XPS Stewardship Code Report

October 2021

XPS Investment

Stewardship Code Report

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

Principle 1: Purpose, Strategy and Culture

XPS Investment sits within XPS Pensions Group, the largest pure pensions consultancy in the UK. XPS Pensions Group provides pensions actuarial, investment consulting and administration services to over 1,500 pension scheme clients in the UK, combining expertise, insight, and technology to address the needs of both pension trustees and sponsoring employers.

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

> **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.

> **Our Purpose:** We exist to shape and support safe, robust, and well-understood pension funds for the benefit of people and society.

XPS Investment is a fast-moving, exciting business, with a team of 75 people across 8 locations exclusively focused on the UK market. We advise pension schemes on all aspects of investment, from objectives and strategy to fund selection and monitoring. We advise DB and DC schemes. We do not provide fiduciary management services as we believe it would create a conflict for us to do so, but we do provide fiduciary management oversight services to clients.

Our culture and values

Our culture is embedded in our interactions with all of our stakeholders, whose interests shape our decision-making and business model, and are vital to our ongoing ability to achieve our goals.

We aim to develop long-term partnerships with our clients in our role as their trusted advisor. We are absolutely clear that the only way for us to do this is to always ensure that we do the right thing for them for the long-term. Further, this is the number one objective given to all our people, and so this shapes the way they interact with stakeholders, making it a key driver of our culture.

We are committed to managing our business in an ethical and responsible way and recognise acting with integrity, honesty and respect for others is critical for success.

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 embrace technology. 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 invite bold thinking and actions within our business, and we give each person the support they need to become their very best.
- **We are agile** – We're forward-thinking, innovative and quick-moving. When we see a better way to do something, we make change happen. We don't just follow the way things have always been done in our industry. We take a fresh look at things and find new ways of achieving the best outcomes for our clients.
- **We are helpful** – We are one firm who build 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. And we have fun together.
- **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 – we use it, share it and support each other for the benefit of our clients and colleagues every single day. We each put what we know to good use and build on this with constant learning.
- **We do the right thing** – We're approachable, honest and fair; both with our clients and each other. We are inclusive, we value each person for what they bring to the company. We respect and reward hard work and talent. We act with integrity, build great relationships and take responsibility for what we do.

Our culture, driven by our values, has yielded benefits for our staff and clients alike. Our core values of agility, helpfulness and always doing the right thing were at the heart of our successful response to the challenges posed by the COVID-19 crisis. In a survey of our people, 93% stated that they thought XPS Pensions Group was a good place to work.

Commitment to diversity and inclusion

XPS supports staff in ensuring they feel they belong, have a voice, are valued and can be their true selves at work.

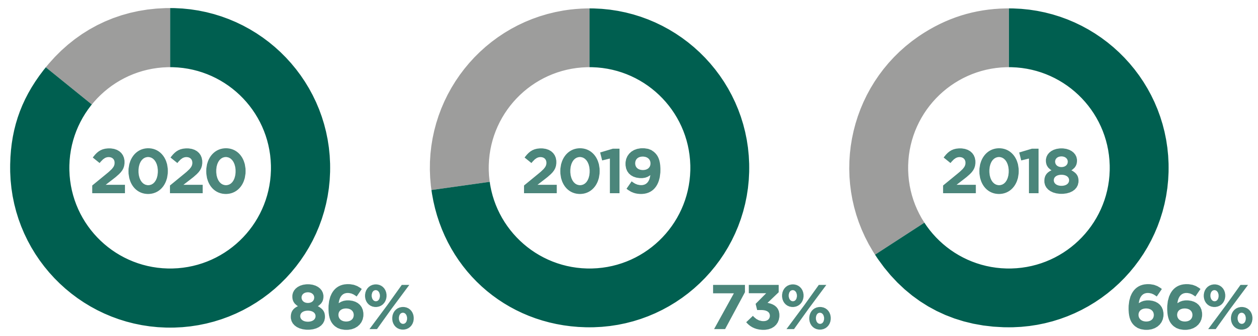
When recruiting we try where possible to advertise every possible role with flexible terms and gender-neutral language and, once new joiners are working for XPS, we aim to give them the support they need without being singled out.

Our Board is committed to zero tolerance of harassment and bullying, and have made it clear that supporting equality in the workplace is the responsibility of every employee, with a focus on all leaders and managers being positive role models. This is evidenced by a combination of communication, training and showcasing the behaviours expected.

At an organisation level, we have a Diversity and Inclusion Working Group (which was set up in 2018) and an Employee Engagement Group, which both regularly meet. These both give staff a voice to discuss policies, procedures, processes and culture within the company.

Before 2020 we ran an annual staff engagement survey but no baseline to measure change. Now in addition to our annual staff survey questions, we have also collected demographic data on our HR systems, and we are also starting to use focus groups. This is a crucial step towards our reporting on gender and ethnicity pay differentials as well as progress on all the other areas of our inclusion strategy.

We understand that achieving real D&I is a journey and, as you can see in 2020, we have made significant progress. Our staff survey shows that the percentage of staff who agree the XPS leadership team are committed to Equality, Diversity and Inclusion has increased over the last 3 yearsas would be expected.



Source: XPS Pensions Group

In 2020 we have increased the number of females at senior management level by 7% and are focused on increasing this further in the year ahead. XPS has been part of the Actuarial Mentoring Programme (AMP) since 2017, we have been members of the 30% Club for the last three years. Additionally, XPS has internal mentoring and reverse mentoring to help develop gender equality.

We recognise the LGBTQ+ people working for XPS by reviewing our policies and procedures to ensure that we are inclusive of LGBTQ+ people and their needs. XPS is a member of the Valuable 500, which puts disability on the Board agenda, and a member of the Business Disability Forum, which supports employers to make the most of the talents of disabled people in the workplace. In October 2020, we published our menopause policy and launched our menopause network to support staff.

In 2020 we started to roll out mental health training for managers, educating them about the signs of mental health problems and training them to respond appropriately. A caring conversation between a supervisor and an employee can be instrumental in encouraging an individual to get help.

In our 2020 staff survey, 90% of employees felt they could talk to their line manager if they felt the demands of their job were becoming an issue and this has risen from 85% in 2019.

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. XPS has formal anti-bribery and corruption policies, supported by a whistleblowing process and, where necessary, proportionate, and independent investigation and follow-up of any matters reported. 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.

Promoting awareness of responsible investment

In our capacity as a service provider, XPS neither owns its own funds nor does it take the role of a fiduciary manager. We decided early on that to act as both an advisor and fiduciary manager creates conflicts and, as such, we wouldn't do it. For example, higher fees for fiduciary management might encourage our people to push clients towards this approach or our people may feel unable or unwilling to advise a client to replace us as fiduciary manager if performance is poor. This means we are able to be truly independent, tailoring our advice solely to the needs of, and for the benefit of, our clients.

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. Further, we consider ESG integration and the stewardship of underlying investments, including proxy voting and engagement, to be not only an essential part of risk management but also key to generating sustainable long-term returns.

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

As a firm

> We have firm level commitment through our Sustainability Committee. The Committee was created 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 has oversight of the views and interests relating to sustainability of the internal and external stakeholders of the Company including employees, clients, and community.

> We demonstrate our commitment through participation in various industry initiatives. During the reporting period we became signatories of the UN PRI, active participants of the Investment Consultants Sustainable Working Group and influencing members of Pensions for Purpose.

> Since the reporting period ended we have signed up as early adopters of the Impact Institute's "Impact Investing Principles for Pensions". We continue to seek ways to learn and engage on matters of good stewardship.

Our research

> 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. ESG risk management is captured in Principle 5 and Sustainable investing is captured in Preference 6:

Principles – the foundation of all our advice

- **Clear objectives and strategic direction.** Objective taking into account liabilities are a vital requirement for setting the strategic asset allocation – which is the most importatnt investment decision.
- **Remove undesirable risks, diversify desirable risks.** Diversification can be a powerful way to manage risk but it has finite limits. Undesirable risks that offer no benefit to a pension scheme should be reduced as far as practically possible.
- **Avoid short term tactical decisions.** They are difficult to get right consistently and the temptation to second guess markets should be resisted.
- **Cost control.** Cost can have a significant drag on returns and all costs should be fully understood and tightly managed.
- **ESG is a fundamental aspect of risk management.** Investment managers should incorporate ESG considerations into day to day investment management.
- **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 – what we would do if it were our money

- **Simple is good.** Portfolios should be pragmatic and free of unecessary complexity. Excessive numbers of managers and funds should be avoided.
- **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.
- **Active management to access new markets.** Active should be used where passive management isn't viableor as a means of allocating between mainstream and specialist asset classes to improve governance and diversification.
- **Leverage is a powerful tool.** It can reduce risk or enhance returns but needs to be carefullly managed.
- **Illiquidity can provide attractive opportunities.** For long-term investors it is and important source of risk reduction, diversification and return enhancement.
- **Sustainability can improve outcomes.** Investors have a role to play in making the future world a place where our investment returns still have value.

- 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. Further we encourage clients to set high expectations of fund managers in this regard.
- We review ESG integration and in particular stewardship across all asset classes. We consider this to be key in promoting effective stewardship across asset classes and is aligned to the more extensive 2020 UK Stewardship Code
- 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.

Our clients

- We work with our clients to formulate their beliefs on ESG integration and stewardship which are then reflected in their Statement of Investment Principles. Subsequently we help our clients implement their beliefs and policy within their investment strategy.
- 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.
- We are committed to educating clients on ESG and stewardship related topics through training programs, webinars and conferences.

We believe that our culture, values, business model and strategy are completely aligned to serving the best interests of our clients. Our success in growing our client base and very low rate of losing existing clients provides an indicator that our existing and new clients agree. Our stated approach to assessing ESG within fund recommendations has been followed universally during the reporting period with no clients appointing new funds with an XPS red rating for ESG. This, as in previous years, has served an important role in sending a clear message to investment managers that ESG integration is not optional for our clients.

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. As described above, stewardship plays a key role in our research of third-party investment managers and how we interact with our clients. This is reflected in our governance structure set out below.

Our approach to responsible investing is led by Sarita Gosrani, Head of ESG Research, and overseen by Simeon Willis, Chief Investment Officer. 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 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 two partners, and led by Sarita Gosrani. 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.

Across XPS Investment we encourage everyone to take professional exams to help build their knowledge. We currently have 16 qualified actuaries and 9 CFA charterholders. Additionally, we currently have 38 people actively studying for one of these qualifications.

We ensure that our teams have the appropriate level of expertise. 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. 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.

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'.

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. This is supported through our annual performance development process and reflected in each consultant's end of year rating, that impacts their bonus.

Principle 4 of our Principles and Preferences is Cost control. We help clients understand the sources of cost within their portfolio both explicit costs such as fund management charges and expenses and implicit costs such as turnover costs. We are working to provide greater detail using the Cost Transparency Initiative template in conjunction with third parties and during the reporting period began a pilot exercise with a view to rolling out to our full client base in 2021.

We also follow a pricing matrix for our fees to ensure fairness and consistency across our clients. 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.

The extent of regulatory oversight is increasing, and we support our clients' good stewardship by informing them of their obligations and helping them satisfy these. Taking advantage of our scale and the commonality of issues across the pension industry, we routinely provide clients with ongoing advice pieces on topical matter at no extra charge. During 2020 we provided 7 such pieces of advice, including advice on the regulatory changes in disclosure requirements and CMA Order confirmation to ensure all of our clients can comply. We keep a central log of our clients' adherence to key regulatory requirements. However, during 2020 also took it upon ourselves to provide guidance and keep a checklist of all clients' compliance in relation to the CMA Order confirmation to support our clients meeting their regulatory obligations.

Over the year our proactive approach has supported our clients meeting their regulatory requirements and achieve appropriately high standards in terms of their investment arrangements through tailored advice and attention to their specific needs. We will continue to develop new propositions (e.g. support under the Cost Transparency Initiative) and services (e.g. expand our lists of recommended sustainable-rated funds) to help our clients incorporate even more effective stewardship.

Principle 3: 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'.

XPS takes all reasonable steps to prevent conflicts occurring or mitigate/manage any conflicts we identify. 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.

Conflict checks are carried out either when a new business lead is received or as part of our client take-on process. 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. The process for carrying out a conflict check is detailed in our Compliance policy.

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 explanation is always in enough detail to allow clients to make an informed decision. Clients must consent in writing to our controls. Any XPS staff working on conflicted clients will be made aware of the agreed measures in writing and will confirm they will comply with those measures.

Given that XPS does not offer fund management services the occurrence of conflicts of interest is relatively infrequent. A situation we sometimes encounter is where clients wish to receive advice on an appropriate governance model. For instance, the choice of utilising a traditional advisory or Fiduciary Management approach. XPS does not provide advice on governance arrangements where XPS may be a beneficiary or otherwise as a result of the outcome of that advice. Instead we refer clients to alternative providers of this service who are in a position of independence.

We have a policy on being fair to all clients. This is particularly relevant when communicating a 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. We did not have any fund events that required this protocol during 2020.

Our approach to manage 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.

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. Some of the ways by which we help our clients assess and mitigate risk, allocate capital and maintain transparency are detailed below:

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, underlying entity and sector, whilst also ensuring portfolios have enough liquidity to meet short-, medium- and long-term liabilities and cash requirements.

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. 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 established an internal climate change working group that is focussed on helping clients meet climate related regulatory requirements both from an investment and actuarial perspective. We are also an active member in the Investment Consultants Sustainability Working Group.

In-depth manager research: We have a highly structured and disciplined approach to manager research at XPS. 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

Avoiding speculative holdings: Given the long-term time horizon of our investors, we avoid tactical asset allocation as we believe market timing is notoriously difficult to get right and getting it wrong can have significant financial implications for our clients.

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. We supplement this with assessment of turnover and transaction costs as an integral part of our research, and during the reporting period have begun supplementing this with additional cost information in line with the Cost Transparency Initiative by working with an independent firm to supply this data.

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, such the RPI/CPI reform, Taskforce on Climate-Related Financial, and much more.

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 several consultations including acting on climate change and property fund liquidity.

Our overall approach to responding to the emergence of the pandemic was to reassure clients and not encourage knee-jerk or speculative behaviour, but instead focus on risk management and long-term objectives with full information. The importance of this approach played out in the subsequent rally in market, the benefit of which would not have been experienced were clients to have tried to time markets. This has created opportunity for clients to benefit from improvements in their funding level over 2020 as a whole. We believe our encouragement for our clients to focus on their long-term objectives rather than knee-jerk reactions as exemplified during the pandemic last year, is a good example of how we contribute to well-functioning financial markets.

Principle 5: Supporting client's stewardship

We provide investment advisory services to over 300 UK defined benefit pension schemes, of all different sizes. We also advise on 40 DC arrangements and schemes range from those with assets of £10m to those with assets in the multi-billions. Our overall client base during the period totals approximately £70bn.

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

Helping clients develop their approach

We understand that one size does not fit all when it comes to ESG and stewardship and work with our clients to ensure that our advice and solutions are tailored to their specific needs.

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.

One of the key features of our approach is our use of technology to help clients better understand the options and make decisions. It is vital for trustees to discuss and establish their desired approach to managing assets in respect of ESG and stewardship matters.

During 2020 we issued three papers specifically on ESG matters: (i) Sustainable investment: harnessing the power of pensions, (ii) ESG Integration: How Fiduciary Managers stack up and (iii) A new decade, a new Stewardship Code, alongside our 12 monthly updates with corresponding videos. We issued many others on other topics.

In November we held a webinar event focused on sustainable investing where we illustrated how returns go hand in hand with good stewardship. At this event we launched 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 were able to offer this service at no charge to both clients and non-clients.

This provides a powerful tool for aiding a productive discussion and unearthing views from the whole trustee board. We will be publishing the collective results of this exercise during the second quarter of 2021. This has been well received by clients and by establishing ESG beliefs in this way clients are able to develop bespoke ESG and stewardship policies.

We have developed a comprehensive Responsible Investment policy document to capture the detail of a Trustee board's chosen approach.

Research approach

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 assess investment managers using detailed ESG questionnaires that comprise of around 70 targeted questions covering 5 key ESG aspects, alongside face-to-face meetings as required. The 5 key aspects include:

- **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 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.

The ESG rating is integral to our overall view of a fund 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, in January 2020 we supplemented this with our first comprehensive review of our clients existing holdings. This is has become an annual activity where we will continue to provide assessment of suitability along with assessment of improvement relative to prior years.

In 2020, we assessed 64 managers on 129 individual funds that our clients held. Our findings were that the industry still had a long way to go.

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

	Rating explanation	Equity	Credit	Real assets	LDI	Multi asset
Green	Manager has a credible ESG capability implemented consistently within the investment process on this fund	1	5	1	2	4
Amber	Manager has credible ESG capability but extent to which it is applied in decision making varies	21	41	14	7	26
Red	Manager has either no credible capability or does not factor ESG into decision making on this fund	1	0	3	0	3
	TOTAL	**23**	**46**	**18**	**9**	**33**

Raising industry standards: We provide detailed feedback to all investment managers we have assessed on ESG, identifying specific areas where they have not scored well so as to drive improvements in their processes and practices. Improvements (or the lack of) are captured in our annual review and, where relevant, in between the annual assessment cycle.

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. This feeds into our annual review schedule to monitoring for evidence of the required improvements coming through.

Carbon footprint monitoring: During the reporting period we developed a carbon-related monitoring dashboard format which we introduced to clients in November 2020. Subsequent to the end of the reporting period we have begun the process of incorporating this into client reporting where clients have requested it. We note considerable limitations in the availability of suitable data from the fund management industry at this point in time, with only a small proportion of funds having the necessary information readily available. This is an area where we continue to have a dialogue with the fund managers to seek improvement and expect the soon-to-be implemented Taskforce for Climate Related Financial Disclosures requirements to aid this progress significantly. We believe is it likely to be 2022 and onwards that such reporting becomes more commonplace but is still an area we are actively engaging with our clients on.

XPS Sustainable designation

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
- High degree of ESG integration into decision making reflected in an XPS Green rating for ESG
- Strong active ownership
- UNPRI fund score of at least A+
- Exclusions of UN recognised unacceptable practices

We conducted our first whole of market search for a sustainable strategy, starting with passive equities in 2020. As a result of this research we identified 3 different sustainable passive equity funds that meet all of our sustainable requirements and will recommend to our clients.

We have plans to broaden our coverage through similar sustainably focused searches for a number of other asset classes during 2021.

Client feedback

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 review 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 focussed on minimum compliance whilst others 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" approaches to engaging with our clients. That said the majority of responses to our online questionnaire have indicated a considerable desire from trustees to do more to contribute to an improvement in wider ESG issues in society through their investment decisions.

We also undertake a periodic Client Satisfaction Survey, covering aspects such as timeliness, competence, clarity of communication, helpfulness and pro-activity. Further we collate feedback via the Greenwich Associates survey.

Data from these surveys is assessed by the most senior members of the team. At a broader level, we assess trends in client satisfaction with the various aspects of our service and ensure all feedback, whether good or bad, is acted on appropriately.

In addition, our clients are required by the Competition Market Authority to set us investment adviser objectives against which we will be assessed against on an annual basis. We actively encourage clients to assess us, which includes an evaluation on ESG and stewardship and how we have helped our clients achieve their wider objectives.

Communication

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.

Due to COVID-19, as a firm, we felt it was more important than ever to communicate effectively with clients and contacts. Within one week we switched face-to-face events to virtual events. XPS Pensions Group hosted 13 live webcasts across a range of topics with over 3,700 registrations in nine months, representing 1,100 schemes. We also published 17 videos, including monthly quarterly updates on global markets.

Parts of our approach feed through directly to our clients' investment strategies, for instance our minimum ESG criteria for recommendations. Other aspects require greater client understanding and adoption. The culmination of our approach is increasing engagement with our clients on ESG matters through time. We recognise that there is a still a long way to go and we are committed to progressing both our own learning and understanding and bringing our clients with us.

Principle 6: Review and assurance

Our research function is overseen by our CIO and Investment Committee, which comprises the most senior members of our investment practice. Given the rapid and continual development of the industry, in particular in relation to regulation and data availability as well as fund manager product offerings, our ESG processes have not yet settled into a business-as-usual program. During the reporting period we undertook a number of significant exercises to review and improve our policies and activities in pursuit of supporting clients' effective stewardship. This has included a full range of development activity in relation to online tools, frameworks, policy templates, client training, dashboards and investment in training our consultants.

We became signatories of the UN PRI during the reporting period and will be reporting in line with its requirements on an annual basis. This will provide an objective assessment of our processes and regular milestone for our review as part of our continuous 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.

Fund Manager Feedback

In June 2020 we sought 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 applied to each research area, including ESG. We show a summary of the feedback in relation to our overall research and ESG below.

Assessment of XPS's overall approach to research	Average manager feedback score (0-10)	Number of respondents
Quality of research capability	8.3	39
Technical understanding	8.3	40
Professionalism	8.9	44
Clarity of communication	8.2	43

Assessment of XPS's approach to ESG research	Average manager feedback score (0-10)	Number of respondents
Quality of research capability	8.4	28
Technical understanding	8.2	29
Professionalism in relation	8.9	29
Clarity of communication	8.2	28

Additional detailed comments were provided by 28 respondents for ESG. All feedback was reviewed by our CIO who collated a short list of actions in response. Fund managers appreciated our direct approach to feedback, our professionalism and our early adoption of key ESG concepts but noted some areas that could be improved in terms of more frequent than annual updates on our research activity, more granular feedback and clearer messaging around what we think good ESG risk management looks like. We responded to this at our investment manager conference webinar in July 2020, committing to respond in a number of ways including with additional and more frequent communications on our research priorities to the market through a quarterly CIO update email.

We review our methodology in relation to ESG scoring for client funds at least annually and this year took steps to make the questions shorter and more straight forward for managers to complete.

It is on the basis of the variety of feedback and review mechanisms including peer group comparison, fund management industry feedback and assessment in context of the associations we are affiliated to, that we believe our approach is fair, balanced and understandable. However we seek to continue to enhance the approach we take.

If you would like to find out more, please contact Alex Quant:

Alex Quant
Head of ESG research

t 020 8059 7652
e alex.quant@xpsgroup.com
@xpsgroup
company/xpsgroup

Alternatively, please speak to your usual XPS Investment contact.

Award winning