Sustainable Ownership Report 2017

BRITISH TRANSPORT POLICE

RAILWAYS PENSION SCHEME

Chairman's Introduction

"On behalf of the Railpen Investment Board, I would like to introduce our first Sustainable Ownership Annual Report for the railway pension schemes (the schemes). This report provides you with a summary of our Sustainable Ownership activity in 2017."

Paul Trickett,
Chairman, Railpen Investment Board

As the schemes' investment manager Railpen is responsible for the safekeeping and investment of around £28 billion on behalf of its 350,000 members who are connected with the railways industry.

Our Mission is to pay members' pensions securely, affordably and sustainably. To achieve this, Railpen invests the schemes' assets to generate strong investment returns over the long-term.

We believe that companies with good corporate governance practices and engaged shareholders are more likely to achieve superior long-term financial performance. Strong governance ensures companies will manage their risks and opportunities appropriately, including those related to environmental and social factors.

This report summarises our Sustainable Ownership activities over 2017 which span three areas:

1. Integration

Our goal is to incorporate environmental, social and governance (ESG) considerations into the portfolios we manage on behalf of our beneficiaries.

2. Active ownership

Thoughtful voting alongside constructive engagement with portfolio companies supports our objective of enhancing long-term investment returns for our beneficiaries.

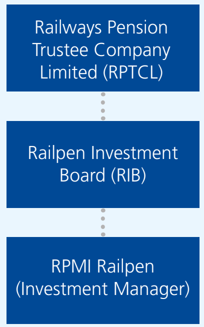
3. Longer-term risks and opportunities

As long-term investors, we monitor risks and opportunities over the timeframe we will be paying members' pensions.

The Railways Pension Trustee Company Limited (RPTCL), also called the Trustee, is responsible for the railway pension schemes.

The Trustee has appointed the Railpen Investment Board (RIB) to oversee RPMI Railpen who manage the day-to-day investment of the schemes' £28 billion of assets.

The Trustee is the parent company of RPMI Railpen.



The Railways Pension Scheme (RPS) was created in 1994 after the privatisation of the railway industry and reorganisation of the British Rail Pension Scheme. It is the largest of the four pension schemes managed by the Trustee Company (Trustee) and one of the largest schemes in the UK, and provides pensions for over 150 companies operating within the privatised railways industry.

Sustainable Ownership is Railpen's approach to incorporating sustainability considerations into the investments we manage on behalf of our beneficiaries.

This is underlined by the Trustee's related investment belief:

"Environmental, social and governance (ESG) factors materially impact long-term investment returns and must be taken into account."

Integration

Sustainable Ownership Framework
Our investment process considers environmental, social and governance factors through four lenses:

1. Improves investment returns
2. Reduces investment risk
3. Impacts our reputation as a responsible investor
4. Impacts the world our beneficiaries retire into

We believe that incorporating this framework into our investment process increases our chances of achieving our mission to pay members' pensions securely, affordably and sustainably.

United Nations Sustainable Development Goals (SDGs)
One of the ways in which we manage members' money is to make investments in private companies that we believe can generate attractive long-term returns needed to pay members' pensions.

We track the impact of new private company investments against an internationally recognised framework: The United Nations' Sustainable Development Goals (SDGs). The SDGs are a universal set of goals, targets and indicators that UN member states are expected to use to frame their agendas and political policies. They are set out in the table below.

Case Study One: Travel company

In 2017 we were presented with an investment opportunity to take a minority stake in a privately owned travel company. The Sustainable Ownership assessment was incorporated from an early stage in the investment process.

The opportunity was assessed against each of the SDGs and the Sustainable Ownership framework. The company's business plan was anticipated to have a limited impact on any of the SDGs and we identified three areas to analyse further.

Emissions regulation
We spoke with the company and gained assurance that new transport vehicles were equipped with engines which were compliant with recent emissions regulations and that the company intended to reduce their carbon emissions through a fuel optimisation plan.

Seasonal workers
We confirmed that staff were paid at least the minimum wage within the jurisdictions they were working in and were entitled to keep 100% of their tips.

Key man risk
Finally, we established that the Chief Operating Officer would be in a position to take over should the Chief Executive Officer decide to leave or become incapacitated.

After confirming that the proposed remuneration plan aligned management with our financial interests we proceeded with the investment.

Active Ownership

As a provider of long-term capital to financial markets we undertake stewardship activities to encourage good market practices. We believe that by actively engaging with companies and where appropriate exercising our voting rights, we can have a positive influence. This in turn helps support our objective of enhancing long-term investment returns for our beneficiaries.

UK Stewardship Code

In 2010 we were a launch supporter of the UK Stewardship Code for investors which is also written into our Statement of Investment Principles (SIP). The Code aims to enhance the quality of engagement between investors and companies to help improve long-term returns. We make a public declaration of our own compliance with the Code on our website and where appropriate we encourage our external fund managers to adopt it.

Voting

For the year under review, we exercised our votes in around 3,500 meetings of the companies in which we invest. At over half of these meetings Railpen voted against, withheld or abstained from at least one resolution on the ballot.

The voting policy for 2018 is the first time we have published a single, global set of principles which allows portfolio companies to understand how we apply our three key themes of:

- Board composition and effectiveness
- Remuneration
- Shareholder rights and disclosure

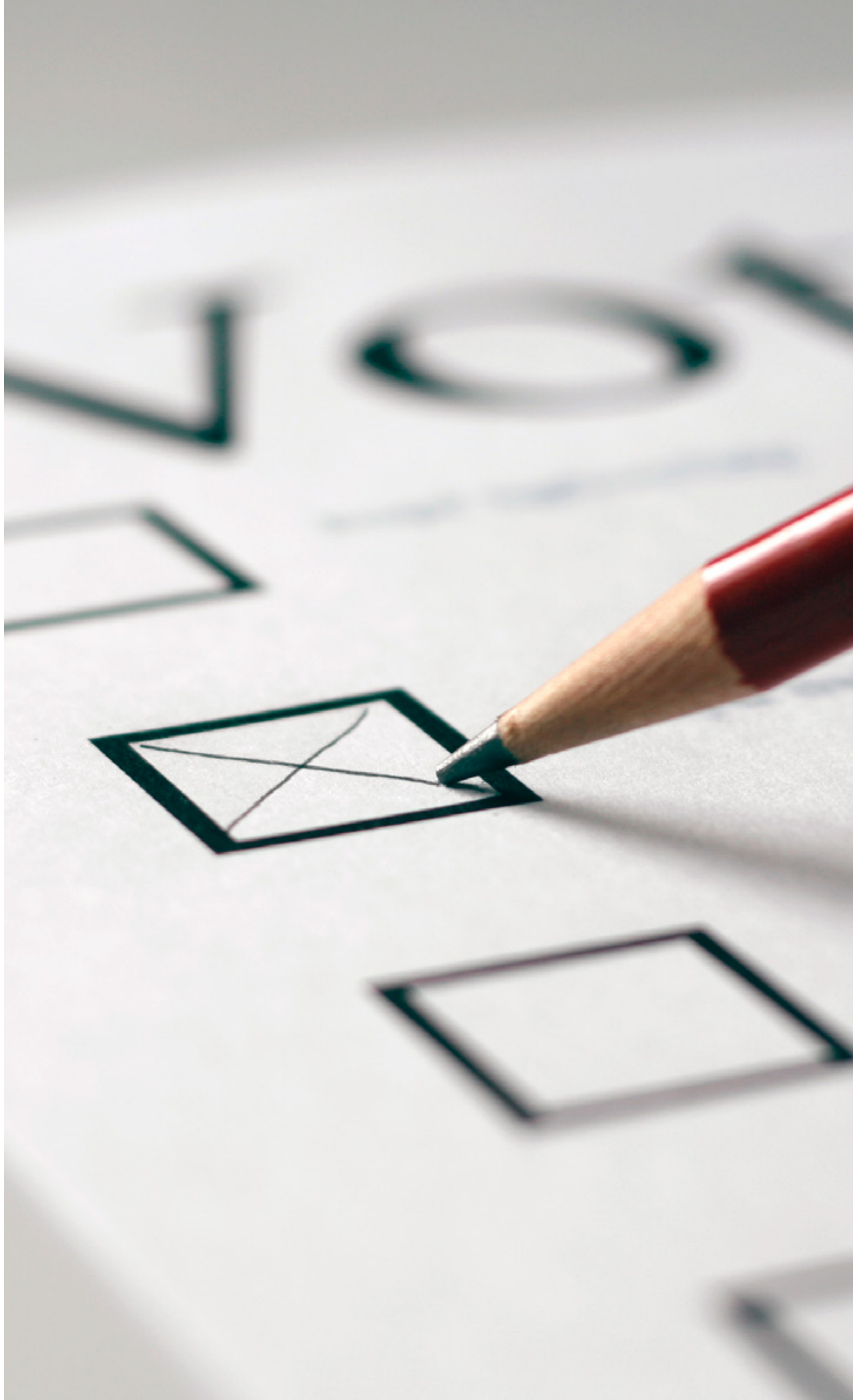
We have also extended the voting positions which we previously held in certain key markets on issues, notably our support for board diversity and our concern for excessive auditor tenure, so they will be applied globally in 2018 for the first time.

Board composition and effectiveness
As an asset owner who invests for the long-term our voting policy communicates our expectations to the companies in which we invest.

We are supporters of the International Corporate Governance Network (ICGN), whose mission is to promote effective standards of corporate governance and investor stewardship worldwide. Their eight Global Governance Principles are the baseline for our global voting policy, including Principle 4 which relates to corporate culture. We draw our portfolio companies' attention to our expectation that they will operate within the parameters of widely-accepted business practices, such as the United Nations Global Compact.

Case Study Two: Glencore plc

In 2014 Glencore plc, one of the world's largest natural resource companies, was the last FTSE100 company to appoint a female board director. At the 2017 AGM we voted against the re-election of Peter Grauer, the Chairman of the Nomination Committee, as female board representation remained stubbornly behind its FTSE100 peers at 12% (the UK government-sponsored Davies Review sought to ensure that all FTSE100 boards had 25% female representation by 2015).



Remuneration

Remuneration is a key theme on which we have a history of making public statements at company meetings, where we feel our concerns are not being adequately addressed.

Excessive pay levels remain a matter of significant concern for Railpen, and we will vote against plans which do not align with our interests as shareholders.

Case Study Three: Oracle Corporation

US technology company Oracle has a history of pay controversies, with five consecutive seasons of failed votes in relation to the remuneration of executives. The plan which was proposed at the 2017 AGM contained performance option grants for three senior executives - Larry Ellison, Mark Hurd and Safra Catz - of $103.7 million each, which were considered excessive even though they were supposed to cover a five-year period.

To reflect the magnitude of our concerns, we voted against the advisory say-on-pay vote to ratify the named executive officers' compensation at Oracle's AGM, and three directors serving on the Remuneration Committee in the year under review.

Shareholder rights and disclosure

The rights of shareholders depend on the rights attaching to their shares under the company's articles of association, and can include rights relating to the appointment of directors and a right of approval, consultation or information before the company takes a particular action. We also seek to enhance the quality of publicly available reporting.

What we engaged on…

About one-third were discussions with companies held in our internally-managed fundamental equity portfolio to review their governance and sustainability practices. These were typically individual engagements, attended by the Fund Managers and the Sustainable Ownership team.

About one-third were governance discussions with companies usually in relation to the most recent company meeting or the Railpen 2018 voting policy with companies. The rest were either about executive pay or discussions facilitated by investor organisations like the PRI (see below).

How we engaged…

In over a third of these cases we met face-to-face with representatives of the companies. The rest were reached by phone or by letter.

Collective engagement

Railpen is a lead participant in several national, regional and global investor networks, alliances and trade bodies. By working with other leading investors we can have more impact on the issues that we care about. Below are two examples of our work with other investors:

We are a supporter of the 30% Club Investor Group in the UK which aims to promote gender diversity on FTSE boards and in the executive pipeline.

Signatory of:

We are also a signatory to the United Nations Principles for Responsible Investment (PRI). We are part of the current PRI-coordinated engagement on Cyber Security.

Long-term Risks and Opportunities

As a long-term investor we believe it is important to consider risks and opportunities over the time horizon we will be paying pensions. An important area of focus in 2017 related to the long-term risks and opportunities presented by climate change.

We integrate climate risk considerations into our investment process and encourage our portfolio companies to improve their disclosures to support their transition to a low-carbon economy. We will also use our capital to take advantage of targeted opportunities which aim to generate a positive impact alongside a financial return.

Consistent with the disclosure theme in our global voting policy, we are signatories to the following initiatives related to climate risk management:

TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

We support the Task Force on Climate-related Financial Disclosures (TCFD). This disclosure framework, published in June 2017, asks companies to disclose their governance, strategy, risk management, and metrics and targets related to climate risk. In January 2018 we wrote to over 200 companies comprising our most significant holdings to encourage them to provide enhanced corporate disclosure in line with the framework. We are prioritising climate risk management in our company engagements for 2018 and were pleased to see certain portfolio companies respond to our letter and confirm their support for the TCFD.

Climate Action 100+ Global Investors Driving Business Transition

In 2017, Railpen also signed up to Climate Action 100+, a five-year climate risk initiative intended to co-ordinate pressure on companies to cut greenhouse gas emissions, and improve disclosure and oversight of climate-related risks. Climate Action 100+ is aligned with the TCFD, which we are proud to support.

TRANSITION PATHWAY INITIATIVE

In 2017 we built upon our support for the CDP (formerly the Carbon Disclosure Project) when we became a founding supporter of the Transition Pathway Initiative alongside 12 other leading international asset owners. The initiative will assess how individual companies are positioning themselves for the transition to a low-carbon economy through a public, transparent online tool.

Additional disclosure of material climate-related information will help Railpen as a long-term asset owner better assess how our current and potential portfolio companies are responding to climate risk and opportunities. Where companies have not responded appropriately to disclosure requests then Railpen will vote against the resolution to approve the company's report and accounts, in such markets where that resolution exists.

We welcome feedback at so@rpmi.co.uk