



AA Pension Scheme ('the Scheme')

Engagement Policy Implementation Statement 2021

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AA Pension Scheme

Introduction

On 6 June 2019, the Government published the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 (the "Regulations"). The Regulations require that the Trustee produces an annual implementation statement which outlines the following:

- Explain how, and the extent to which, it has followed its engagement policy, which is outlined in the Statement of Investment Principles ("SIP").
- Describe the voting behaviour by, or on behalf of the Trustee (including the most significant votes cast) during the scheme year, and state any use of the services of a proxy voter.

The Engagement Policy Implementation Statement ("EPIS") for the AA Pension Scheme ("the Scheme") has been prepared by the Trustee and covers the Scheme year 1 April 2020 to 31 March 2021.

Scheme Stewardship Policy Summary

This statement has been prepared in line with the Trustee's stewardship policy as set out in the SIP, effective September 2020.

The relevant extracts from the SIP are in relation to 'Stewardship – Voting and Engagement' are 6.2-6.7.

The SIP can be found on the AA website at www.aapensions.com and is included as an Appendix to the accounts.

Through this report, the Trustee reviews how the actions of its investment managers (and sub-investment managers within its fiduciary arrangement) have aligned with its expectations and principles set out in the SIP. The Trustee will set out where it expects more information or engagement to be undertaken by its managers.

Scheme Stewardship Activity Over the Year

Training

Over the year, the Trustee had responsible investment training sessions with their investment advisor, which provided updates on the evolving regulatory requirements and the importance of stewardship activity and appropriate consideration of ESG factors in investment decision making. In addition, the Trustee has received training on the Task Force on Climate-Related Financial Disclosures (TCFD) requirements which the Scheme will need to comply with by 1 October 2022.

Updating the Stewardship Policy

During the training sessions and throughout the year, the Trustee has been proactive to ensure the Scheme appropriately updated the Stewardship policy in the SIP.

In line with regulatory requirements, to expand the SIP for policies such as costs transparency and incentivising managers, the Trustee also reviewed and expanded the Stewardship policy in September 2020. The updated wording in the SIP illustrates how the Trustee recognises the importance of its role as a steward of capital, as well as indicating how the Trustee would review the suitability of the Scheme's investment managers and other considerations relating to voting and methods to achieve their Stewardship policy.

This has been made available on the AA website where it can be accessed by the public.

Ongoing Monitoring

Investment monitoring takes place on a quarterly basis with monitoring reports being provided to the Trustee by Aon. The reports include ESG ratings and highlight any areas of concern, or where action is required. The ESG rating system is for buy rated investment strategies and is designed to assess whether investment managers integrate responsible investment, and more specifically, ESG considerations into their investment decision making process. The ESG ratings are based on a variety of qualitative factors, starting with a proprietary due diligence questionnaire, which is completed by the fund manager. Aon's researchers also conduct a review of the managers' responsible investment related policies and procedures, including a review of their responsible investment policy (if they have one), active ownership, proxy voting and/or stewardship policies. After a thorough review of the available materials, data and policies, as well as conversation with the fund manager, the lead researcher will award an ESG rating, which is subject to peer review using an agreed reference framework. Ratings will be updated to reflect any changes in a fund's level of ESG integration or broader responsible investment developments.

TCFD

The Scheme is currently progressing towards meeting the requirements as set out as part of the TCFD. The TCFD establishes a set of eleven clear, comparable and consistent recommended disclosures about the risks and opportunities presented by climate change. The increased transparency encouraged through the TCFD recommendations is intended to lead to decision-useful information and therefore better informed decision-making on climate-related financial risks. Aligning the Scheme to the TCFD can be a long process and requires careful planning. Aon are currently working with the Trustee to agree an action plan to meet the required deadline, 1 October 2022.

Engagement

The Scheme's fiduciary manager, Aon Investments Limited ("AIL") presented to the Investment Committee of the Trustee (IC) on a quarterly basis engaging on a number of areas including performance, strategy, risk, corporate governance. AIL report their ESG ratings for all rated managers within the fiduciary portfolio on a quarterly basis. These ESG Ratings reflect the extent of ESG integration as well as the features and impact of their respective Stewardship programs.

The Scheme's non-fiduciary managers present to the IC on an annual basis (including at manager days held in April 2020 and October 2020). The IC engaged with the managers on performance, strategy, risk, corporate governance and ESG practice. Reporting on performance and Aon's ESG rating of a manager is provided by the Scheme's investment adviser on a quarterly basis.

In appointing a new manager over the year (Blackstone), the IC considered the ESG policies of the manager before making the appointment and concluded these to be in line with the Trustee's ESG policy.

Engagement – Fiduciary Manager - Aon Investments Limited (AIL)

Under the Trustee's fiduciary mandate managed by AIL, AIL appoint underlying asset managers to achieve an overall target return. The Scheme's assets are invested in a range of funds which can include multi-asset, multi-manager and specialist third party liability matching funds.

The Trustee delegates the monitoring of ESG integration and stewardship quality to AIL and AIL have confirmed that over the relevant period, all equity and fixed income managers have been rated 2 or above on AIL's four-tier ESG ratings system. This means that all the appointed investment managers are at least aware of potential ESG risks in the investment strategy and have taken some steps to identify, evaluate and potentially mitigate these risks.

AIL have undertaken a considerable amount of engagement activity over the period. AIL held around 35 Environmental, Social and Governance ("ESG") specific "deep-dive" meetings in 2020 with most of their equity and fixed income managers across all delegated funds in which AIL's clients invest. At these meetings, AIL discussed the voting and engagement activities undertaken by the investment managers during calendar year 2019, highlighting areas of improvement and discussing manager strategy in the area of RI moving forward. Similar meetings have been ongoing through the beginning of 2021.

The Trustee received the AIL Annual Stewardship Report and is content that AIL is using its resources to appropriately influence positive outcomes in the strategies in which it invests.

Voting and Engagement Activity – Underlying Managers

Over the period the Scheme was invested in a number of equity, fixed income and alternative funds through their AIL fiduciary investment. In addition, the Scheme held assets outside of the fiduciary arrangement. This section provides an overview of the voting (where applicable) and engagement activities of some of the most material managers over the reporting period, noting where assets were not held within the AIL mandate.

Voting and Engagement activity – Equity

Over the year, the Scheme was invested in the following equity funds, either through the fiduciary arrangement with AIL or with funds managed by Legal and General Investment Management (LGIM).

- AIL Global Active Equity Strategy
- AIL Emerging Markets Wealth Strategy
- AIL Global Impact Strategy
- AIL Global Multi-Factor Equity Strategy (LGIM (Multi Factor Fund))

The Trustee acknowledges that a number of managers were unable to provide data on significant votes and notes that AIL continue to engage these managers to track and provide such information moving forward.

All equity managers in these funds utilise at least one of the Institutional Shareholder Service (ISS), Glass Lewis and/or ProxyEdge for various services that may include research, vote recommendations, vote execution and record keeping.

Voting statistics for the most material sub-investment managers within these strategies over the year are provided in the Appendices.

AIL Global Active Equity Strategy

Within the Active Global Equity Strategy, all managers voted in over 95% of resolutions over the year to 31 March 2021. No more than 10% of votes were abstained by any manager during the period in question.

The Global Active Equity Strategy invests in a number of sub-investment managers, including Longview. In April 2020, Longview voted against management on a resolution to change shareholders' right to act by written consent, a proposal brought forward by a multinational financial services corporation. Longview's rationale for the voting

decision was that written consent enables shareholders (including minority shareholders) to take action on important issues that arise between annual meetings.

AIL continue to engage with two investment managers in particular in this strategy to improve transparency of voting case studies relevant to the fund. They currently lag their peers in this area due to being based in jurisdictions where disclosure requirements are not as advanced or because they use a quantitative investment process.

AIL Emerging Markets Wealth Strategy

Within the Emerging Markets Wealth Strategy, all managers voted in over 95% of resolutions over the year to 31 March 2021. Notably, Neuberger Berman and Coronation had more than 10% of votes each that were votes against company management recommendation.

The most material manager engagement within this fund over the period was by Oaktree. In March 2021, Oaktree voted against management at mining company, Vale, in an amendment to reduce the number of ordinary meetings and amend the minimum number of members required to call a meeting of the board of directors. Oaktree voted against the proposal (which violated the manager's proxy guidelines). Oaktree believed this proposal would not benefit minority shareholders and engaged Vale management to offer suggestions on ways to improve governance practices.

With respect to engagement, Oaktree believe it can play a constructive role in helping companies improve their practices through their strong relationships with company management. The manager added capability to its research database allowing it to note ESG relevant activity and also implemented an ESG "Escalation Committee" to enhance decision-making process when a significant ESG-related event occurs at the company level. In general, AIL was satisfied with voting and engagement policies of managers within this fund.

Overall, AIL found the voting and engagement policies of all managers within this fund to be adequate.

AIL Global Impact Strategy

An allocation to the Global Impact Strategy was implemented in October 2020, The Strategy invests in multiple funds addressing a range of impact themes that contribute to the transition to a more sustainable economy while also delivering competitive financial returns. Within the active global impact strategy, the managers voted in over 95% of eligible resolutions over the year to 31 March 2021, with the exception of Nordea falling below that mark. AIL appreciate the case by case approach Nordea take to making voting decisions, though have raised this concern with Nordea previously and will continue to do so moving forward. The Trustee shares this concern and notes that AIL will provide feedback that a higher level of voting frequency is expected.

The most material manager engagement within the Strategy as at the end of the period was by Mirova. The manager's voting principles are defined by Mirova's Responsible Investment Research Team. A significant voting example by Mirova is in March 2021 in relation to Novo Nordisk A/S where they abstained from voting (an against vote was not available) from the resolution to re-elect Kasim Kutay as director. The rationale for this vote was that the rate of female directors was below 40%. Mirova is aware that its views on Responsible Corporate Governance are disruptive, specifically in the US/Asia markets where the stakeholder-centred approach and the integration of Corporate Social Responsibility ("CSR") at governance level remain limited. They intend to continue promoting these values leveraging their votes. In addition, their Research Team engage individually and collaboratively with companies on key sustainability issues. They also intend to be more active on the proxy voting sphere by co-filing and filing shareholder resolutions which would allow them to gain leverage and visibility.

The firm level engagement is conducted by each ESG analyst on their relative coverage. Mirova's ESG analysts engage in dialogue with the companies which represent the majority of Mirova's equity and fixed-income investment portfolios. This type of engagement aims not only at encouraging companies to adopt better ESG practices, but also at promoting the development of solutions to key environmental and social challenges in every sector via dedicated products and services.

AIL Global Multi-Factor Equity Strategy (LGIM Multi Factor Fund)

The Scheme invests in the Global Multi Factor Equity Strategy, which primarily invests in the LGIM Multi Factor Fund. The Scheme also invests in this fund outside of the AIL fiduciary arrangement. Over the year to 31 March 2021, LGIM voted on over 99% of all resolutions in the Multi-Factor Fund and abstained from 0% of resolutions.

LGIM use ISS as a proxy advisor for voting on this fund. LGIM regularly monitor the proxy voting services through quarterly due diligence meetings to ensure execution is in line with their custom voting policy. An example of a significant vote was in September 2020, where LGIM voted against a remuneration policy put forward by an investee company Pearson.

The company put forward a resolution seeking shareholder approval to grant a co-investment share award (an award of the right to purchase shares as part of the remuneration policy), an unusual step for a UK company; if this resolution was not passed the proposed new CEO would not take up the role. Many shareholders were keen for the company to appoint a new CEO but were not happy with the share award plan being proposed. Shareholders were not able to vote separately on the two distinct items and felt forced to accept an unattractive remuneration structure in order to secure the new CEO.

LGIM spoke with the chair of the Pearson's board in relation to plans for the change in leadership and discussed the shortcomings of the company's current remuneration policy. LGIM also relayed their concerns prior to the EGM that the performance conditions within the remuneration policy were not appropriate and should be re-evaluated to best align management incentives with those of the shareholders.

In the absence of any changes, LGIM decided to vote against the amendment to the remuneration policy. In all, 33% of shareholders voted against the remuneration policy and by default the appointment of the new CEO. While the proposal received sufficient support to be passed, the engagement highlighted concerns around governance, which LGIM has stated will be challenged through continued engagement going forward. Given the unusual approach taken by the company and LGIM's outstanding concerns, this vote was deemed to be significant.

LGIM make use of proprietary ESG tools to assess risks and opportunities in relation to its holdings. The manager has defined a framework for engagement activities from identifying issues to reporting on outcomes. More information on LGIM's engagement can be found in their annual reports: [LGIM Active ownership 2020 2021](#).

Engagement Activity – Fixed Income

Over the period, the Trustee primarily invested in fixed income strategies through the bespoke AIL portfolio. Whilst voting rights are not applicable to non-equity mandates, the Trustee recognises that debt investors have significant capacity for engagement with issuers of debt. Debt financing is continuous, and there is therefore a vested interest on the part of debt issuers to ensure that institutional investors are satisfied with the issuer's strategic direction and policies. Additionally, the Trustee considers downside risk mitigation and credit quality to be a critical part of investment decision-making. The Trustee also believes engagements from fixed income managers are key to reducing ESG risks within the Scheme's portfolio, such as the ability to contribute to the transition towards a low carbon economy. As new investment solutions emerge within the industry, AIL introduce fixed income funds with a sustainability focus into portfolios as deemed appropriate.

AIL have confirmed that all applicable appointed managers in this asset class have demonstrated responsible investment policies and practices consistent with the Trustee policy and will promote continued transparency and improvements in transparency over time.

Engagement Activity – Alternatives

The Scheme was invested in a number of alternative strategies (property, infrastructure, private debt, private equity, hedge funds) both within and outside of the AIL fiduciary mandate.

All the private equity managers are either PRI signatories or adopt guidelines from the PRI and the Trustee is comfortable that all managers continue to consider financially material ESG factors in their due diligence processes and make reasonable efforts to encourage their portfolio companies to consider relevant ESG-related principles and to support their implementation.

The Trustee recognises that the investment processes and often illiquid nature of the alternative investments may mean that stewardship is potentially less applicable or may have a less tangible financial benefit than with other asset classes. Nonetheless, the Trustee expects that all their managers should open a dialogue to engage with issuers/companies they invest in should they identify concerns that may be financially material. An example over the year was the Blackrock Property Fund which had received a reduction in ESG score, relative to its benchmark. Blackrock are actively engaging with tenants to help and improve the data they provide relating to ESG.

Opportunities for engagement may also be limited in liquid alternative investments given their investment process and the nature of the investments. In particular, the Trustee acknowledges voting activity from the hedge fund managers may be limited due to the potentially short-term/opportunistic nature of the underlying investments. The Trustee notes that AIL will still periodically ask the responsible investment related questions and engage with hedge fund managers where appropriate.

AIL have engaged with some of the appointed hedge funds where voting and stewardship are more applicable. From the information received, AIL see evidence that sub-investment managers acknowledge the importance of climate change and take steps to integrate these issues into investment decisions.

The Trustee is comfortable with ongoing developments and encourage improved reporting.

In Summary

Overall, the Trustee is of the opinion the stewardship carried out on behalf of the Scheme is adequate but with room for continued improvement:

1. The Trustee expects that equity managers vote in more than 95% of eligible resolutions, and
2. The Trustee expects increased levels of detail from equity managers with respect to rationale for significant votes.

The Trustee delegates responsibility to AIL to encourage and monitor these areas of improvement within the appointed underlying equity managers.

The Trustee acknowledges that stewardship may be less applicable to certain alternative asset classes such as property, but generally would still expect to see policies and processes formalised.

The Trustee uses its influence as a large institutional investor to encourage investment managers to improve disclosures and expects improvements over time in line with the increasing expectations on investment managers and their significant influence to generate positive outcomes through considered voting and engagement.

This statement has been approved by the Trustee of the AA Pension Scheme, 15 September 2021

Appendix – Voting Statistics for the Scheme year

Below are the standard statistics gathered by managers in relation to their voting behaviour.

AIL Global Active Equity Strategy	% of resolutions voted on for which the fund was eligible	% that were voted against management	% that were abstained from
Sand Global Growth fund	98.1%	4.5%	0.0%
Harris Global Equity fund	100.0%	5.0%	0.0%
GQG Global Equity fund	100.0%	6.7%	0.0%
Longview Global Equity fund	100.0%	5.3%	0.5%
Arrowstreet Global Developed Equity fund	96.5%	9.4%	1.1%

Source: Investment Managers, AIL.

AIL Emerging Markets Wealth Strategy	% of resolutions voted on for which the fund was eligible	% that were voted against management	% that were abstained from
Neuberger Berman	100.0%	10.9%	0.7%
Oaktree	100.0%	9.1%	1.8%
Coronation	100.0%	10.3%	4.2%
TT International	98.2%	9.5%	0.0%
GQG Emerging Markets Fund	97.2%	9.0%	2.4%

Source: Investment Managers, AIL.

AIL Global Impact Strategy	% of resolutions voted on for which the fund was eligible	% that were voted against management	% that were abstained from
Mirova Global Sustainability Equity Fund	100.0%	12.0%	5.0%
Nordea Global Climate and Environment Fund	83.9%	8.8%	0.0%
Baillie Gifford Positive Change	95.2%	2.5%	0.6%

Source: Investment Managers, AIL.

AIL Global Multi-Factor Equity Strategy (LGIM Multi Factor Fund)	% of resolutions voted on for which the fund was eligible	% that were voted against management	% that were abstained from
LGIM Global Developed Four Factor Index Fund	99.9%	18.0%	0.2%

Source: Investment Managers, AIL.

Note: This fund is held both within the AIL mandate and outside the AIL mandate.

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