fit all when it comes to ESG and stewardship and we work with our clients to ensure that our advice and solutions are tailored to their specific needs**.**
- We have a clear process to help our clients with their approach as shown below:

1) Beliefs	2) Objectives	3) Approach	4) Implement	5) Accountability
XPS ESG beliefs questionnaire helps to capture and document Trustees' views *Undertake training to fill in gaps in*	*Discuss and agree areas of focus for incorporation into the strategy and policy*	*Map the scheme's current position on the XPS framework against where the scheme wants to be in terms of ESG integration*	*Assess existing managers in terms of ESG score and carbon footprint using our carbon dashboard* *Implement any changes to address laggards*	*Monitor and engage with managers on their ESG, climate change and stewardship related activity*

Governance

Development of our approach to responsible investing is led by Simeon Willis, our Chief Investment Officer, and supported by Alex Quant, Head of ESG Research. As discussed above we embed ESG, sustainability and climate change into our investment advice via the following channels:

- **Investment Committee:** The Committee is comprised of the most senior members of the investment team and led by Ben Gold, Head of Investment at XPS and a Director of XPS Investment. 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 ratified by our Investment Committee. This ensures consistent application of our approach. The members of the Committee have an average of around 20 years' experience of advising pensions schemes and investment.
- **ESG research team:** The ESG research team is comprised of 9 individuals from across the team, including three partners, 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.
- **Asset class research teams:** 5 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.

Our consultants are incentivised through their 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. ESG is a specific element of annual performance development process and therefore is a component in each consultant's end of year rating, which impacts their bonus.

Training / Education

We have a baseline expectation that knowledge of ESG and climate change is a core competency for our investment consultants.

ESG and climate change integration into institutional investment strategy now forms an integral part of graduate training programme.

We provide ongoing training to all our consultants around responsible investing through our planned series of training sessions. We also encourage all consultants to attend seminars hosted by fund managers to raise awareness of the different approaches taken across the industry.

Disclosure / Public record

XPS are a signatory of the UN Principles of Responsible Investing and a recognised signatory of the 2020 UK Stewardship Code – our submissions report for 2020 can be found **here**.

We report annually to the UN PRI and on our adherence to the UK Stewardship Code.

We are also early adopters of the Impact Investing Principles of Good Governance, Pensions for Purpose, and Investment Consultants Sustainable Working Group.

We proactively advise our clients to be forward thinking and to do the right thing, mindful that our advice will retrospectively be judged against ever higher standards set by society.