



# Merchant Investors Staff Pension Scheme Implementation Report

February 2021

**isio.**

# Background and Implementation Statement

## Background

The Department for Work and Pensions ("DWP") is increasing regulation to improve disclosure of financially material risks. This regulatory change recognises Environmental, Social and Governance ("ESG") factors as financially material and schemes need to consider how these factors are managed as part of their fiduciary duty. The regulatory changes require schemes to detail their policies in their Statement of Investment Principles ("SIP") and demonstrate adherence to these policies in an implementation report.

## Statement of Investment Principles

The Scheme has updated its SIP in response to the DWP regulation to cover:

- policies for managing financially material considerations including ESG factors and climate change
- policies on the stewardship of the investments
- policies in relation to the investment management arrangements for the Scheme

The SIP can be found online at the following web address:

<https://www.sanlam.co.uk/getmedia/3418b673-b19a-4d10-9dbf-7c96c5f2088b/Merchant-Investors-Staff-Pension-Scheme-Statement-of-Investment-Principles-01-10-2019.pdf>.

Changes that have been made to the SIP over the accounting year are detailed on the following pages.

## Implementation Report

This Implementation Report is to provide evidence that the Scheme continues to follow and act on the principles outlined in the SIP. This report details:

- actions the Trustee has taken to manage financially material risks and implement the key policies in its SIP
- the current policy and approach with regards to ESG and the actions taken with managers on managing ESG risks
- the extent to which the Trustee has followed policies on engagement, covering engagement actions with its fund managers and in turn the engagement activity of the fund managers with the companies they invest

## **Summary of key actions undertaken over the Scheme reporting year**

- In September 2019 the Trustee implemented a new Cashflow Driven Investment ("CDI") strategy which has a strategic allocation of 80% Buy and Maintain Corporate Bonds and 20% Liability Driven Investment ("LDI"), although the allocation may change with market conditions. The strategy is invested in solely contractual assets that reflect the cashflow profile of the Scheme's liabilities. There is ongoing work to align the Scheme's liability discount rate with the investment strategy, which is due to be completed in 2021.
- In October 2019 the Trustee updated the Scheme's SIP to reflect the new investment strategy, the Trustee's policies towards financially material considerations including ESG and the Trustee's policies in relation to investment management arrangements. Further details on these updates can be found in this report.
- The Trustees invited Legal and General ("LGIM") to the November 2019 Trustee meeting to discuss the new investment strategy and understand how ESG factors are built into LGIM's investment processes. LGIM provided further information after the meeting on how ESG was considered in LDI.

## **Implementation Statement**

This report demonstrates that the Trustee of the Merchant Investors Staff Pension Scheme has adhered to its investment principles and its policies for managing financially material considerations including ESG factors and climate change.

**Signed**

**Position**

**Date**

# Managing risks and policy actions DB

Risk / Policy	Definition	Policy	Actions
<b>Interest rates and inflation</b>	The risk of mismatch between the value of the Scheme assets and present value of liabilities from changes in interest rates and inflation expectations.	To broadly hedge 100% of the Scheme's interest rate and inflation risk (using a combination of pooled LDI and Buy and Maintain Funds) as measured on a Self-Sufficiency type basis.	In September 2019 the Trustee implemented a new Cashflow Driven Investment ("CDI") strategy which has a strategic allocation of 80% Buy and Maintain Corporate Bonds and 20% Liability Driven Investment ("LDI"). The LDI mandate has been structured to match the Scheme's sensitivity to inflation and the LDI and Buy and Maintain mandates combined match the Scheme's sensitivity to interest rates.  These changes to the asset allocation were reflected in the SIP and IID which were updated in October 2019.
<b>Liquidity</b>	Difficulties in raising sufficient cash when required without adversely impacting the fair market value of the investment.	To maintain a sufficient allocation to liquid assets so that there is a prudent buffer to pay members benefits as they fall due (including transfer values) and provide collateral to the LDI mandate.	The Scheme's investment strategy is designed to regularly distribute capital from the Buy and Maintain mandate which can be used to meet members' benefit cashflows.  The Scheme's assets are sufficiently liquid to be disinvested at short notice, if required.  An automatic instruction has been set up to meet LDI capital calls as and when required.
<b>Market</b>	Experiencing losses due to factors that affect the overall performance of the financial markets.	To remain appropriately diversified and hedge away unrewarded risks, where affordable and practicable.	As part of the implementation of the new CDI strategy in September 2019, the Trustee reduced the Scheme's investment risk by completely disinvesting from equity funds and increasing the

		<p>level of interest rate and inflation hedging</p> <p>The Trustee also agreed to align the Scheme's liability discount rate with its investment strategy. This will further reduce funding level volatility and is expected to be reflected in the July 2020 actuarial valuation which will be finalised in 2021.</p> <p><b>The changes to the asset allocation were reflected in the SIP and IID which were updated in October 2019.</b></p>
Credit	<p>Default on payments due as part of a financial security contract.</p>	<p>To diversify this risk by investing in a range of credit markets across different geographies and sectors.</p> <p>To appoint investment managers who actively manage this risk by seeking to invest only in debt securities where the yield available sufficiently compensates the Scheme for the risk of default.</p>
Environmental, Social and Governance	<p>Exposure to Environmental, Social and Governance factors, including but not limited to climate change, which can impact the performance of the Scheme's investments.</p>	<p>To appoint managers who satisfy the following criteria, unless there is a good reason why the manager does not satisfy each criterion:</p> <ol style="list-style-type: none"> <li>1. Responsible Investment ('RI') Policy / Framework</li> <li>2. Implemented via Investment Process</li> <li>3. A track record of using engagement and any voting rights to manage ESG factors</li> <li>4. ESG specific reporting</li> </ol> <p>ESG actions undertaken:</p> <ul style="list-style-type: none"> <li>• This updated ESG policy was reviewed by the Trustee as part of the SIP and IID update in October 2019</li> </ul> <p>The Trustee received an ESG update from LGIM at the November 2019 Trustee meeting and are due to receive annual updates moving forward.</p> <p>The Trustee has agreed to undertake a review of LGIM from an ESG perspective and the results will be</p>

		<p>5. UN PRI Signatory</p> <p>The Trustee monitors the managers on an ongoing basis.</p>	presented to the Trustee in Q1 2021.
<b>Currency</b>	<p>The potential for adverse currency movements to have an impact on the Scheme's investments.</p>	<p>To broadly hedge all currency risk on assets that deliver a return.</p>	The Trustee invests in solely GBP share classes.

# Changes to the SIP

The Scheme's SIP was updated in October 2019 and the main updates were:

- Details of the Trustee's investment manager monitoring and engagement policies, which are outlined on page 8 of this document.
- Policies in relation to risk and financially material considerations, which are detailed on page 4 of this document.
- Policies in relation to the Scheme's investment management arrangements, which are outlined in the table below.

## Policies in relation to the Scheme's investment management arrangements

Date updated: October 2019

### How the investment managers are incentivised to align their investment strategy and decisions with the Trustee's policies.

- As the Scheme is invested in pooled funds, there is not scope for these funds to tailor their strategy and decisions in line with the Trustee's policies. However, the Trustee invests in a portfolio of pooled funds that are aligned to the strategic objective.

### How the investment managers are incentivised to make decisions based on assessments of medium to long-term financial and non-financial performance of an issuer of debt or equity and to engage with them to improve performance in the medium to long-term.

- The Trustee reviews the investment managers' performance relative to medium and long-term objectives.
- The Trustee monitors the investment managers' engagement and voting activity on a periodic basis as part of their ESG monitoring process.

### How the method (and time horizon) of the evaluation of investment managers' performance and the remuneration for their services are in line with the Trustee's policies.

- The Trustee reviews the performance of all of the Scheme's investments on a net of cost basis to ensure a true measurement of performance versus investment objectives.

### The method for monitoring portfolio turnover costs incurred by investment managers and how they define and monitor targeted portfolio turnover or turnover range.

- The Trustee does not directly monitor turnover costs. However, the investment managers are incentivised to minimise costs as they are measured on a net of cost basis.

### The duration of the Scheme's arrangements with the investment managers

- For open-ended funds, the duration is flexible and the Trustee will from time-to-time consider the appropriateness of these investments and whether they should continue to be held.

# Implementing the current ESG policy and approach

## ESG as a financially material risk

The SIP describes the Scheme's policy with regards to ESG as a financially material risk. This page details how the Scheme's ESG policy is implemented and the Trustee has agreed to conduct an impact assessment in Q1 2021 which will formally review LGIM from an ESG perspective.

The below table outlines the areas which the Scheme's investment managers are assessed on when evaluating their ESG policies and engagements. The Trustee intends to review the Scheme's ESG policies and engagements periodically to ensure they remain fit for purpose.

### Implementing the Current ESG Policy

Areas for engagement	Method for monitoring and engagement	Circumstances for additional monitoring and engagement
Environmental, Social, Corporate Governance factors and the exercising of rights and engagement activity	<ul style="list-style-type: none"><li>Through the manager selection process ESG considerations will form part of the evaluation criteria</li><li>The Scheme's investment advisor Isio will monitor managers' ESG policies on an ongoing basis</li><li>When attending Trustee meetings, investment managers will be asked to present to the Trustee on actions they have taken in respect of ESG factors and their exercise of rights and engagement activity;</li><li>The Trustee is provided with a report detailing the managers' ESG policies as well as a summary of actions Isio has engaged with managers on to ensure the scheme is not exposed to risks relating to Environmental, Social or Governance factors.</li></ul>	<ul style="list-style-type: none"><li>The manager has not acted in accordance with their policies and frameworks.</li></ul>

# ESG summary and engagement with the investment managers

## Legal and General Investment Management ("LGIM")

The Trustee invited LGIM to the Trustee meeting in November 2019, where LGIM's approach to ESG was discussed, including how they engage with investee companies in the Buy and Maintain portfolio.

The Trustee requested further information on engagement in the LDI portfolio and LGIM provided this in December 2019.

Isio are due to complete an impact assessment for the Trustee in Q1 2021. This report will outline Isio's view on LGIM's approach to ESG in the Buy and Maintain and LDI portfolios. The results will then be used by Isio to engage with LGIM on the Trustee's behalf.

# Engagement

The table below outlines LGIM's approach to engagement in Buy and Maintain and LDI funds:

Fund name	Engagement summary	Commentary
<b>LGIM Buy and Maintain</b>	LGIM currently do not provide details of their engagement activities at a Fund level, however, this is something they are looking to implement by Q2 2021, and Isio remains in contact with LGIM surrounding the firm's engagement reporting.	LGIM's Investment Stewardship team are responsible for engagement activities across all funds. LGIM share their finalised ESG scorecards with portfolio companies and the metrics on which they are based.
<b>LGIM LDI Funds</b>	LGIM have engaged with a number of industry participants on long term strategic issues in relation to LDI, including: <ul style="list-style-type: none"><li>- The introduction of central clearing</li><li>- The LIBOR transition</li><li>- Recognising the pricing issues with bilateral RPI swaps</li></ul>	As mentioned above, LGIM leverage the wider capabilities of the global firm to engage with companies. The team also regularly engage with regulators, governments and other industry participants to address long term structural issues, aiming to stay ahead of regulatory changes and adopt best practice.

