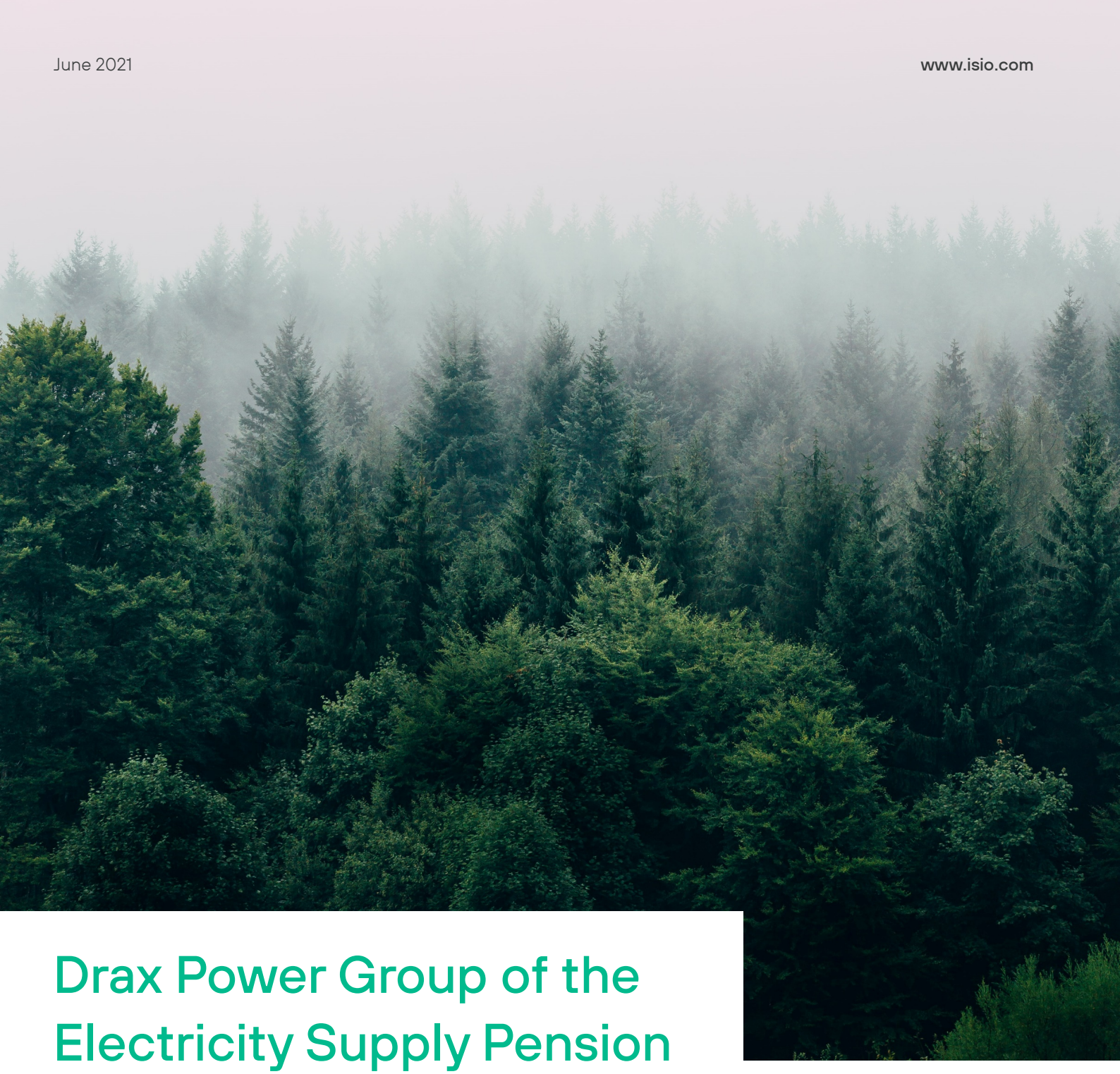

Drax Power Group of the Electricity Supply Pension Scheme

Implementation Statement

June 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 pension schemes need to consider how these factors are managed as part of their fiduciary duty. The regulatory changes require that schemes detail their policies in their statement of investment principles (SIP) and demonstrate adherence to these policies in an implementation report.

Statement of Investment Principles (SIP)

The Group updated its SIP in to 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.

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

https://www.drax.com/wp-content/uploads/2020/09/001-Drax-SIP-Sep-2020-web-version.pdf

Changes to the SIP are detailed on page 6.

Implementation Report

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

- Actions the Group 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 Group 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 in the investment mandate.
- Voting behaviour covering the reporting year up to 31 March 2021 for and on behalf of the Group including the most significant votes cast by the Group or on its behalf.

Summary of key actions undertaken over the Group reporting year

- There were no major strategic changes over the 12 months to 31 March 2021. During the year, there were a number of actions to rebalance the Group's assets towards their strategic benchmark weights and increase the expected return of the portfolio. During Q1 2021 £20.7m was disinvested from the Group's LDI holdings and used to top up the Cardano mandate.
- The Group's absolute return bond holdings are primarily used to meet ongoing cashflow requirements. During the year, these holdings were topped up to their 3% target allocation in order to ensure sufficient liquidity in the portfolio.

Implementation Statement

This report demonstrates that Drax Power Group of the Electricity Supply Pension Scheme has adhered to its investment principles and its policies for managing financially material consideration including ESG factors and climate change.

Managing risks and policy actions

Risk / Policy	Definition	Policy	Actions and details on changes to policy
Interest rates and inflation	The risk of mismatch between the value of the Group assets and present value of liabilities from changes in interest rates and inflation expectations.	To hedge c.75% of these risks on a gilts +0% basis.	The Group's hedging arrangements are reviewed periodically to ensure they remain appropriate.
Liquidity	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 to provide collateral to the LDI manager.	The Group holds an allocation to the L&G Absolute Return Bond Fund in order to maintain sufficient liquidity to meet ongoing cashflow requirements. During the period, the Fund was topped up to its 3% target allocation.
Market	Experiencing losses due to factors that affect the overall performance of the financial markets.	To remain appropriately diversified and hedge away any unrewarded risks, where practicable.	No changes to policy during the period.
Credit	Default on payments due as part of a financial security contract.	To diversify this risk by investing in a range of credit markets across different geographies and sectors. To appoint investment managers who actively manage this risk by seeking to invest only in debt securities where the yield available sufficiently compensates the Group for the risk of default.	No changes to policy during the period.
Environmental, Social and Governance	Exposure to Environmental, Social and Governance factors, including but not limited to climate change, which can impact the performance of the Group's investments.	To appoint managers who account for ESG factors as a part of their investment process. The Group Trustees monitor the managers in this regard on an ongoing basis.	Further detail provided later in this report.

Currency	The potential for adverse currency movements to have an impact on the Group's investments.	Hedge the currency risk on direct lending assets as much as practically possible.	No changes to policy during the period.
Non-financial	Any factor that is not expected to have a financial impact on the Group's investments.	Non-financial matters are not taken into account in the selection, retention or realisation of investments.	No changes to policy during the period.

Changes to the SIP

Policies added to the SIP	
Date updated: 23 September 2020	
How the investment managers are incentivised to align their investment strategy and decisions with the Group Trustees' policies.	• The Group Trustees invest in pooled funds which are aligned to the strategic objective. It is recognised that due to the nature of pooled funds, there is not scope for these funds to be specifically tailored to the Group Trustees' policies. • The Group's mandate with Permira is subject to a performance related fee.
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 Group Trustees review the investment managers' performance relative to medium and long-term objectives as documented in the investment management agreements. These objectives being medium-long term in nature mean that the investment managers position their portfolios accordingly. • The Group Trustees monitor the investment managers' engagement and voting activity on an annual basis as part of the annual investment meeting. By doing this, it indirectly incentivises the investment managers to make decisions based on non-financial information.
How the method (and time horizon) of the evaluation of investment managers' performance and the remuneration for their services are in line with the Group Trustees' policies.	• The Group Trustees review the performance of the Group's investments on a net of cost basis to ensure a true measurement of performance versus investment objectives. • The Group Trustees evaluate performance over the time period stated in the investment managers' performance objective, which is typically 3 to 5 years. • Quarterly investment performance reports are produced documenting the performance of each of the Group's investment managers. • Investment manager fees are reviewed periodically to make sure that they remain competitive.

The method for monitoring portfolio turnover costs incurred by investment managers and how they define and monitor targeted portfolio turnover or turnover range.	• The investment managers are incentivised to minimise costs as they are measured on a net of cost basis. • The Group Trustees monitor portfolio turnover costs indirectly as part of its ongoing monitoring of the Group's assets and investment managers. • Where relevant, portfolio turnover costs are considered periodically, particularly for the Cardano mandate which is expected to be more active in its asset allocation and hence experience higher turnover over time. The mandate also represents a sizeable proportion of overall Group assets (37% target allocation) whereby excessive turnover can have a reasonable impact on the overall Group asset return.

The duration of the Group's arrangements with the investment managers	• The Group Trustees are aware of the duration of the Group's arrangements with each of its investment managers (e.g. as part of ongoing monitoring). Ultimately, however, the duration of each arrangement is determined by its suitability and contribution to meeting the Group's overall investment objectives.
	• It is also considered in the context of the type of fund the Group invests in.
	  ○ For open ended funds, the duration is flexible, and the Group Trustees will from time-to-time consider the appropriateness of these investments and whether they should continue to be held.
	  ○ For closed ended funds, or funds with a lock-in period, the Group Trustees ensure the timeframe of the investment or lock-in is in line with the Group Trustee's objectives and the Group's liquidity requirements.

Current ESG policy and approach

ESG as a financially material risk

The SIP describes the Group's policy regarding ESG as a financially material risk. The Group has agreed a more detailed ESG policy which describes how it monitors and engages with the investment managers regarding the ESG polices. This page details the Group's ESG policy.

Current 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	• The Group Trustees' investment managers provide annual reports on how they have engaged with issuers regarding social, environmental and corporate governance issues. • The Group Trustees receive information from their investment advisers on the investment managers' approaches to engagement.	• The manager has not acted in accordance with their policies and frameworks. • The manager's policies are not in line with the Group Trustees' policies in this area.

Areas of assessment

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

Risk Management	1. Integrating ESG factors, including climate change risk, represents an opportunity to increase the effectiveness of the overall risk management of the Group. 2. ESG factors can be financially material and managing these risks forms part of the fiduciary duty of the Group Trustees.
Approach / Framework	3. The Group Trustees should understand how asset managers make ESG decisions and will seek to understand how ESG is integrated by each asset manager. 4. ESG factors are relevant to investment decisions in all asset classes. 5. Managers investing in companies' debt, as well as equity, have a responsibility to engage with management on ESG factors.
Reporting & Monitoring	6. Ongoing monitoring and reporting of how asset managers manage ESG factors is important. 7. ESG factors are dynamic and continually evolving; therefore the Group Trustees will receive training as required to develop their knowledge. 8. The role of the Group's asset managers is prevalent in integrating ESG factors; the Group Trustees will, alongside the investment advisor, monitor ESG in relation to the asset managers' investment decisions.
Voting & Engagement	9. The Group Trustees will seek to understand each asset managers' approach to voting and engagement when reviewing the asset managers' approach. 10. Engaging is more effective in seeking to initiate change than disinvesting.
Collaboration	11. Asset managers should sign up and comply with common codes and practices such as the UNPRI & Stewardship code. If they do not sign up, they should have a valid reason why. 12. Asset managers should engage with other stakeholders and market participants to encourage best practice on various issues such as board structure, remuneration, sustainability, risk management and debtholder rights.

Engagement

Isio engaged with the Group's investment managers over the year on behalf of the Group Trustees to discuss their ESG policies and set actions and priorities. Full details of each manager's approach to ESG for each of the Group's underlying assets can be found in an Impact Assessment Report. The Trustees have not undertaken an Impact Assessment Report at this stage but are reviewing their approach to ESG factor monitoring at the annual investment meeting in Q4 2021, after which Impact Assessment Reports may form part of their ongoing monitoring.

As the Group invests in pooled vehicles accessed via fund managers the managers provided details on their engagement actions, including a summary of the engagements by category for the 12 month period to the end of March 2021.

Fund name	Engagement summary	Commentary
Cardano Solution Fund 12	Total direct engagements: 0	Given the fund of funds structure of the Group's mandate with Cardano, there were no direct engagements between Cardano and the underlying portfolio companies over the reporting period. Instead Cardano have provided engagement data for their external investment managers. Cardano engage with all investment managers regularly through their manager research team, operational due diligence team and as part of the delivery of Implementation Statements for their clients. Examples of significant engagements from the external investment managers include: **Crake –** In June 2020 Crake held a meeting with the senior management of Glencore to discuss the company's plans regarding their exposure to coal. The company commented that they had a positive outlook on coal and saw a steady demand for it in emerging markets. However, it was noted that coal production was capped and that no new capacity was planned, and that if at any point Glencore's coal exposure became an issue with their investor base they would consider further limiting their exposure. Recently the company provided further assurances that their exposure to coal will be declining over the future years as coal mines come to the end of their lives. **Amia Capital** – In June 2020 Amia Capital led the formation of the External Bondholder Committee in relation to their debt holdings in a Sub-Saharan sovereign. The Committee was comprised of fourteen international financial institutions, and formally published a response to a consent solicitation request in September 2020 which outlined the focus on achieving a restructuring outcome in line with the Principles

		for Stable Capital Flows and Fair Debt Restructuring. These Principles include governance aspects such as: transparency and timely flow of information, open dialogue, good faith actions, and fair treatment among creditor losses.
Permira Credit Solutions II	Total engagements: 3	Permira's position as lenders means that they often rely on the equity sponsor to report ESG-related concerns and lead ESG improvements. However, Pemira maintain ongoing contact with the management teams of their portfolio companies and are able to leverage their influence when applicable. Examples of significant engagements include: **Paperchase** – During the year Permira took ownership of the company, thereby increasing their engagement rights in comparison to their previous position as a lender. Management recognises that sustainability should form a key part of Paperchase's new strategy. Permira have also introduced external advisors to support the company on the development of its sustainability strategy. This is due to be developed further in H2 2021, and Permira plan to continue engaging with the company to discuss next steps. **David Brown** – Permira engaged with the company to discuss its ESG strategy. An internal team at the company is developing this strategy and approach, and an ESG committee has been formed which includes senior members of the team. The company is also planning to release an external ESG report by the end of 2021. Permira intend to continue engaging with the company as they develop and roll out the strategy.
Permira Credit Solutions IV	Total engagements: 0	Permira's position as lenders also limits their engagement power with respect to the PCS IV Fund. Although there were no formal engagements over the period, during 2020 and early 2021 Permira issued an ESG-related data request to 27 portfolio companies in the PCS IV Fund for the first time. Information relating to GHG emissions, diversity and ESG policy-related questions were included in this request. Going forward, Permira intend to issue an annual ESG request to all portfolio companies the PCS IV Fund.
L&G LDI Funds	Total engagements: 0	L&G were not able to provide the requested engagement data. However, this is something the manager is looking to implement going forwards, and Isio remains in contact with L&G surrounding the firm's engagement reporting. L&G's Investment Stewardship team manage the voting and engagement across all funds, leveraging all possible capital to maximise effectiveness. The team also regularly engages with regulators, governments and other industry participants to address long term structural issues, aiming to stay ahead of regulatory changes and adopt best practice.
L&G Active Corporate Bond All Stocks Index Fund		
L&G Long Lease Property Fund		
L&G Absolute Return Bond Fund		

Voting (for equity/multi asset funds only)

As the Group invests via fund managers the managers provided details on their voting actions including a summary of the activity covering the reporting year up to 31 March 2021. The managers also provided examples of any significant votes.

Fund name	Voting summary	Examples of significant votes
Cardano Solution Fund 12	Proposals voted: 0 As Cardano holds no direct equity investments, they do not have voting rights for the underlying portfolio companies. Instead, Cardano provided voting data and examples of significant votes cast for the external investment managers they deem as being 'high focus' in relation to ESG (meaning ESG factors could materially impact the risk and return profile of the underlying manager's strategy).	Examples of significant votes cast by the external investment managers include: **Crake** – Crake use third party services as part of their approach to voting, and use ISS Proxy Exchange to highlight proposed votes at the companies they are invested with in which have ESG implications. During the period, Crake voted against the approval of an underlying portfolio company's remuneration policy. Their view was that the incentive framework did not have enough performance conditions and was unnecessarily complex. Crake also believed that Executive Directors would be eligible to receive excessive payments including a lump sum in the event of a change of control. **Egerton** – Egerton voted in favour of a shareholder proposal for a climate assessment against the recommendation of management. Egerton's view was that a vote against management was justified on the grounds of ESG considerations. Egerton also noted that they may vote against companies that do not publicly disclose their carbon and other GHG emissions and do not have a credible plan for their reduction.

Full voting data for external managers Cardano have identified as 'high focus' is as follows:

Manager	Potential votes	Proportion of votes cast	Proportion of votes cast for	Proportion of votes cast against	Proportion of votes abstained
AQR	5,448	95%	93%	7%	-
CCAM	296	100%	100%	-	-
Crake	371	27%	94%	6%	-
Egerton Capital	500	64%	94%	-	6%
Invesco GTR	5,332	98%	93%	6%	1%
Sands Capital	381	94%	92%	5%	3%

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