



Capability Scotland Pension Scheme: Implementation Report

August 2022

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 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 SIP can be found online at the web address:
https://www.capability.scot/assets/000/000/543/Capability_Scotland_-_September_2020_SIP_original.PDF

The SIP in the above link was updated in September 2020, having previously been revised in September 2019 to reflect changing regulatory requirements. Changes to the SIP are detailed on the following pages.

Implementation Report

This implementation statement covers the Scheme's reporting period from 1 April 2021 to 31 March 2022 (the "Scheme Year"). It sets out: (i) how, and the extent to which, in the opinion of the Trustees, the Trustees' policy on voting, stewardship and engagement has been followed during the Scheme Year and (ii) the voting behaviour by, or on behalf of, the Trustees during the Scheme Year, including the most significant votes cast and any use of a proxy voter during the Scheme Year.

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 Trustees have 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 Trustees have 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
- voting behaviour covering the Scheme Year for and on behalf of the Scheme including the most significant votes cast by the Scheme or on its behalf

Summary of key actions undertaken over the Scheme reporting year

- On 17 December the Trustees restructured the Scheme's LDI portfolio with Insight, to target a revised hedge target of 100% (of both interest rate and inflation risk). The restructure also incorporated an additional c. £0.6m switched from the JPMorgan Unconstrained Bond Fund to the LDI portfolio.
- In light of the expected move to secure the Scheme's liabilities via an insurance transaction in the near term, the Trustees moved to divest the Scheme's illiquid asset holdings. They instructed a full divestment of the holdings in the Apollo Total Return Fund, which was executed at the end of 2021, with proceeds (c. £7.7m) transferred to the trustee bank account in the middle of February. The proceeds from this divestment were invested in an Insight cash fund on 25 February. The Trustees also instructed a full divestment of the holdings in the LGIM LPI Income Fund. LGIM were able to facilitate a secondary market transaction which meant the Scheme received the proceeds of this divestment in the trustee bank account on 4 March 2022. The proceeds from this divestment were invested in the Insight cash fund on 17 March.
- As part of the expected upcoming transition to an insurance contract, the Scheme's insurance adviser (Mercer) and proposed insurance provider (Legal & General Assurance Society) provided the Trustees with a target 'price lock portfolio' comprised of LGIM gilt and index-linked gilt funds. In order to implement this, the Trustees instructed full divestments from the holdings in the BlackRock Dynamic Diversified Growth Fund, the Insight LDI portfolio, the Insight Cash Fund, and the JPMorgan Unconstrained Bond Fund, with the trades executed over 15 and 16 March. The proceeds were split between an LGIM fixed interest gilt fund and an LGIM index-linked gilt fund.

Implementation Statement

This report demonstrates that the Trustees of the Capability Scotland Pension Scheme have adhered to their investment principles and their policies for managing financially material considerations, including ESG factors and climate change.

Signed	 F514A79063BB4C0...	Ian Gordon
		Director McGrigors Pension Trustees Limited
Date		30-08-2022

Managing risks and policy actions DB

Risk / Policy	Definition	Policy	Actions
Interest rates and inflation	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 hedge 100% of movements in interest rates and inflation on a flat gilts basis.	The Scheme increased its level of hedging to better protect the Scheme against interest rate and inflation risk. The change to the hedging level was not reflected in a change to the Scheme's SIP prior to the end of the Scheme year.
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).	The Trustees monitor the Scheme's liquidity position to reduce the impact of this risk via the annual report provided by the investment consultant. Ad hoc advice is also received from the Investment Consultant on a more regular basis, if cashflow requirements become significant.
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.	The Trustees have implemented a number of changes to the investment strategy over the Scheme year, as outlined above. These changes to the asset allocation were not reflected in any change to the Scheme's SIP prior to the end of the Scheme year.
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.	The Trustees indirectly monitor this risk as part of annual performance reporting. This risk has been significantly reduced as part of the strategic changes implemented over the Scheme year.

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 Scheme's investments.	Please see Appendix 3 of the Scheme's SIP for the policy relating to managing Environmental, Social and Governance considerations.	ESG actions undertaken: The managers' ESG policies and approach were reviewed in Q1 2020. The Trustees are scheduled to receive training and to review their ESG policies over the next 12 months.
Currency	The potential for adverse currency movements to have an impact on the Scheme's investments.	The Scheme's current mandates hedge any currency risk back to Sterling.	The Trustees indirectly monitor this risk as part of annual performance reporting. This risk has been significantly reduced as part of the strategic changes implemented over the Scheme year.
Non-financial	The views of Scheme members and beneficiaries in relation to ethical considerations, social and environmental impact, or present and future quality of life of the members and beneficiaries of the Scheme in the selection, retention and realisation of investments.	Non-financial matters are not taken into account in the selection, retention or realisation of investments. This policy will be reviewed at least annually.	There was no action taken in relation to this risk over the Scheme year.

Changes to the SIP

There were no changes made to the SIP over the reporting period.

Implementing the current ESG policy and approach

ESG as a financially material risk

The SIP describes the Scheme's policy with regarding to ESG as a financially material risk. This page details how the Scheme's ESG policy is implemented, while the following page outlines Isio's assessment criteria as well as the ESG beliefs used in evaluating the Scheme's managers' ESG policies and procedures. The rest of this statement details our view of the managers, our actions for engagement and an evaluation of the stewardship activity.

The below table outlines the areas which the Scheme's investment managers are assessed on when evaluating their ESG policies and engagements. The Trustees intend 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	<p>The Trustees will obtain regular training on ESG considerations in order to understand fully how ESG factors including climate change could impact the Scheme and its investments;</p> <p>As part of ongoing monitoring, the Trustees will use any ESG ratings information provided by their investment consultant to assess how the Scheme's investment managers take accounts of ESG issues;</p> <p>Through their investment consultant, the Trustees will request that all of the Scheme's investment managers provide information about their ESG policies, and details of how they integrate ESG into their investment processes on an annual basis.</p> <p>Through the manager selection process, ESG considerations will form part of the evaluation criteria.</p>	<p>The manager has not acted in accordance with their policies and frameworks.</p> <p>The manager has received a 'red' ESG rating from the Investment Consultant, signifying that ESG considerations are below satisfactory.</p>

ESG summary and engagement with the investment managers

Manager and Fund	ESG Summary	Actions identified	Engagement details
Insight Liquidity Plus Fund	Whilst Insight has a clear business level ESG policy, there are currently no formal ESG objectives or engagements targets for the cash fund itself.	It was proposed by Isio that Insight should consider demonstrating how ESG risks are monitored.	Isio engaged with Insight on the Trustees' behalf to review their ESG policies and set actions and priorities. Isio reports back to the Trustees with an update on Insight's engagements annually.
L&G Life AA All Stocks Gilts Index Fund	At a firmwide level, L&G's Investment Stewardship team are responsible for engagement activities across all funds. L&G share their finalised ESG scorecards with portfolio companies and the metrics on which they are based.	It was proposed by Isio that, at a firmwide level, L&G should consider expanding reporting to include descriptions of critical engagements to better satisfy implementation statement reporting.	Due to the nature of the underlying investments, ESG is not considered in the investment framework for gilt funds and hence L&G's engagement with issuers is limited at a fund level.
L&G Life Y All Stocks Index-Linked Gilts Index Fund	L&G leverage the wider capabilities of the global firm to engage with companies meaningfully.		

The Trustees are satisfied with Isio's engagement on their behalf, and are also comfortable that the managers' performance and responses are in line with expectations, given the policies outlined in the Scheme's SIP.

Engagement

As the Scheme invests via fund managers the managers provided details on their engagement actions including a summary of the engagements by category for the Scheme Year.

Fund name	Engagement summary	Commentary
Insight Liquidity Plus Fund	Insight currently do not collect engagement data for their Cash Fund, which is limited to the extent in which they may assess underlying counterparty exposure.	Whilst Insight have a clear business level ESG policy, there are currently no formal ESG objectives or engagements targets for the cash fund itself.
L&G Life AA All Stocks Gilts Index Fund	LGIM have engaged with a number of industry participants on long term strategic issues in relation to gilt funds, including: <ul style="list-style-type: none"> • The introduction of central clearing; 	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
L&G Life Y All Stocks Index-Linked Gilts Index Fund	<ul style="list-style-type: none"> • The LIBOR transition; • The introduction of green gilts. 	Given the nature of the funds and the underlying investments, engagement is limited at a fund level.

