

# **ELECTRICITY SUPPLY PENSION SCHEME**

## **Electricity Pensions Trustee Limited Statement of Investment Principles as at 18 September 2020**

### **Introduction**

Electricity Pensions Trustee Limited (“EPTL”, “the Scheme Trustee”) is the Scheme Trustee of the Electricity Supply Pension Scheme (“ESPS”). The Scheme Trustee has prepared this Statement of Investment Principles (“SIP”) for the Unitised Fund UK Forestry Sector, which is the investment that EPTL has direct responsibility for in relation to operation, investment management and strategy. This SIP is effective from 18 September 2020 and has been prepared in accordance with applicable legislation.

### **Reviews and Revisions**

The Scheme Trustee previously revised this SIP in June 2019 following a triennial review and to incorporate environmental, social and governance (“ESG”) considerations (“2019 reforms”). Before revising the SIP, the Scheme Trustee obtained and considered advice from its Investment Adviser, Aon UK Solutions Limited (“Aon”).

The Scheme Trustee reviews this SIP at least every three years and after any significant change in investment policy.

This SIP is produced to meet the requirements of the Pensions Act 1995 & 2004, the Occupational Pension Schemes (Investment) Regulations 2005 and to reflect the Government’s voluntary code of conduct for Institutional Investment in the UK. The Scheme Trustee also complies with the requirements to maintain and take advice on the Statement and with the disclosure requirements.

### **Investment Objective**

The Scheme Trustee undertakes investment activities in accordance with the Trust Deed and Rules of the Scheme and applicable law.

The Investment Objective of the Scheme Trustee is to provide Sectors in the Unitised Fund which assist Group Trustees to implement their investment policy for the defined benefit (DB) assets of the Scheme in a prudent manner. The Scheme has separate actuarially independent sections known as Groups with each Group having its own Group Trustees who are responsible for the administration of their Group.

Group Trustees normally invest most of their Group’s Assets in Group specific investments managed by investments managers appointed by the Group Trustees. The Unitised Fund acts as an adjunct to Group specific investments and does not provide a full range of Sectors capable of meeting a normal investment strategy

EPTL’s Investment Objective is implemented using the investment options set out in the table on the following page.

Sector	Investment Description	Investment Characteristics
UK Forestry	Forests for timber generation including use of land for windfarms and sport.	Long term illiquid investment with returns linked to timber prices. Returns expected to be more stable than equities or bonds but this has not been the recent experience.

In setting the strategic objective for the Unitised Fund and in considering future changes to the strategy, it is EPTL's policy to consider the following:

- The asset classes, including alternative asset classes such as forestry, which can conveniently be provided within the Unitised Fund;
- The risks and rewards of such asset classes;
- The suitability of the possible styles of investment management;
- Appropriate diversification of investments within asset classes;
- The likely suitability of asset classes for Group Trustees' investment requirements.

EPTL's policy is to review the investment strategy periodically having regard to the views expressed by Group Trustees.

EPTL expects the long-term return of the UK Forestry Sector to exceed price inflation and general salary growth.

### **Implementation of Strategy**

EPTL has appointed Bidwells, LLP as the investment manager for the UK Forestry Sector. The Scheme Trustee is satisfied that its Forestry Manager has the appropriate knowledge and experience for managing the assets in the Forestry Sector in accordance with regulatory requirements and the principles contained in this SIP.

### **Arrangements with the Scheme Trustee's Forestry Manager and Delegations**

The Scheme Trustee has in place a contractual agreement with the Forestry Manager which governs key aspects on the contractual relationship including how the Forestry Manager is remunerated, how performance is monitored and ESG considerations.

The Scheme Trustee's policy is to delegate all day-to-day decisions about operational matters concerning the investments within the Sector to the Forestry Manager. These duties include where applicable:

- Realisations of investments as appropriate to ensure sufficient liquidity and that the necessary cashflow is available.
- Undertaking routine maintenance, repairs of the assets and daily operational activities.
- Taking ESG considerations as well as climate change risk and stewardship into account when assessing the financial potential and suitability of investments.
- Voting and corporate governance in relation to the financial potential of the Scheme's assets (see next section).

The Scheme Trustee expects that any appointed investment manager(s) of the underlying assets in a Unitised Fund Sector to carry out the powers of investment delegated to them with a view to giving effect to the principles in this statement. The Scheme Trustee is supported in this monitoring activity by their investment adviser.

## **Monitoring Performance and Remuneration**

The UK Forestry Sector does not have a performance benchmark due to the lack of suitable options. The IPD Forestry Index is used for guidance only, had been discussed by the Scheme Trustee having recognised the limitations of the benchmark construction and the index has now been discontinued. The Scheme Trustee uses price inflation and general salary growth as performance comparators allowing consideration of the quantitative performance of the investment manager and EPTL's expectations of the Forestry Manager. The Forestry Manager's performance is tracked quarterly, annually and on a triennial basis. The Scheme Trustee and/or its advisers meet with the Forestry Manager at regular intervals in order to discuss relevant issues including the investment strategy, performance, and longer-term positioning of the portfolio.

The Scheme Trustee also receives quarterly reports and annual stewardship reports on the monitoring and engagement activities carried out by the Forestry Manager, which support EPTL in determining the extent to which the Scheme's engagement policy has been followed throughout the year.

The Scheme Trustee shares the policies, as set out in this SIP, with the Scheme's Forestry Manager, and requests that the Manager reviews and confirms whether their approach is in alignment with the Scheme Trustee's policies.

The Forestry Manager's remuneration is on a direct fee basis where the fee is on a fixed percentage and dependent on the capital value of the assets under management. Capital value is determined by an independent valuer appointed by and acting on behalf of the Scheme Trustee. Fees are also charged in standing timber sales value and for any acquisition or sale of forestry property. In addition, the Forestry Manager may pay commissions to third parties on some of the trades that they undertake in the course of managing the forestry assets. The Scheme Trustee monitors the costs incurred through the investment of the Unitised Fund.

The Scheme Trustee accepts that, in general, transaction costs will be incurred to drive investment returns and that the level of these costs varies across asset classes and by manager style within an asset class. Where EPTL's monitoring identifies a lack of consistency, the mandate will be investigated and reviewed.

All transactions require approval by the Scheme Trustee, and in addition, if the Forestry Manager wishes to invest in asset classes not permitted in the Forestry Management Agreement, written authorisation from EPTL is required in advance of any such investment.

Targeted portfolio turnover and turnover range are not defined or measured due to the illiquid nature of forestry investments and the infrequent opportunity to transact.

There is no set duration for the existing arrangement with the Forestry Manager, although the continued appointment is reviewed periodically, and at least every three years, taking into account the views of the relevant Group Trustees.

The Scheme Trustee is of the opinion that that having appropriate governing documentation, setting clear expectations to the Forestry Manager, and regular monitoring of performance and in line with the Scheme Trustee's investment strategy is sufficient to incentivise the Forestry Manager to take decisions that align with EPTL's policies and which are based on appropriate assessments of medium and long term financial and non-financial performance.

Title documents for forestry assets are held by the Land Registry or by the Scheme Trustee's solicitors. Cash is held with the Scheme's Custodian, The Bank of New York Mellon, and in client accounts with RBS.

## **Environmental, Social and Governance considerations**

In providing a UK Forestry Sector for Group Trustees, the Scheme Trustee's primary concern is to act in the best financial interests of the Scheme and its beneficiaries, seeking the best return that is consistent with a prudent and appropriate level of risk. This includes the risk that environmental, social and governance ("ESG") factors including climate change negatively impact the value of investments held are not understood and are not evaluated appropriately. The Scheme Trustee considers this risk by taking advice from its Investment Adviser when considering investment matters and when monitoring Sector performance.

The Scheme Trustee also takes into account that all forests are managed to meet the United Kingdom Forestry Standard ("UKFS") which is the Government standard for managing forests to meet present and future needs. UKFS compliance is assured not only by the fact that all forests are managed to plans approved by the relevant Forestry Authority (Scottish Forestry in Scotland, Forestry Commission England in England), but also are independently audited to comply with the UK Woodland Assurance Scheme, which ensures forests are managed sustainably and timber harvested can be sold as being sustainably produced. As part of agreeing forest management plans and ensuring UKFS and UKWAS compliance all Forest Plans are subject to long standing and public consultation procedures.

## **Stewardship – Voting and Engagement**

As part of their delegated responsibilities, the Trustee expects the Scheme's investment manager(s) to, where appropriate, engage with investee companies with the aim to protect and enhance the value of assets; and to exercise the Trustee's voting rights in relation to the Scheme's assets.

The Scheme Trustee recognises the importance of their role as a steward of capital and the need to ensure the highest standards of governance as this ultimately this creates long-term financial value for the Forestry Sector and the Scheme's beneficiaries.

The Scheme Trustee periodically reviews the suitability of the Forestry Manager and takes advice from its Investment Adviser on this matter as engagement focuses on the long term appreciation of the portfolio. The advice includes consideration of broader stewardship matters, engagement and the exercise of voting rights by the Forestry Manager, which is not currently permitted. If an incumbent manager is found to be falling short of the standards the Scheme Trustee has set out in their policy that the Scheme Trustee will engage with the manager and seek a more sustainable position with a view to replace the manager.

The Trustee reviews the stewardship activities of the Forestry Manager on an at least an annual basis covering both engagement and voting rights, where applicable. The Scheme Trustee will review the alignment of their policies to those of the Scheme’s investment manager(s) and ensure their manager, or other third parties, use their influence as major institutional investors to carry out the Trustee rights and duties as a responsible shareholder and asset owner.

The Scheme Trustee will engage with the Forestry Manager as necessary to obtain sufficient information to ensure that robust active ownership behaviours, reflective of the Scheme Trustee’s active ownership policies, are being actioned. It is the expectation of the Scheme Trustee that the Scheme’s Forestry Manager will prioritise and actively monitor for these risks within the investment, providing transparency on engagement and voting (if applicable) with respect to mitigating these risks as appropriate. The transparency for voting, where applicable, should include voting actions and rationale with relevance to the Scheme.

The Scheme Trustee is responsible for the investment arrangements of the Unitised Fund assets. The Scheme Trustee takes some decisions itself and delegates others to suitable parties. When deciding which decisions to take itself and which to delegate, the Scheme Trustee has taken into account whether it has the appropriate knowledge and expert advice in order to make an informed decision. Having considered advice from its investment adviser, the Scheme Trustee has established the following decision-making structure:

EPTL	<ul style="list-style-type: none"> <li>• Set structures and processes for carrying out its role</li> <li>• Select investment structures and their implementation</li> <li>• Select and monitor direct investments (see below)</li> <li>• Select and monitor investment advisers and fund managers</li> <li>• Make decisions relevant to the operational principles of the Unitised Fund and its investment strategy</li> </ul>
Investment adviser	<ul style="list-style-type: none"> <li>• Advise on all aspects of the investment of the Unitised Fund including implementation of strategy</li> <li>• Advise on this statement</li> <li>• Provide required training</li> </ul>
Investment Manager	<ul style="list-style-type: none"> <li>• Operate within the terms of this statement and the written contracts in place</li> <li>• Select individual investments with regard to their suitability and diversification</li> <li>• Comment to EPTL on suitability of their benchmark</li> </ul>

## Members' Views and Non-Financial Factors

In providing a Unitised Fund Sector for use by Group Trustees, the Scheme Trustee does not explicitly take into account the views of Scheme members and beneficiaries in relation to ESG considerations, and social and environmental impact, or present and future quality of life matters (defined as "non-financial factors"<sup>1</sup>).

The Scheme Trustee recognises that Group Trustees are responsible for their own Group ESG policies for their individual Group Assets. However, EPTL expect Group Trustees to ensure they have considered the following as a minimum.

- How they take account of 'financially material risks', including (but not limited to) ESG factors such as climate change.
- Policies in relation to stewardship of investments.
- How they take account of non-financial matters.

The Scheme Trustee is taking the following steps to monitor and assess ESG related risks and opportunities:

- The Scheme Trustee will have periodic training on Responsible Investment to understand how ESG factors, including climate change, could impact the Scheme's assets and liabilities.
- Regarding the risk that ESG factors including climate change negatively impact the value of investments held if not understood and evaluated properly; the Scheme Trustee considers these risks by taking advice from its Investment Adviser when selecting managers and when monitoring their performance.

## Risk Measurement and Management

The Scheme Trustee has identified a number of risks within its control. These are as follows:

- The failure by the Forestry Manager to achieve the expected levels of return. The Scheme Trustee closely monitors manager performance to control this risk.
- The failure to spread investment risk appropriately within the Sector (i.e. insufficient diversification). Although there is limited scope to diversify the assets within the UK Forestry Sector, EPTL has controls in place to assess other related risks such regional risks and forest age classes.
- The risk of fraud, poor advice or acts of negligence ("operational risk"). EPTL seeks to minimise these risks by ensuring that all advisers and third-party service providers are suitably qualified and experienced and that appropriate liability clauses are included in contracts for services.
- Credit Risk is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation. The forestry assets are not debt instruments and hence there is no direct credit risk that one party will cause a financial loss for the other party.

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<sup>1</sup> The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018

- Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. All of the Forestry Sector's investments are denominated in Sterling and therefore there is no direct currency risk.
- Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The forestry assets are not valued by using discounted cash flow models, and nor do they make use of financial instruments, therefore there is no interest rate risk.
- All investments are subject to idiosyncratic price risks that arise from factors peculiar to that asset class or individual investment in addition to credit risk, currency risk and interest rate risk. The Forestry Sector is exposed to idiosyncratic forestry risks. It is reasonably well diversified geographically (albeit all within Scotland and the North of England). It is also diversified by timber type and by the inclusion of wind farms within the portfolio.

These risks are assessed by EPTL in a qualitative manner. In addition, EPTL receives quarterly reports from its Investment Adviser on performance of the investment managers against the benchmarks comparators, any significant issues which may impact an investment manager's ability to perform to target, and on any high levels of concentration. Additionally, the Forestry Manager provides quarterly and annual reports detailing performance, forestry and windfarm activity, market commentary as well as investment strategy and recommendations. Every three years a UK Forestry Sector Forecast Report is produced by the Forestry Manager to provide a long-term investment appraisal and projection update.

### **Investment Advisor**

Aon has been selected as investment adviser to EPTL. The adviser has the knowledge and experience required under the Pensions Act 1995. Aon has a mandate to provide EPTL with a full service designed to ensure that EPTL is briefed on the decisions it needs to take itself and those it needs to delegate. Aon is paid on a fixed fee basis for work which can be anticipated and on a time cost basis for projects or additional work.

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