Novartis UK Pension Scheme: Annual Engagement Policy Implementation Statement

Introduction

This statement sets out how, and the extent to which, the Engagement Policy in the Statement of Investment Principles ("SIP") produced by the Trustee has been followed during the year to 31 December 2022.

The statement has been produced in accordance with The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018 and the guidance published by the Pensions Regulator.

The statement does not include detailed reference to Additional Voluntary Contribution ("AVC") and Voluntary Purchase Account ("VPA") assets held by the Scheme as these form a small proportion of total Scheme assets.

Investment Objectives of the Scheme

The Trustee believes it is important to consider the policies in place in the context of the investment objectives it has set. The objectives included in the SIPs dated July 2020 and May 2022, which were in force over the year, are as follows:

"The primary objective of the Trustee is to ensure that members' benefits are payable as they fall due. From an investment perspective, this involves (given the agreed Schedule of Contributions) balancing a wish to generate investment returns to meet payments with a wish to limit the potential (downside) volatility of the returns (and the consequent impact on member benefit security). The view of what is and is not acceptable to the Trustee in investment terms ties in with funding and covenant considerations.

The Trustee recognise that the Scheme liabilities are long term (several decades) and hence the investment time horizon is potentially also very long term. They also recognise the potential for risk transfer opportunities e.g. through bulk annuities which could reduce the investment time horizon substantially for a proportion of the invested assets."

Policy on ESG, Stewardship and Climate Change

The Scheme's SIP includes the Trustee's policy on Environmental, Social and Governance ("ESG") factors, stewardship and climate change. This policy sets out the Trustee's beliefs on ESG and climate change and the processes followed by the Trustee in relation to voting rights and stewardship. A copy of the latest SIP can be found here: https://novartis.compendiatouch.co.uk

The Trustee have also adopted a Responsible Investment ("RI") Policy document, which sets out the Trustee's Responsible Investment beliefs and policies in more detail. A copy can be found here: https://novartis.compendiatouch.co.uk

The Trustee's policy in relation to ESG factors, stewardship and climate change over the course of the year, as set out in the SIP, is as follows:

"The Trustee believes that good stewardship and ESG issues may have a material impact on investment risk and return outcomes and will therefore be considered as part of the Scheme's investment process. The Trustee also recognises that long-term sustainability issues, particularly climate change, present risks and opportunities that require explicit consideration. When setting investment strategy, ESG factors, including climate change, will be considered alongside a number of other factors that can influence investment strategy.

The Trustee will ensure that an appropriate governance budget is available for developing and implementing ESG and Climate Change related governance policies. The Trustee will adhere to the annual reporting requirements under the Task Force on Climate-Related Financial Disclosures ("TCFD") regulations.

The Trustee's intention is to align the Scheme's investments with the targets set under the Paris Agreement (which aims to limit climate change to well below 2°C, preferably to 1.5°C, compared to pre-industrial levels) in relation to greenhouse gas emissions and carbon neutrality, to the extent that this is consistent with overall risk and return considerations (including for example, avoiding, a material detriment to return expectations through the existence of "green premia" or a concentration of risk that could result from an excessively narrow investment universe). Further detail on the Trustee's beliefs and policies in relation to ESG factors and Climate Change is set out in the Trustee's Responsible Investment Policy document.

Subject to this Policy the Trustee has given the appointed investment managers full discretion when evaluating ESG factors, including climate change considerations, and in exercising voting rights and stewardship obligations attached to the Scheme's investments, in accordance with their own corporate governance policies and taking account of current best practice, including the UK Corporate Governance Code and the UK Stewardship Code. Where investment is in multi-investor pooled funds, the Trustee will consider the guidelines of the relevant pooled fund when deciding to appoint or retain the manager. The Trustee expect its managers to take these factors into account as appropriate to the mandate in the selection, retention and realisation of investments. This covers a range of matters including the issuers' performance, strategy, capital structure, management of actual or potential conflicts of interest, risks, environmental and social impact and corporate governance.

The Trustee will review periodically the responsible investment policies and practices of the appointed investment managers, with the assistance of their advisers. The Trustee will, where it is deemed appropriate, engage the managers in discussion on their responsible investment policies and may request the managers consider collective engagement further. It will however be made clear to the managers that any decisions taken by the managers should be in the best long term financial interest of the Scheme and its members.

The Trustee considers the ESG credentials of investment managers in the selection and ongoing monitoring of investment managers, making use of Mercer's ESG ratings and investment reports. Given a shortlist of highly rated strategies, the Trustee would consider those strategies with positive ESG tilts more favourably and under normal circumstances, the Trustee would not expect to appoint a strategy that is afforded the lowest rating by their adviser in relation to ESG.

The Trustee will consider the ESG policies and practices of prospective annuity providers to the extent possible. Furthermore, the Trustee will consider the ESG policies and practices of AVC providers noting that the impact of AVC performance is on individual members, but notes also that these contracts are a small proportion of total assets and hence will not have a significant impact on the Scheme's overall ESG. "

Engagement

The following work was undertaken during the year to 31 December 2022 relating to the Trustee's policy on ESG factors, stewardship and climate change, and sets out how the Trustee's engagement and voting policies were followed and implemented during the year.

- All of the Scheme's investment managers confirmed that they are signatories of the current UK Stewardship Code.

- In May 2022, the Trustee updated their investment guidelines with LGIM in order to include new climate alignment objectives for the Scheme's bespoke buy & maintain credit portfolio. These include the fund targeting a weighted average GHG emissions (scope 1 and scope 2) intensity of at least 40% lower than that of the reference portfolio (the pooled L&G Buy and Maintain Credit Fund) at the reference date. The portfolio will also target a weighted average temperature alignment score of 2.6ºC or below after the restricting period. The update also included the Fund having a target of net zero carbon emissions by 2050 in line with the Paris agreement.

- The Trustee reviewed their investment guidelines with RLAM, to include climate-related objectives. These were finalised in early 2023.

- Managers are expected to report on their own ESG related policies and activities as and when requested by the Trustee. Over the year, the Trustee asked their investment managers to summarise their approach to ESG when presenting at Trustee or Investment Sub-Committee ("ISC") meetings. RLAM, Wellington, and Aviva presented at meetings during 2022.

- The Scheme's investment performance report is reviewed by the Trustee on a quarterly basis. This includes ratings (both general and specific to ESG) from the investment consultant. All of the managers remained generally highly rated during the year. The investment performance report includes how each investment manager is delivering against their specific mandates.

- In October 2022, the Trustee conducted a Responsible Investment Total Evaluation (RITE) and scored a B+. This was an improvement from a score of C+ scored in the previous year. [The summary score can be found by following this link: https://novartis.compendiatouch.co.uk

- The Trustee also requested details of relevant engagement activity over the year from each of the Scheme's investment managers, noting that the Scheme does not hold invest in equity mandates and therefore its managers have little or no ability to influence investee companies through voting activity.

    - The Scheme's investment managers engaged with companies over the year on a wide range of different issues, including ESG factors. This included engaging with companies on climate change to ensure that companies were making progress in this area and better aligning themselves with the wider objectives on climate change in the economy (i.e. those linked to the Paris agreement).

    - The Scheme's managers provided examples of instances where they had engaged with companies they were invested in/about to invest in which resulted in a positive outcome. These engagement initiatives were driven mainly through regular engagement meetings with the companies that the managers invest in, or by voting on key resolutions at companies' Annual General Meetings. Examples are set out below. The Trustee notes that, while it does not invest in Equity mandates, its appointed managers do manage equities for other investors, and expects its managers to apply its views consistently across mandates and for this to influence the behavior of investee companies. Examples of key activities are shown on this basis.

Engagement activity

The following is based on information provided to the Trustee by the Scheme's investment managers:

LGIM

LGIM engaged with companies on ESG issues over the year, mainly focussing on human rights, deforestation, public health and climate transition. A few examples are set out below.

Royal Mail Plc

In 2022, LGIM voted against the re-election of Keith Williams as director. This was an escalation vote as LGIM have engaged with the company on their gender diversity policies. From 2022, LGIM have applied voting sanctions to the FTSE 100 companies who do not have at least one woman on their executive committee, with the expectation that there should be a minimum of 33% over time. The vote against re-election was applied due to the company having an all-male executive committee.

ExxonMobil – Oil and Gas Sector

LGIM voted FOR a resolution to set a credible net zero plan in alignment with a 1.5ºC trajectory. The company had an absence of reductions targets for emissions associated with the company's sold products and insufficiently ambitious interim operational targets.

LGIM expects companies to introduce credible transition plans, consistent with the Paris goals of limiting global average temperature increase to 1.5ºC. This includes the disclosure of scope 1, 2 and material scope 3 GHG emissions and short, medium and long-term GHG emissions reduction targets consistent with the 1.5ºC goal.

The vote FOR the resolution went against management recommendation and although the vote received 27% support, LGIM stated that they will continue to engage on the subject. They have also communicated their expectations regarding the net zero transition to the company.

RLAM

RLAM engaged with companies on a number of issues over the year, including corporate disclosures related to achieving net zero carbon emissions, ethnic diversity, workforce engagement and cybersecurity. Two such examples are set out below.

Frasers Group plc

In 2022, RLAM engaged with the group surrounding their concerns over the company's remuneration framework and practices. Although RLAM acknowledged that no awards had been received during the year they voted against changes to the executive share scheme. The changes would see awards under the executive share scheme limited to caps expressed in shares as opposed to determined percentage of salary. The remuneration committee retain discretion to allow all awards to vest early in case the £15 share price target is achieved, which could pose the risk of rewarding executives for short spikes in performance, rather than focusing on the long-term view. RLAM also voted against the election of the remuneration committee chair as they had ongoing concerns with the remuneration at the company and wanted to reflect this by voting against the chair. RLAM also voted against the election of the nomination committee chair as they have diversity concerns. RLAM have acknowledged that the company's progress efforts to diversify below the board level, as well as the company's recent FTSE 100 index promotion, their concerns surrounded the company's efforts to address Parker Review targets and its board gender balance.

Wilmington Plc

RLAM engaged with the company surrounding concerns with the re-election of the chairman. RLAM noted that it would be in breach of Provision 24 of the UK corporate governance code, they raised their concerns over the board chairman's re-election on the audit committee. RLAM noted that in absence of a sufficient justification over non-compliance, they abstained on the chairman's re-election. They also engaged with Wilmington plc surrounding the annual remuneration report. RLAM's analysis discovered that the bonus outturn for the year was achieved at maximum despite a failure to meet targets. Given a lack of reasoning in its disclosures, RLAM considered this outcome to be an inappropriate use of discretion by the remuneration committee. Following RLAM's vote, the company confirmed the Chairman's decision to step down from the audit committee and explained that RLAM had captured a misprint in the company's annual report concerning the bonus targets, which were in fact achieved at maximum.

Aviva

Aviva has stated that the concept of engagement and voting in Real Assets, or private markets, is fundamentally different to listed equity and fixed income. This is because:
- Where real assets managers invest in companies, the companies are not listed and so don't operate a traditional listed company voting system.
- Where real assets managers invest directly, the manager's staff make decisions about how the asset is managed, so there is no 'company' to engage with.
- Where real assets managers invest in private debt, the opportunity to engage with counterparties concerns only the management of the secured asset, and not the general management of the borrowing company itself.

Based on these factors, Aviva Investors believe engagement in real assets should focus on structured interaction on environmental and social issues with the occupier, sponsor or counterparty. The engagement should be carried out through the transaction process, or through ongoing asset management, dependent on the asset class.

On this basis, Aviva engaged with a total of 21 entities within the LIME Fund over the reporting period. Their engagement focused on occupiers and focused on providing support for decarbonisation of their assets in line with the occupier's own business priorities and ambitions.

Next PLC, South Elmsall – Solar PV installation

In late 2020 the Aviva Lime Fund funded the installation of a solar photovoltaic ("PV") installation at Next PLC's Distribution Centre in South Elmsall, Southampton. With installation targeting completion in June 2021, the solar project will facilitate renewable energy supply for Next, and help to advance

Aviva Investors' net zero commitments. The project involves the installation of a 2,900 kWp1 system which is expected to:

- Generate over 1,980 MWh of clean energy each year.
- Offset an estimated 1,027,000 kg of carbon dioxide (CO2) per year.
- Provide clean energy for on-site consumption by Next, enabling Aviva's tenant to generate energy independently of the grid. This will be used to power the tenant's own bespoke initiatives, such as the recent installation of a robotic picking system, an efficient way to organise clothes within their warehouses.

Aviva will fund the cost of the solar array installation, in return for an additional rent. This demonstrates the value-add of incorporating low carbon technology into Aviva's assets. Other economical benefits of the solar PV system include:

- Significant savings within year one of the system installation.
- A predicated payback period of just over seven years.

Financing clean energy initiatives not only provides effective engagement with tenants on net zero initiatives, but also further enhances the environmental resilience.

Wellington

Wellington see opportunity to supplement their knowledge of companies and enhance their influence on their long-term success, through engagement. They have regular conversations with management and boards in order to establish a two-way dialogue. They believe their exchanges help them assess companies for their corporate culture, adaptability, responsiveness and their alignment with incentives of sustainable long term targets.

Over the reporting period, 1029 engagements with the funds held names were conducted on a broad range of ESG topics.

Acadia Healthcare Co

Throughout the year Wellington engaged with Acadia on a number of topics covering governance, social and environment issues. These included discussions on the capital structure and refinancing requirements of the firm. There were also discussions relating to compensation and succession planning of the firm going forwards which tied into discussions surrounding the long term corporate strategy. The environment issues focused on the product sustainability and innovation.

AT&T INC

Wellington engaged with AT&T INC a communication services company on several occasions which include conversations about the environmental practices of the company. The culture, talent and labour health of the employees have also been discussed on a couple of occasions.
In relation to Governance, capital structure, resource allocation and long term corporate strategy were the main topics of engagement.

Voting Activity

The Scheme’s current investment strategy is composed of fixed income and property portfolios only. These portfolios do not have securities that hold voting rights, hence no voting activity was provided by the Scheme’s investment managers for the year to 31 December 2022.

From October 2022 the Trustee are required to identify key themes and priorities as part of what constitutes a significant vote. The Trustee have completed an ESG beliefs session during the year and have a Responsible Investment policy in which their beliefs are set out. If the Trustee were to obtain voting rights in the future they would follow their Responsible Investment Policy to determine significant voting activity and would report them as such.