RPMI RAILPEN

2020 Stewardship Report

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Foreword

Both the Railways Pension Trustee Company Limited (the Trustee) and Railway Pension Investments Limited (Railpen) have long considered stewardship to be a core part of our fiduciary duties.

The Trustee, which delegates investment powers to Railpen, was one of the first UK occupational pension schemes to publish a corporate governance and voting policy, and to introduce voting for all UK equities, in 1992.

The Trustee is therefore supportive of the UK Stewardship Code – and other similar initiatives around the world. As one of the first asset owner signatories to the UK Stewardship Code we think that these initiatives are an important and necessary tool to support and encourage asset owners to undertake responsible allocation, management and oversight of capital to create long-term value for our members as well as sustainable real world outcomes.

This report provides a response both from the Trustee and Railpen. Railpen is responsible for implementing the Trustee's mission to pay our 350,000 members' pensions securely, affordably and sustainably. Both the Trustee and Railpen undertake responsibilities attributed to asset owners and asset managers, and we have prepared this report in a way that reflects the breadth of our responsibilities.

Chris Hannon,
Chair
Railways Pension Trustee Company Limited

John Chilman,
Chief Executive Officer
RPMI

How we have ensured this report is fair, balanced and understandable

We have written this report in alignment with the UK Stewardship Code 2020.

This report has been reviewed by Railpen's in-house Business Assurance team. This team is independent, objective and provides challenge and insights across the wider Railpen business, in conformance with the International Standards for the Professional Practice of Internal Auditing ('the Standards') and the Chartered Institute of Internal Audit's guidance, 'Effective Internal Audit in Financial Services'.

This report has also been reviewed by multiple internal teams including Legal, Client Investment Services, Investment Communications and Investment Management. Compliance and Human Resources have also reviewed key sections, while senior stakeholders have signed off the full report. This process has given us confidence that our reporting is fair, accurate and balanced – as well as of interest and use to members and employers.

Further details of the assurance process can be found in Appendix 3.

Contact us

We welcome comments and feedback from our members on our responsible investment approach and activity. If you would like to speak to us, please get in touch at **SO@rpmi.co.uk.**

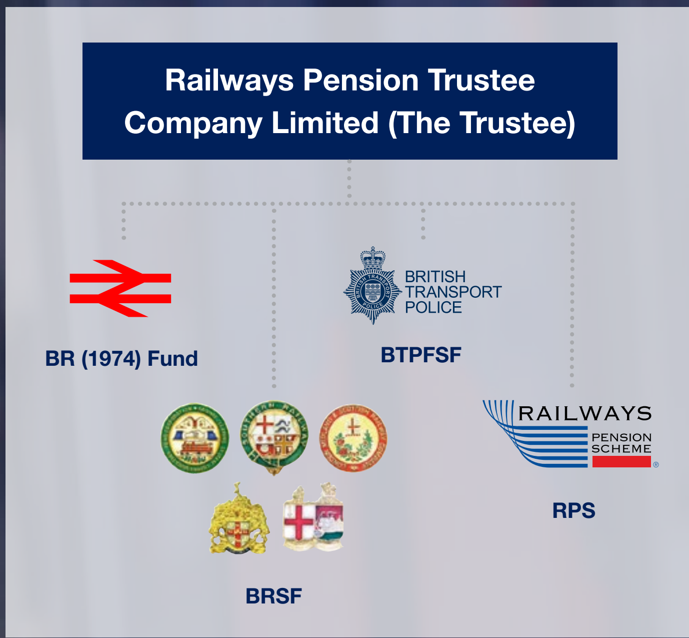
You can find further information, including our 2020 Climate-related Disclosure and our Sustainable Ownership Annual Reports, on **www.rpmirailpen.co.uk/sustainable-ownership.**

Our philosophy and approach

About the Railways Pension Trustee Company Limited (The Trustee)

The Railways Pension Trustee Company Ltd (the Trustee) is responsible for managing four railways pension schemes:

- BR (1974) Fund
- British Transport Police Force Superannuation Fund
- British Railways Superannuation Fund
- Railways Pension Scheme



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

Railpen is the trading name of Railway Pension Investments Limited, which is authorised and regulated by the Financial Conduct Authority (FCA). Railpen acts as the investment manager for the RPS and is responsible for the management of around c. £32 billion of assets. The Trustee is Railpen's only client, ensuring that all our activities are aligned with the interests of the schemes' members.

The railways pension schemes include many open defined benefit sections. Therefore, the Trustee plans based on the expectation that it will be paying the pension of an eighteen-year-old who is in their first job today out to 2100 and beyond. As a result, both the Trustee and Railpen consider our investment time horizon to be very long.

The length of our time horizon and investment mandate means that the management of long-term risk and opportunity has always been fundamental to the Trustee's and Railpen's investment approach. This includes our long-standing work on Sustainable Ownership - incorporating our ESG Integration and Active Ownership workstreams into the investment process.

The role of stewardship in achieving our core purpose

> **"Our mission is to pay our members' pensions securely, affordably and sustainably."**

We recognise that members and employers trust us with a significant responsibility, and that the decisions and actions we take affect members' future lives and wellbeing. We are proud of this responsibility, take it very seriously and are committed to and passionate about improving the lives of members.

We realise that generating the required returns to achieve this mission is challenging, and that to succeed, we must constantly strive to be considered an influential pension fund by our stakeholders. We are not afraid to think innovatively and act boldly, and we are prepared to stand our ground and not follow the herd.

We leverage our significant level of assets under management to invest wisely and influentially, guided by convictions and a clear set of investment beliefs. This scale allows Railpen to benefit from an expert in-house Sustainable Ownership team, working closely with our in-house Investment Management team, the Trustee and others across Railpen. This means we can incorporate material environmental, social and governance (ESG) considerations into our investment analysis, consider systemic issues and risks, directly engage with portfolio companies, play a leading part in industry collaborations and thoughtfully exercise our voting rights.

How our values and culture drive our approach to stewardship

Our purpose and the strong sense of our duty to members underpins our broader culture, values and behaviours:

We Take Ownership: We know what we are responsible for and empowered to deliver. We have clear priorities and share a sense of personal accountability, which means we trust each other to deliver their part in our collective goals.

We Are Collaborative: We go further by acting together, sharing our ideas, expertise, ambition and energy. By being open and challenging, we make better decisions.

We Are Pioneering: We are curious and courageous, always open to new ideas and striving for better ways of doing things. We embrace innovation and act on our convictions.

These values are reflected in the Trustee Investment Belief **"Strong governance, leadership and culture are essential requirements for an influential investor of pension assets"**, including the corresponding sub-beliefs that:

- An effective governance structure has clear goals, authorities and accountability for all participants in the investment process. Lack of organisational clarity can result in poor decision-making.
- Investment choices are rarely straightforward. Fully engaged leadership is required to balance multiple inputs and to make difficult but necessary decisions.
- A healthy culture attracts and empowers high-quality individuals and encourages behaviours that are consistent with our investment beliefs. Investment businesses with weak cultures are ineffective over the long-term.
- Being an influential investor demands a leadership role in the wider industry – both as an asset owner and as an investment manager.

Taken together, these drive our stewardship approach in the following ways:

Value	Railpen's stewardship approach
Taking Ownership	▪ Each year we review and agree the strategy, goals and accountability for our Sustainable Ownership Strategy for the following year and, within it, the Active Ownership and ESG Integration workstreams alongside others. This includes well-defined objectives and priorities, clear targets and regular opportunities to update and review.
Collaborative	▪ We collaborate with individuals across the Railpen Investment Management and Fiduciary teams, as well as with the Trustee. The relevant Sustainable Ownership expert jointly engages with key holdings alongside Railpen portfolio managers and liaise on key voting decisions. We also continue to focus on building a shared understanding of the importance of stewardship and ESG integration across the broader organisation. ▪ We also collaborate extensively with others across the sustainable investment industry, to help drive long-term improvements in corporate behaviour and shape a policy and market environment which supports sustainable investment. sustainable ownership.
Pioneering	▪ Railpen and the Trustee were early pioneers on corporate governance. As one of the largest UK pension schemes, we continue to lead by example as well as working with others to raise standards in the industry overall.

Case study: **Working to raise industry standards**

The Trustee and Railpen recognise our responsibility as a leading and large UK pension scheme to try to shape the policy and regulatory framework in a way which supports sustainable investment by investors. We also collaborate with others to raise industry standards and support those schemes without extensive resources or in-house support on sustainable ownership issues.

To this end, we have played a leading role in a number of investment industry initiatives aimed at providing practical guidance to smaller schemes and to raise industry standards. In 2020, this included:

- A proactive role on the **government's Pensions Climate Risk Industry Group (PCRIG)** which produced voluntary guidance for pension scheme investors on how to undertake mandatory climate risk reporting across the TCFD recommendations. In particular, Railpen was one of a few investors asked to help shape and review the final drafts of the guidance.
- Directly shaping and drafting the extensive update of the **PLSA's Stewardship Guidance and Voting Guidelines** as part of their Voting Guidelines Working Group. This document is aimed at supporting smaller schemes to pull together their own voting guidelines, as well as highlighting what good stewardship looks like and how to hold investee companies to account.
- Sharing knowledge, undertaking dialogue with policymakers and creating open source stewardship resources through our active participation in industry forums such as the **RI Roundtable**, the **SASB** and **FRC Investor Advisory Groups**, the **LGPS Scheme Advisory Board Responsible Investment Advisory Group** and the **British Venture Capital Association (BVCA) Responsible Investment Advisory Group**[1]. Many of these are explicitly tasked with raising standards of sustainable investment across different parts of the investment industry.

We supplement these activities through regular participation in webinars aimed at supporting scheme investors, such as: the PLSA 2020 Trustee Conference, the Pensions Management Institute (PMI)'s 2020 ESG webinar week; and Westminster and City Forum's "ESG in Pensions" conference.

We understand that the PLSA's Voting Guidelines were one of their most downloaded documents in 2020 and the PCRIG guidance has been well-received by the industry, as well as providing the basis for some of the government's follow-up work on climate risk reporting by schemes.

We ensure that our external-facing work on key sustainable investment issues facing the pensions industry are discussed with the broader Railpen team. There are several different avenues for doing so, such as through specific updates in internal communications newsletters or regular meetings between the Sustainable Ownership and other teams such as the Investment and Fiduciary teams.

[1] *Please also see our section on "Working to tackle market-side risk".*

Stewardship in line with the Trustee's Investment Beliefs

Each of the Trustee's in-depth investment beliefs[2] provide the parameter and framework for all parts of the investment process used across the organisation as well as for our stewardship activities more specifically. As well as the belief on governance, leadership and culture above, this includes the following on Sustainable Ownership (a term we define below) specifically:

- "Environmental, social and governance factors materially impact long-term investment returns and must be taken into account."
  - Integration of ESG factors improves investment decisions in the long-term.
  - Active ownership empowers investors to influence corporate behaviour and benefit from sustainable business practices.
  - Long-term themes expose our portfolios to substantial risks and opportunities which cannot be fully quantified but should be managed.

These Investment Beliefs are occasionally revised to take account of any changes in composition of the Trustee as well as market and regulatory developments.

Railpen's approach to stewardship

"Sustainable Ownership" is the term we give to Railpen's approach to incorporating sustainability considerations into the investments it manages on behalf of members. This work is enabled by and delivers against the Trustee's related investment beliefs. The explicit link between the Sustainable Ownership work undertaken to protect the value of members' savings is provided through our role in the Fiduciary team[3], which was established to act as the internal representative of the Trustee, clients and – ultimately – members within the Railpen business.

The Railpen investment process considers ESG factors through four lenses: improving investment returns, reducing investment risk, impacting Railpen's reputation as a responsible investor and impacting the future world members retire into. Railpen believes that incorporating these lenses into the investment process increases the likelihood of achieving the Trustee's mission to secure our members' future. The lenses are then used to inform the three areas within Sustainable Ownership:

- **Active ownership:** Railpen's approach to engagement and voting;
- **ESG integration:** incorporation of ESG considerations into the investment process; and
- **Longer-term risks and opportunities:** those themes Railpen believes will play out over the long-term timeframe during which members' pensions will be paid.

We believe that companies with good corporate governance practices and engaged shareholders are more likely to achieve the superior long-term financial performance that members need. Strong governance in portfolio companies tends to ensure effective management of all relevant risks and opportunities, including those related to environmental and social factors.

By actively engaging with portfolio companies and exercising voting rights, it is possible to have a positive influence. This helps Railpen, on the Trustee's behalf, to enhance long-term investment returns for members.

Progress and effectiveness at serving beneficiaries' best interests

Guided by the Trustee's Investment Beliefs, the December 2019 Strategy for the new Fiduciary Team set out a series of Success Measures to measure the wider Team's success against delivery of its core purpose to pay members' pensions securely, affordably and sustainably and support the Trustee and employers. For Sustainable Ownership, these filtered to an overarching objective to undertake ESG integration and exercise active ownership in a way which protects the value of members' income in retirement and the following 2020 Success Measures:

- Extending ESG Integration across more asset classes;
- More regular reporting to the Trustee Board on Sustainable Ownership and;
- Greater recognition of Railpen's leadership in responsible investment by external stakeholders

[2] *Please also see Appendix 1 for the full list of Trustee Investment and Scheme Beliefs.*
[3] *The Fiduciary team brings together the Client Investment Services, Investment Strategy and Research, Employer Covenant, Pensions Policy, Sustainable Ownership and Risk and Performance teams.*

Success measure 1	Extending ESG integration across more asset classes
Progress in 2020	▪ Strengthen ESG investment risk governance across all relevant asset classes. ▪ Climate Working Group set up (June 2020) and explored application of Net Zero Investment framework. ▪ New due diligence process for private equity and VC funds. ▪ Review of external managers' approach to ESG Integration.
Next Steps	▪ Create proprietary ESG metrics and ranking system. ▪ Expanded Sustainable Ownership training for the Railpen Investment Team.
Success measure 2	**More regular dialogue with the Trustee**
Progress in 2020	▪ Set up programme of 'Deep Dives' with the Trustee. ▪ Developed integrated reporting of stewardship and ESG integration activities to the Railpen Investment Board through the Investment and Risk Report.
Next Steps	▪ Set up a Sustainable Ownership Client Forum for Pension and Management Committee members. ▪ Undertake a survey of members to explore attitudes to sustainable investment.
Success measure 3	**Railpen leadership on sustainable investment recognised**
Progress in 2020	▪ Invited to join government and industry committees e.g. the DWP's Pensions Climate Risk Industry Group and Occupational Pension Schemes Council, the PLSA's Stewardship Advisory Group. ▪ Created a new 'triage' process for assessing external-facing and public policy opportunities. ▪ Spoke at 20 industry events on sustainable investment in Q4 2020 alone.
Next Steps	▪ Continue ongoing participation in relevant and priority industry forums and groups. ▪ Publicly contribute to and shape the policy debate on issues which align with Railpen's core purpose and priority engagement themes.

Despite the challenges of Covid-19, we believe that 2020 has been a year of significant growth both for Railpen as an organisation and the stewardship work we undertake on behalf of members. The case study below shows how the coronavirus pandemic has provided additional momentum to work to further align our culture to our purpose.

Case study: **Coming Back Better — The legacy of Covid-19**

In 2019, Railpen undertook a programme of work under the new Chief Executive to ensure stronger links between our purpose and our working culture. A new Strategy team was created within Railpen to lead this work and interact with the Trustee.

The 2020 Covid-19 crisis gave fresh impetus to these efforts to align our culture to our purpose and we consider it to have presented an opportunity to ensure that Railpen "Comes back better" and to actively and thoughtfully reshape our working culture so we can better serve our members' needs and interests. Regular communications and discussion of this programme of work have taken place for all Railpen staff during Railpen Town Hall meetings.

Discussions are currently ongoing, but one emerging theme from the dialogue between the Trustee and the Railpen Executive Committee has been our responsibility as a large asset owner to consider our impact on society. This would have relevance for how we undertake and approach our stewardship work and we look forward to reporting more in future statements.

Stewardship in the interests of members

The RPS, which is the largest of the four schemes managed by the Trustee, comprises six parts: the 1994 Pensioners Section, the Shared Cost Arrangement, the Defined Contribution (DC) Arrangement, the Defined Benefit (DB) Arrangement, the Omnibus Section and the IWDC Section. Employers may participate in more than one arrangement and in more than one section of the Shared Cost Arrangement. There are 107 sections across the six parts of the RPS as illustrated below:

Railways Pension Scheme

	1994 Pensioners Section	Shared Cost Arrangement	Defined Contribution Arrangement	Defined Benefit Arrangement	Omnibus Section	IWDC Section
sections	1	104	0	0	1	1
employers	1	105			40	32
members	93,407	237,994			751	9,476

The £32 billion portfolio helps to pay the pensions of around 350,000 members. Given that many of the DB sections are open to new members and future accrual, as well as having open DC sections, our investment time-horizon is extremely long. This means we have a substantial allocation to growth assets such as listed equity, which is why a significant proportion of our Sustainable Ownership in-house resource is dedicated to thoughtful exercise of our (substantial) voting rights alongside constructive engagement.

AUM by asset class (31 December 2020)

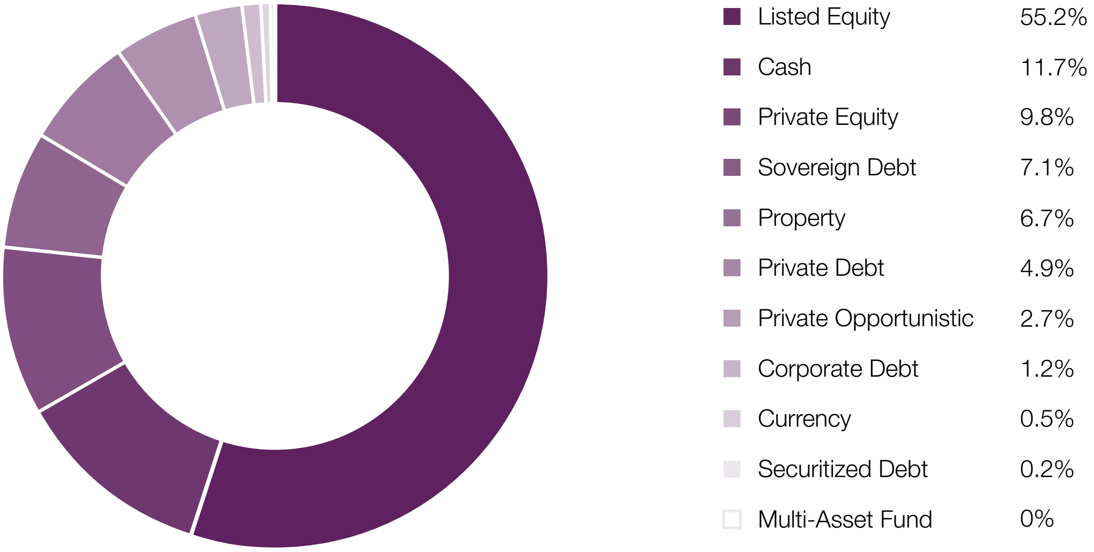


Figure 1 RPS Asset Allocation - by asset class

AUM by region (31 December 2020)

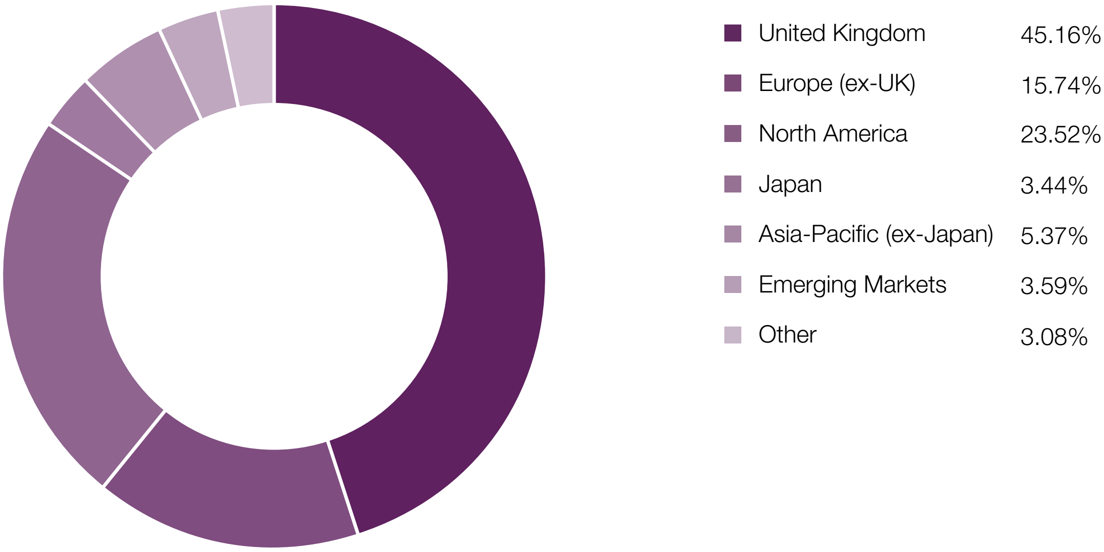


Figure 2 RPS Asset Allocation - by region

Our portfolio is mostly concentrated in developed markets and, in particular, the United Kingdom and United States. This influences the level of resource we dedicate to stewardship activities in these jurisdictions including our engagement and voting activities, as well as participation in relevant industry initiatives and policy debates. Prioritisation is vital to ensure that we focus resource on where we can achieve the greatest impact on members' behalf.

The geographical split also reflects the nature of some of our private markets and real estate holdings, where we believe we can achieve greater oversight and exert a positive influence over holdings in the domestic market.

How we understand the views of members

The average member is a 45-year-old man who works on the railways. Although there is an emerging body of evidence that seeks to highlight how attitudes to sustainable investment differ across gender, age and other demographic indicators, we believe that the results are, as yet, too inconclusive for us to draw firm conclusions. We recognise that the significant proportion of unionised members gives a clear mandate which reinforces our engagement and voting focus on workforce issues in particular.

Given the diversity of views across 150 different employers (and their employees), key mechanisms for understanding the membership's perspectives on sustainable investment are through:

- **The Trustee.** All sixteen members are nominated by the members or employers of the scheme and bring a valuable understanding of member views to their trusteeship.
- **The Pensions and Management Committees (Pension Committees).** These have been implemented by around a quarter of sponsoring employers – covering around 85% of the membership – to provide additional governance oversight and are another key forum for understanding the member perspective; and
- **The Railpen Investment Board.** This has been established by the Trustee to oversee the management of the Pooled Funds by Railpen. The membership of RIB includes two Trustee Directors, three non-executive directors (including the chair) and the Chief Executive of Railpen.

The Sustainable Ownership team has a number of formalised opportunities for interaction with these groups. For instance, each year the team hosts offsite days with Trustee representatives, the Railpen Investment Board, the Investment Management team and other internal stakeholders. Although this usually happens face-to-face, the pandemic has meant that interactions with stakeholders happened virtually in 2020.

In 2020 the Trustee also worked with the Sustainable Ownership team to agree a programme of 'deep dive' discussions for 2021, on various aspects of the team's work. These half-day sessions seek views from the Trustee on Railpen's activities across sustainable investment as well as provide training on sustainable investment issues, including regulatory and disclosure duties. Outputs from our January 2021 Trustee Deep-Dive session are in the case study below. Our May 2021 session will be dedicated to climate change specifically, with an additional session focusing on a review of the Trustee's investment beliefs on sustainable investment issues.

Case study: **Trustee Sustainable Ownership Deep Dive and impact on Sustainable Ownership work – January 2021**

In January 2021, members of the Trustee attended a deep dive session on Sustainable Ownership with the full Sustainable Ownership team and other Railpen staff including both the Chief Investment Officer and the Chief Fiduciary Officer.

The objectives of the session were to:

- Explore the latest developments in trustee duties on Sustainable Ownership;
- Discuss the relative importance to trustee investment decision-making of issues including ESG risk, reputational risk and member views; and
- Discuss the investment approvals process and how the Investment Risk, Investment and Sustainable Ownership teams work together to integrate ESG analysis into Railpen's approach to investment risk.

To elicit the Trustee's perspectives and beliefs on a rapidly evolving market and legislative environment for sustainable investment, the session was designed to be interactive and included:

- A 'war-game' session on a hypothetical investment decision on a controversial issue;
- 'Ask anything' coffee breakouts with individual team members;
- Polls to gauge the Trustee's perspective on specific issues;
- Presentations on the regulatory environment as well as how the Sustainable Ownership team works with the Investment Management team across our ESG analysis and stewardship activities; and
- A recorded video interview with an Australian peer asset owner on reputational risk.

Issues raised by the Trustee included:

- The importance of asset owners like Railpen seeking to positively influence the regulatory and policy environment on responsible investment;
- The usefulness of shareholder resolutions in encouraging positive corporate behaviour;

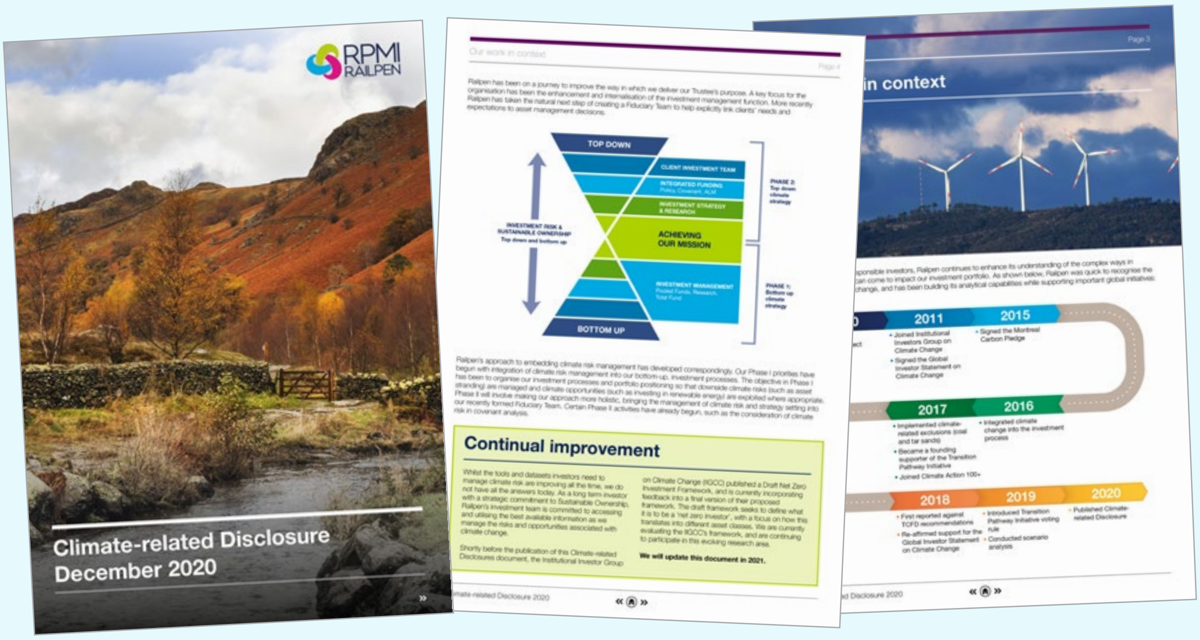
- The need to consider and understand members' views within the context of trustees' fiduciary duty; and
- That reputational risk to the Trustee of an investment is a key consideration.

Intelligence from the session has been an invaluable input into Railpen's approach to sustainable investment issues. It has:

- Encouraged us to create a bespoke shareholder resolution template for 2021, which takes a more robust and positive approach to resolutions on issues which align with our core ESG priorities and engagement themes;
- Highlighted the importance of a two-way dialogue with members, which has led to further discussion between the Sustainable Ownership team and the Communications team regarding how we can best use the RPS website as well as Railpen's to highlight our work and encourage direct questions from members; and
- Given the Sustainable Ownership team comfort that our proactive approach to sustainable investment public policy continues to be in line with the Trustee's investment beliefs and approach.

The Sustainable Ownership team also has regular discussions with RIB and Pension Committees (please see case study below). In 2020 this included a discussion on which companies should be placed on the exclusions list (currently comprising companies involved in thermal coal production, indiscriminate weaponry, and companies exhibiting particularly poor conduct).

Case study: **Dialogue with Pensions Committees**



Over 2020, Railpen's team discussed sustainable investment issues with a number of Pensions and Management Committees. Issues discussed included:

- Decarbonisation of the portfolio;
- How we decide our thematic engagement priorities;
- Our approach to gender and ethnic diversity at portfolio companies;
- Our work on deforestation across the portfolio; and
- How we voted on executive remuneration (both quantum and structure).

This was additional useful input into our thinking, in Autumn 2020, about our Sustainable Ownership priorities for 2021. In light of these and other discussions, Railpen has:

- Created a new 'materiality matrix' for ascertaining thematic priorities, with variables including "the Trustee perspective", "the member perspective" and "materiality to our portfolio";
- Incorporated new, more stretching lines on ethnic and gender diversity into our engagement and voting priorities for 2021;
- Prioritised "deforestation and biodiversity" as a key thematic engagement priority for 2021 and beyond;
- Pressed ahead with our formation of a cross-Railpen Climate Working Group to consider how we not only decarbonise our portfolio, but also invest in new climate opportunities; and
- Communicated in greater detail about our work on climate to members. This includes our December 2020 "Climate-related Disclosure" which pulled together Railpen's approach to climate risk across the portfolio and is designed to be accessible to members.

Given how useful these interactions have been in shaping our work, we have also proposed a Sustainable Ownership Client Forum in 2021 with representatives drawn from the Pensions and Management Committees. This will allow us to discuss sustainable ownership issues with employer representatives on an in-depth and more regular basis.

Dialogue on stewardship with members

We believe that accessible, engaging communication on sustainable investment issues can have benefits for member engagement with their pension savings more generally. As a result, Railpen has always taken member communication seriously. This is why we have published a standalone Sustainable Ownership Report, designed to be interesting and user-friendly for our members, each year since 2017.

We are transparent about our engagement and voting activities. Our Active Ownership page on the Railpen website offers access to our:

- Latest Global Voting Policy and Engagement Policy;
- Questions asked at AGMs;
- Thought-leadership publications and consultation responses;
- Sustainable Ownership Reports;
- Climate-related Disclosures; and
- Voting Activity (UK)

We also seek a dialogue on sustainable investment issues with members through our social media channels. Sustainable Ownership content forms a significant proportion of our content on the @RPMIpensions Twitter feed and our posts on LinkedIn.

Members are encouraged to feed back views and questions via email, with contact details given on every Sustainable Ownership publication. This includes during AGM season, where the Sustainable Ownership team responds to member queries on how Railpen intends to vote at any contentious meetings.

A key theme for our 2020 and 2021 stakeholder communications has been the Trustee's and Railpen's work on climate change. Late 2020 saw us start work on climate change content for the Q1 2021 newsletter. There will be further newsletters on sustainable investment issues scheduled for regular intervals throughout the year. We think that this will be an effective mechanism to encourage member engagement on sustainable investment issues and to support them to consider our approach and feed through their views.

We put a significant amount of effort into our communication with members, but we are looking to do more to encourage proactive queries or comments. In 2021 and 2022 we will be exploring alternative options for understanding our members' concerns directly, and thinking about how to build a two-way conversation on sustainable investment issues.

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Climate change and your pension

Sustainability, and climate change in particular, can have a huge impact on making sure you get the retirement income you've been promised, as well as on the world in general.

As such, climate change is something that we consider carefully in all our investment decisions, and are also actively involved in helping to tackle.

Our work on climate change to date

In 2019, we formally committed to voting in Annual General Meetings (AGMs) against any companies that we believed lacked oversight of climate change at management level.

And this year that policy will be expanded to include voting against companies in key climate-affected sectors that do not make the impact of climate change clear in their financial accounts.

This is the latest in a series of steps we've taken, recognising the importance of climate change and its impact on your savings (see timeline to the right).

Our plans on climate change

Over the past 12 months, we've been working hard to reduce the impact of climate change even further. We recently published our Climate-Related Disclosure at **www.rpmirailpen.co.uk/wp-content/uploads/2018/05/SO-Climate-related-Disclosure-report.pdf** so you can see exactly how this is going.

We've also established a cross-team Climate Working Group, chaired by Railpen's Chief Investment Officer, Richard Williams, to look at how we can play our part in helping the UK achieve its ambition to bring greenhouse gas emissions to net zero by 2050.

This is an ever-changing field, but one we are committed to remaining at the forefront of.

We are actively involved in the Government's Pensions Climate Risk Industry Group (PCRIG), which supports the pensions industry in responding to climate change and aims to raise standards of climate-aware investment.

And we will continue to use our voice, alongside those of other investors, to publicly call for positive corporate action on climate change and to apply positive influence on the companies we invest in.

We also hope that the UK hosting the 26th UN Climate Change Conference (UKCOP26) later this year will provide more opportunities to discuss the impact of climate change, not only on your pension but on the world you will retire into.

Find out more about our approach to climate change

You can read more about our work on climate change and other environmental, social and governance factors (ESG) in our Sustainable Ownership Report, available online at **railwayspensions.co.uk**

2012	Signed up to Carbon Disclosure Project - helping companies around the world to measure, manage, disclose and reduce their emissions
2013	Committed to Aiming for A - a group of organisations calling for greater disclosure around climate change
2014	Began participating in Institutional Investors Group on Climate Change and now lead on company engagements
2015	Signed Montreal Carbon Pledge, committing to measuring and publishing our carbon footprint each year
2016	Integrated climate change into investment decision-making process
2017	Divested from companies on climate grounds (thermal coal and tar sands)
2018	First publicly reported our approach to climate governance, strategy and risk management Signed the Global Investor Statement on Climate Change, supporting The Paris Agreement's goal of keeping global temperature rise below 2˚c
2019	Formally committed to voting against company boards which lack climate expertise
2020	Published our first standalone Climate-related Disclosure

Figure 3 From the February 2021 edition of Re:view, the newsletter for RPS members

How our structures enable effective stewardship

Our Investment Transformation Programme

In 2013, Railpen began to shift management of its assets to an in-house Investment Management team. This was to provide more efficient and effective oversight and implementation of its long-term investment strategy on members' behalf. This momentum towards internalisation has continued ever since, with a significant proportion of Railpen's assets invested in-house. This has significant benefits for Railpen's stewardship and ESG integration work as it allows us more direct control over the sustainable investment implementation both at the pre- and post-investment phases.

Governance and oversight

Acting as a long-term, responsible investor is fundamental to the Trustee's investment purpose, beliefs and objectives as well as our mission of paying members' pensions securely, affordably and sustainably. As a result, oversight of our Sustainable Ownership activities takes place from the top of our organisation.

The Sustainable Ownership team sits within Railpen in the Fiduciary team. The Fiduciary team brings together those teams which are responsible for supporting the Trustee and the Pensions and Management Committees in their oversight and top-down investment responsibilities. Our role in the Fiduciary team explicitly links the Trustee's – and in turn members' – needs and expectations to the sustainable investment decisions we make on their behalf, to protect the value of members' savings. The Head of Sustainable Ownership reports to the Chief Fiduciary Officer who in turn reports to the Railpen Chief Executive.

The Sustainable Ownership team works alongside the Railpen Investment Management team. The Investment Management team reports to the Chief Investment Officer, who reports to the Railpen Chief Executive. Both the Chief Investment Officer and Chief Fiduciary Officer sit on the Investments Executive Committee and on the Railpen Executive Committee.

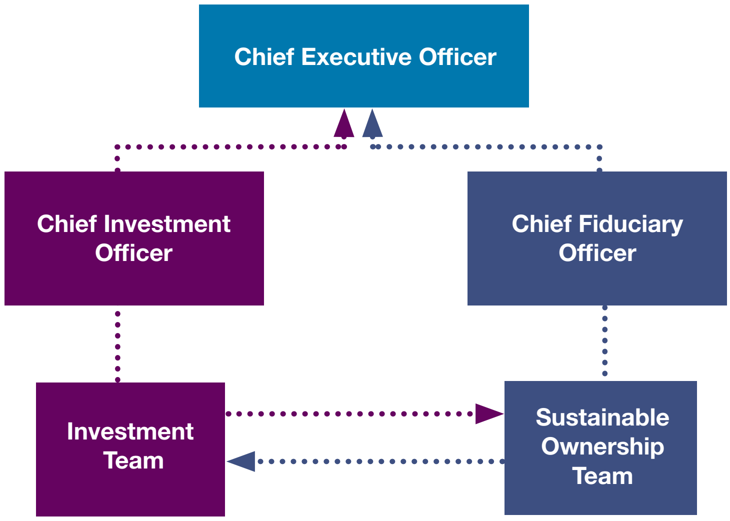
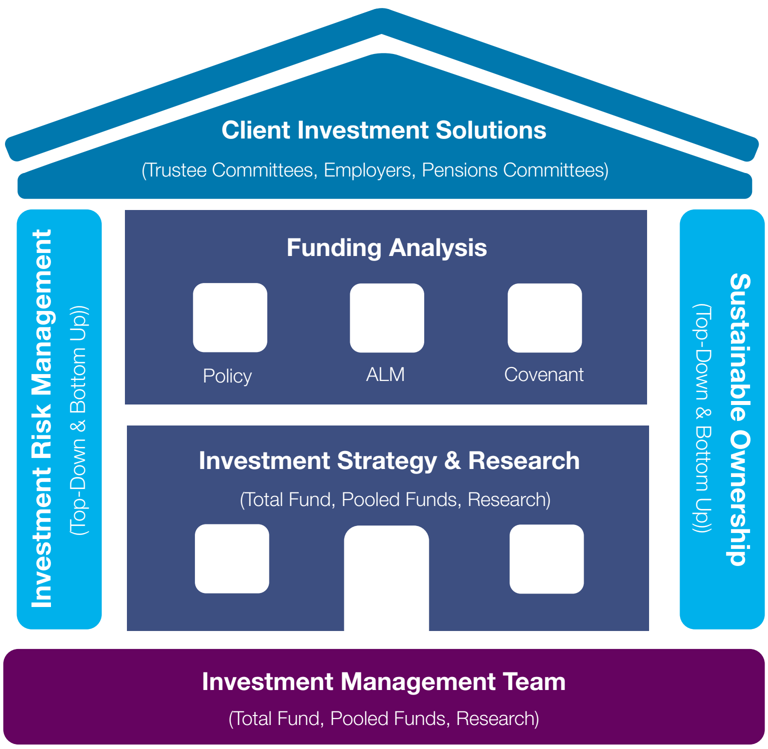


Figure 4 Investment Management and Fiduciary Team: reporting structure

The Sustainable Ownership team is one of Railpen's investment "guardrails", with top-down responsibility for delivering the Trustee's commitment to sustainable investment, while also working closely with the Investment Management team and the Investment Risk team to ensure that sustainable investment is considered and applied throughout the Investment Business from the bottom-up.



The Sustainable Ownership and Investment teams work closely and collaboratively across all parts of the lifecycle of an investment, as illustrated below:

- **Before a decision to invest.** The Sustainable Ownership team undertakes an analysis and, where necessary, co-engages alongside the Investment Management team with the company to probe any areas of interest or concern. The Sustainable Ownership team will assess and quantify the level of ESG risk and make a recommendation on possible mitigating activities.

- **After a decision to invest.** The Sustainable Ownership and Investment Management teams co-engage with key portfolio companies on stock-specific issues, as well as discussion of Railpen's overall thematic sustainability and governance priorities.

- **Voting recommendations.** Recommendations are, where relevant, made and implemented by the Sustainable Ownership team. If the holding is in one of our fundamental equities portfolios, decisions to abstain or vote against go to the relevant Investment Management team portfolio manager for approval. If the two teams cannot reach a consensus, there is a process for escalation to the Chief Investment Officer.

- **Class Actions.** The Chief Investment Officer provides final sign-off on the decision as to whether to participate in opt-in class action suits against a company. The Sustainable Ownership and Legal teams feed in views, including whether there is a likelihood of being able to influence and improve corporate governance because of the class action or whether participation in the lawsuit risks undermining an engagement with the company.

- **Exclusion analysis and decisions.** These are led by the Sustainable Ownership team and discussed with the Investment Management team at regular catch-ups before going to the Railpen Investment Board for approval. This is then implemented across both the internally-managed portfolio and sent to our external managers where relevant.

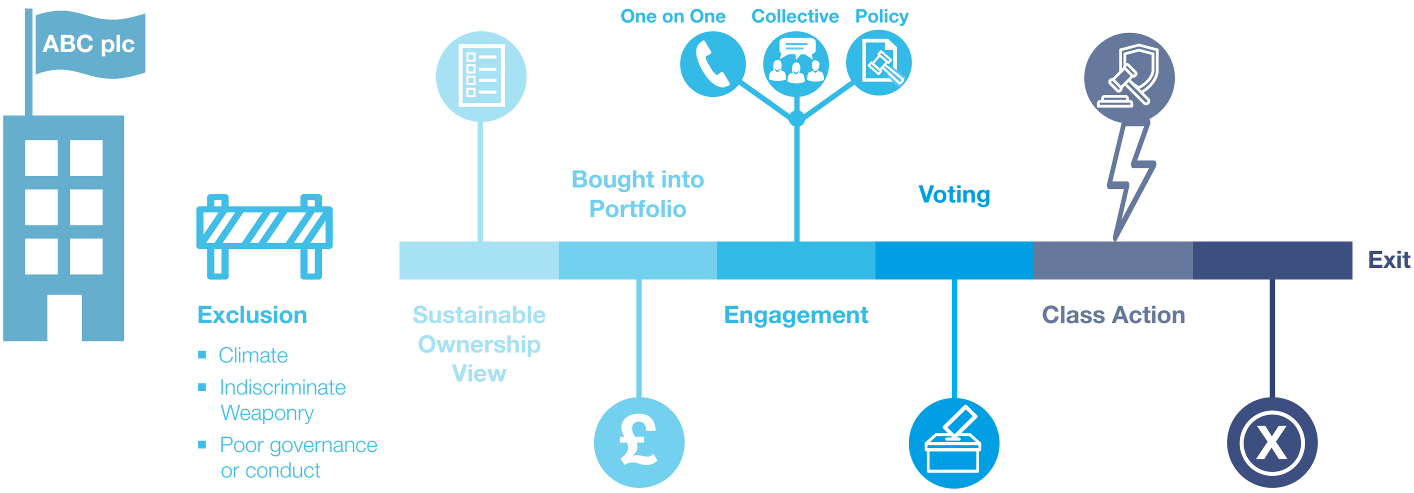


Figure 5 The life-cycle of an investment at Railpen

Review of our processes and policies

Railpen recognises that the expectations for sustainable investment are rapidly changing and to remain truly “pioneering” we therefore regularly review and update our approach to, and policies governing, our ESG integration, engagement and voting activities.

Review activity (annual)	2020 updates
Global Voting Policy	▪ New lines on climate accounting, auditor remuneration and workforce treatment. ▪ Move to a more consistent approach to gender diversity across markets. ▪ Strengthen focus on key sustainability themes.
Exclusion Policies ▪ Climate ▪ Indiscriminate Weaponry ▪ Poor governance or conduct	▪ Expand the scope of Indiscriminate Weaponry. ▪ Clarify approach to and process for companies involved in oil sands extraction.
Global Engagement Policy (Summer 2021)	▪ Include further details on 2021/22 thematic engagement priorities. ▪ Design to be more accessible to members. ▪ More clearly aligns with our 2021/22 Voting Policy.
Engagement targets and objectives	▪ Process changed – creation of a “materiality matrix” to assess potential ESG issues against specific criteria to help determine approach and prioritisation. ▪ Decision to dedicate more resource to thematic engagement activity in recognition of systemic risks faced by Railpen as a universal owner. ▪ Create a new database to enable us to map progress against one-year, three-year and five-year engagement objectives.
Due diligence processes (external managers)	▪ Update sustainable investment activities and outcomes questions across both manager selection and monitoring of private equity (PE) and venture capital (VC) managers.

Conflicts of interest

Railpen expects all directors, employees and secondees that provide services to the Company to comply with the content and spirit of its Conflicts of Interest Policy.

It is important that the business environment and operations are monitored on an ongoing basis to ensure that all conflicts of interests are captured, particularly that new conflicts of interest are identified and escalated to senior management and the compliance function where appropriate. Therefore, a conflicts of interest register is kept by the compliance function and each employee is responsible for reporting items to be included on the register.

Potential conflicts of interest include, but are not limited to:

- Personal interest in suppliers of services to the company
- Any interest in a business which may be a client of the Trustee Company
- Dealing on one's personal account in a security in which there may be insider information or other confidential information held by the company.

These Conflicts of Interest policies are reviewed on an at least annual basis. For instance, the Compliance team reviews conflict management policies concerning personal account dealing, gifts and hospitality rules and carries out the appropriate monitoring tests regularly. The team also sends out a Notification of Interests form across the organisation to remind employees to complete this if they have any outside interests. A Conflicts of Interest Register is in place and presented to the RPMI and Railpen Investment Boards on an annual basis.

In 2021, to further strengthen the culture of compliance across the organisation, Railpen is introducing a system to assist with recording requests and providing details of any Gifts and Hospitality and annual declaration attestations. This will generate Management Information (MI) that we can then use to further enhance monitoring and evaluation.

Managing potential stewardship conflicts

Railpen recognises the serious impediment that poorly managed conflicts can pose both to our external managers' ability to act in the best interest of their clients, and to the Sustainable Ownership team's ability to act as stewards on members' behalf.

We manage potential conflicts of interest in the following key ways:

- The Trustee expects its external asset managers to have effective policies addressing potential conflicts of interest, when it comes to matters of stewardship and investment practice. Railpen has asked external asset managers for updated information on their approach to stewardship conflicts of interest, using the Pensions and Lifetime Association (PLSA) Vote Reporting Template.
- The Railpen Sustainable Ownership team has a process by which we expect every team member to bring any potential stewardship conflicts to the surface on a rolling basis. Our approach aligns with that recommended by the PLSA in their Vote Reporting Template guidance for asset owners. Potential conflicts which are expected to be disclosed include:
  - Whether individuals hold roles at a company in which we have an equity or bond holding.
  - Whether individuals have a personal relationship with relevant individuals (e.g. on the Board or the company secretariat) at a company in which the firm has an equity or bond holding.
  - Where such a conflict is disclosed, steps are taken to ensure that the relevant team member does not take part in any engagement (collective or direct) or voting activity at the company concerned.
- The Trustee Company's voting policies are applicable to all listed companies, including without exception those that participate as employers in railway industry pension schemes.

Case study: **Managing potential stewardship conflicts of interest**

Voting against an RPS employer: If we vote against management at an AGM of a company which is a sponsoring employer within the Railways Pension Scheme, we will notify our Chief Fiduciary Officer and the Head of the Client Investment Team. In 2020, we sent 14 notifications of this type.

Voting against a tenant in our Property portfolio: We follow a similar process when we vote against management at the AGM of a company which is a tenant in our internally managed Property portfolio. In this case, we notify the Head of Property. In 2020, we sent nine notifications of this type.

Stewardship conflicts on the Sustainable Ownership team: A member of our Sustainable Ownership team is also a trustee of an authorised master trust where a FTSE 100 insurance firm is the Scheme Funder. Railpen exercises its voting rights directly on UK stocks in its pooled passive index fund and so a potential stewardship conflict arises.

To manage this conflict, the team member's conflict has been declared, the company has been placed on a watchlist and the individual is barred from undertaking any direct or collective engagement activity with the company, or from any discussions or decisions on relevant voting decisions.

Internal sustainable investment and stewardship resources

The internalisation of Railpen's investment management function means that the majority of Railpen's assets are managed by an expert in-house Investment Management team, which comprises individuals with expertise across fundamental and quantitative equities, corporate and sovereign debt, private markets, real estate and infrastructure.

Railpen also has a dedicated in-house Sustainable Ownership team of six individuals, each of whom brings the appropriate level of skills, knowledge and understanding to be able to deliver on the Trustee's commitment to sustainable investment and delivering for members.

Individuals across the Investment Management and Sustainable Ownership teams offer a diverse range of backgrounds and perspectives. Pertaining to Railpen's sustainable investment work specifically, the teams' backgrounds span ESG investment analysis and research, public policy and advocacy, social policy and anthropology, thematic engagement and pension trusteeship. Direct organisational experience also varies widely and individuals have experience of investment management, academia, policy and regulatory bodies, and DB, DC and public sector pension schemes.

This breadth of experience means the team is well-positioned to act as an effective and impactful steward of members' savings.

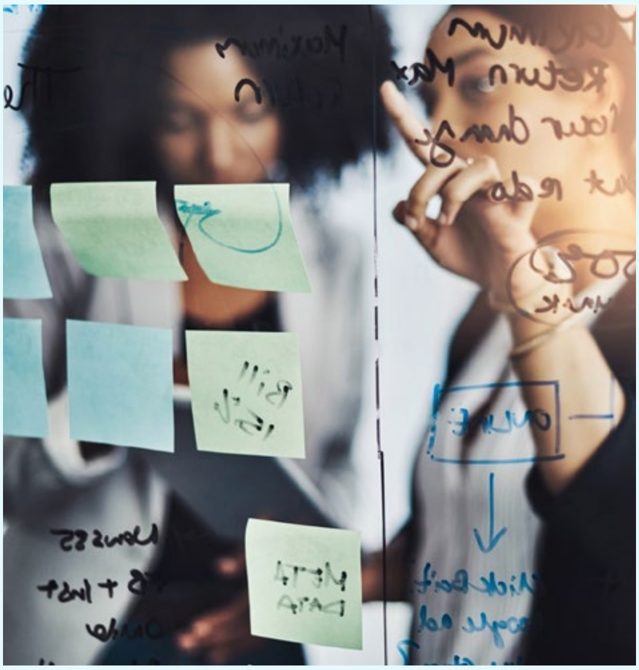
Case study: **Sustainable Ownership team recruitment in 2020**

In 2020, there was an active focus on recruitment of more staff into the Sustainable Ownership team to ensure the best possible mix of expertise and backgrounds. This would in turn support effective delivery of the Trustee's stewardship priorities and the 2020 Sustainable Ownership Business Plan objectives of:

- Formalising a top-down approach to and framework for ESG risk management;
- Broadening the reach of the Sustainable Ownership team to ensure a balanced consideration of financially material ESG factors within the Fiduciary Team's activities, and to develop a roadmap and strategy for ESG integration across the portfolio;
- Further developing public policy and Sustainable Ownership communication activities as part of the Active Ownership workstream's approach to thematic risk and in line with Railpen's "pioneering" culture and the Trustee's Investment Belief that Railpen should act as a "leader"; and
- Deepening the relationship between the Sustainable Ownership team and the Trustee, the Railpen Investment Board and the Pensions and Management Committees, to ensure the team's activities remain closely aligned with the members' interests.

This was in addition to being able to deliver the BAU activities across the ESG Integration and Active Ownership workstreams.

The Sustainable Ownership, Investment and Fiduciary teams worked together to consider detailed job descriptions and responsibilities aligned with these responsibilities and in 2020 recruited individuals into the teams with experience across the following areas:



- Listed equity analysis and integration of ESG into financial analysis and investment themes;
- Collective and thematic engagement;
- Scheme governance (policy and practice); and
- Public policy and advocacy.

We also paid close attention to broader diversity considerations in our recruitment, including gender, background and experience. In 2021, one of Railpen's core HR priorities is working to create a diverse workplace where everyone feels included, valued for their differences and empowered to be their true selves at work and this will further support our future recruitment of diverse talent.

Training

Railpen's culture is one of continued learning and progression for all individuals, regardless of seniority or length of tenure. We recognise that this is necessary in order to ensure that Railpen continues to live up to its core values and to act as a leading UK asset owner. We also continuously train employees to ensure we abide by our regulatory standards and procedures.

This culture is mirrored in the seriousness with which the Investment, Fiduciary and Sustainable Ownership teams take the responsibility to ensure all relevant individuals are up to date on the key issues in what is a rapidly evolving market. In the Sustainable Ownership team, specifically, a core element of each individual's performance assessment and appraisal is how well the individual has behaved with a "high degree of analytical rigour" and this in turn requires investment in ongoing support and training.

Examples of training activities undertaken by the Sustainable Ownership and Investment Management teams in 2020 include:

- Studying for CFA UK ESG certificates, as well as other relevant certificates;
- Participating in workshops and teach-ins on key active ownership or ESG issues;
- Attendance at conferences organised by external providers (e.g. MSCI, the ICGN, the PLSA); and
- E-learning modules on ESG issues such as modern slavery.

This is supplemented by activities to create a learning culture across the teams including through:

- Online forums for dedicated discussion of the latest ESG research and analysis;
- A commitment from the senior team members to lead by example with weekly attendance at webinars and training sessions; and
- The development of personal training plans, progress against which is discussed at regular intervals.

The Sustainable Ownership team holds regular workshops with our Investment Management team and Fiduciary team colleagues. For instance, the Climate Working Group – which includes five individuals from the Investment Management team and five individuals from the Fiduciary team – has been a key forum in 2020 for discussion and updates on issues including the UK regulatory requirements on Taskforce for Climate-Related Financial Disclosures (TCFD) and the IIGCC Net Zero framework.

In 2021, analysts and managers from both the Sustainable Ownership and Fundamental Equities teams are working together to create a series of workshops where each team can learn in a structured way from the other. This supplements the Sustainable Ownership "offsite" which takes place each year and includes a series of educational sessions on the most important and interesting sustainable investment issues. Several members of the Investment Management team are also taking the CFA UK ESG Certificate in 2021.

Incentives

Railpen's approach to incentivisation and reward is undertaken in line with the Trustee's Scheme Belief that "alignment of interests across members, employers and all other stakeholders improves the prospects of achieving the Trustee's investment objectives" and the sub-belief that "people respond to incentives. Therefore our reward structure is competitive and designed to motivate our staff to achieve the Scheme's long-term objectives[4]."

The Sustainable Ownership team is eligible for participation in a personal bonus programme, for which they are assessed against a number of objectives including individual delivery of ESG initiatives. Each individual's performance is assessed annually against delivery of his or her core purpose of delivering value for members in alignment with the Trustee's investment objectives, which in turn feeds through to specific accountabilities, behaviours, and delivery of priority projects.

The long-term incentive of the Investment Management team is tied to long-term fund investment performance, to ensure that portfolio managers are not incentivised to pursue short-term performance objectives, and aligns with Railpen's core purpose and mission as a responsible investor.

As sustainable investment continues to be integrated across the Investments Business, as well as Railpen more broadly, a growing number of colleagues outside the Sustainable Ownership team have some element of sustainable investment responsibility written into their job descriptions and objectives, performance against which determines the level of variable pay received.

For instance, one individual in the Private Markets team has "Further integrating ESG analysis across private markets investment decision-making" as a 2021 accountability in their "Job on a Page" which outlines specific accountabilities, objectives and priorities and against which an individual's performance is measured. To this end, they represent the Private Markets team at cross-Railpen sustainable investment initiatives like the Climate Working Group and recently obtained the CFA UK Certificate in ESG Investing.

Railpen's structured development programme also includes regular conversations around what support individuals need from Railpen in order to meet their accountabilities and progress in their career. This increasingly includes sustainable investment training and education as discussed previously.

How effectively the Railpen structure supports stewardship

The current approach in terms of lines of accountability and collaboration with both Fiduciary team and Investment Management team colleagues is effective in enabling co-ordinated activities with portfolio companies and the achievement of positive impact.

A direct line between the Sustainable Ownership team and the Chief Fiduciary Officer ensures that sustainable investment is pursued in line with the Trustee objectives, beliefs and core purpose. The relationship between the Sustainable Ownership and Investment Management team is collaborative at every level and over the entire life-cycle of an investment. To try to understand where further efficiencies could be realised, a review was undertaken in late 2019 and early 2020 in light of:

- The need to avoid duplication of effort by stock analysts in both teams; and
- The fact that the relevant risk-taker owns all risks associated with an individual investment decision.

As a result, the Sustainable Ownership team have in 2020 taken on specific sector allocations for pre- and post-investment engagement and analysis to mirror the sector allocations of the fundamental equities team. This allows for further development of specific sectoral expertise in the Sustainable Ownership team as well as the deepening of key relationships across the Sustainable Ownership and Investment Management teams. This will further ensure effective two-way dialogue and decision-making.

[4] *Please see Appendix 2 for further details of the Trustee's Investment and Scheme Beliefs.*

Systematic ESG Integration

As stated under Investment Belief Four, the Trustee believes that environmental, social and governance (ESG) factors materially impact long-term investment returns and must be taken into account. Railpen aims to implement this belief across the entire global portfolio by integrating ESG analysis into our investment process.

We define ESG risk as the potential for financial loss resulting from ESG related factors. ESG risk can affect business fundamentals and impact the market. The magnitude, nature, timing, and likelihood of the ESG risk associated with an asset or portfolio of assets can be approximated by assessing inherent risk, and the quality of mitigants in place now or in the future.

Working together with the Investment Management team, the Sustainable Ownership team's analysis of a particular company can result in a number of decisions:

- To invest (or not) in the company;
- To hold and engage to improve ESG performance; or
- To sell a security, where the ESG risk proves to be unmanageable.

ESG integration by asset class

Our ESG integration methods differ by asset class, as described in the table below. In 2020 we continued to develop our ESG integration process to a consistent level across all asset classes as the disclosure and availability of company ESG data improves. We provide a case study on our approach to strengthening our ESG Integration across the Long-Term Income Fund (LTIF) below.

Asset class	Integration Approach
Listed Equities	▪ Sustainable Ownership assessment carried out for all companies in our fundamental growth portfolio. We will reflect any concerns from our assessments in our voting and engagement approach. We also use intelligence from engagements to inform our assessment. ▪ Exclusion of some companies on grounds of climate, cluster munitions and governance and conduct. ▪ External manager monitoring.
Fixed Income	▪ Exclusion of some companies on the grounds of climate and controversial weapons. ▪ External manager monitoring.
Private Markets	▪ Sustainable Ownership assessment carried out for all transactions. ▪ External manager monitoring.
Property	▪ The Property Sustainability strategy integrates ESG into ongoing asset management. ▪ External manager monitoring.
Infrastructure	▪ Sustainable Ownership assessment carried out for all transactions. ▪ External manager monitoring. ▪ Exclusion of some projects on the grounds of climate and controversial weapons.

Case study: **Strengthening ESG Integration across our Long-Term Income Fund (LTIF)**

Issue: Our Long-Term Income Fund (LTIF) targets defensive real assets, including core infrastructure, renewable energy and long-lease commercial real estate assets in the UK. Recent investments include the Sleaford Renewable Energy Plant, the Tralorg Wind Farm and the Carraig Gheal Wind Farm.

As part of a broader project to further enhance current approaches to integrating ESG risk into the investment process, in late 2020 the Sustainable Ownership and LTIF teams initiated a joint project to:

- Systematise our assessment of reputational risk;
- Improve process efficiency and good governance, ensuring a shared understanding of LTIF and Sustainable Ownership accountabilities; and
- Co-ordinate communication and reporting to internal stakeholders, as well as improving transparency to external stakeholders on the ESG performance and credentials of existing assets.

Approach: The project will proceed as per the following phases over the course of 2021.

1. Discuss	▪ Opening discussions between Sustainable Ownership team and portfolio team ▪ Ensure shared objectives and principles
2. Design	▪ Work collaboratively design frameworks, tools. templates, processes, who-does what, reporting templates, review suppliers
3. Test	▪ When available test new tools and processes on historic or live investments and incorporate learnings ▪ Asses impacts on time taken/resource requirements
4. Implement	▪ When testing is complete, roll out new procedures, and provide trainings/teach ins, oversight
5. Review	▪ When testing is complete, roll out new procedures, and provide trainings/teach ins, oversight

Outcome: The project is currently in the Design phase. A series of joint workshops between the LTIF and Sustainable Ownership teams has already been undertaken to explore:

- How LTIF can align with the Sustainable Ownership philosophy and other internal directives;
- A draft investment process flow diagram;
- Improvements to the structure and contents of ESG due diligence reports;
- An external manager monitoring framework that is consistent across Railpen's asset classes; and
- The impact of wider Sustainable Ownership initiatives on LTIF's future approach, including improvements that can be made to existing investments.

Sustainable Ownership assessments focus on the evaluation of material ESG risks, which are identified using the SASB Materiality Map as a starting point, incorporate analysis from our research providers and company reports, alongside using our own professional judgement and analysis of source documentation. Assessments take into account evolving drivers of ESG risk, including regulatory action, policy shifts, changing consumer preferences and supply chain dynamics.

In 2020, the Sustainable Ownership and Investment Management teams worked together to create a new standard template for the ESG stock analyses. This will help ensure greater consistency across those analyses produced by different members of the team and quickly highlight the most material information, and any concerns. It also includes recommendations for action, which could be monitoring, further engagement on particular issues or not to proceed with the investment where there is a significant concern on environmental, social or governance grounds.

The case study below gives an insight into our approach to ESG analysis of a potential investment and how this analysis helps shape our stewardship activity.

Case study: **Pre-investment ESG analysis: Small/Mid-Cap European portfolio launch**

To review a potential holding prior to investment we used the following data sources: company reports and intelligence from a pre-investment meeting with company management, sell-side broker research, specialist research and data providers, industry organisations and subscription news services.

Sector analysis: Key sector risks: Human Capital Management, Corruption & Business Ethics, Systematic Risk Management

Company analysis:

Sales growth:

- The company has positioned itself ahead of peers in sustainable bond issuance and ESG ETFs.
- A major subsidiary was an early leader in ESG products and services available.
- A recent acquisition enhanced the range of ESG products.

Risk Management:

- Significant reduction in carbon emissions via shift to 100% renewable energy use.
- Extensive engagement in industry initiatives, including with the UK government and EU.
- Comprehensive ethics training roll-out with oversight from independent Risk committee.

Intangible assets:

- Company efforts to reduce employee turnover following a recent acquisition.
- Management recognition of human capital risks and build out of data to monitor these.
- Strong corporate governance profile with high level of shareholder support for the Board.

After undertaking this analysis, the Sustainable Ownership responsible analyst recommended engagement with the company on:

- Board oversight of the recent acquisition and integration.
- Human capital management, specifically gender equality and work-life balance.
- Disclosure of information security measures and ethics policies and practices.

The Sustainable Ownership responsible analyst noted that there were no ‘red flag’ reasons not to invest on the grounds of ESG risk. The company’s senior executives have been sent Railpen’s Voting Policy together with an invitation to discuss our expectations of corporate behaviour on the issues highlighted above, as well as our thematic concerns and priorities for 2021. The meeting will also provide an opportunity to further discuss the holding-specific issues identified in the analysis.

The Sustainable Ownership and Investment Management teams also work closely together to monitor the ESG risk profile of existing investments. Where we consider that there is now an ESG risk which presents serious implications for the long-term prospects of the company and where there seems to be an unwillingness by the company concerned to acknowledge and address the issue, we will divest.

Case study: **Wirecard: a divestment decision on ESG grounds**

We regularly monitor our key holdings across the portfolio for changes to the ESG risk profile. This includes reviewing the available evidence by research providers and digging down into the aggregate ESG scores provided, but we also supplement this with our own analysis and intelligence gathered from our engagements where our review highlights a serious issue.

Issue: Railpen had a holding in Wirecard, a German payments company, through our quantitative equity portfolio. Reviews of this holding by third-party data providers rated the company averagely on aggregated ESG scores, with the company's impressive financial performance cited as a counter to allegations of fraud reported in the press.

Approach: The Railpen team undertook further internal research into the company to supplement third-party analysis and became increasingly concerned by what appeared to be deep-rooted governance issues around internal controls and management culture.

Outcome: A decision was made to sell out of Wirecard – well ahead of the 2020 regulatory action and the firm's June 2020 insolvency. Doing so will have had a material and positive impact on protecting the value of members' savings.

Negative screening and exclusion

Where we believe there is long-term risk to the value of an investment or significant reputational risk to the scheme we will consider selling our holding. We update our three exclusion lists on an annual basis:

- Companies with exceptionally **poor governance and conduct.** For these exclusions we seek to liaise with our fund managers on how these can be best applied.
- Companies who derive **over 30% of their revenues from thermal coal mining, thermal coal power generation** or **oil sands (exploration, production and services)**. We are seeking to manage our climate risk exposure by excluding companies whose business model is heavily exposed to highly carbon intensive fuels.
- Companies involved in the manufacture of **cluster munitions and landmines** (including cluster bombs, incendiaries, mine dispersers and anti-personnel devices) in line with the Convention on Cluster Munitions.

We identify companies at risk of exclusion through quantitative screening and qualitative ESG analysis. We seek to engage with the identified companies to hear their perspective before deciding whether to proceed with the exclusion. We contacted all companies at risk of exclusion during 2020.

Case study: **Our 2020 Exclusions process — ESG analysis and engagement**

Governance and conduct: Of the 35 companies identified by our screen and analysis, 33 were promoted for immediate engagement. Of these 33 companies, 19 provided detailed responses to our questions and 14 did not. Following the closure of the engagement period, we re-assessed all of the companies.

- We decided that 25 of the companies could remain in the portfolio - many of which were willing to enter into open dialogue with us. Either these 25 companies provided evidence of improvement or the issues identified were ultimately not severe enough to warrant exclusion without further engagement.
- We placed four of the 25 companies on a specific watchlist so we could monitor developments and review their direction of travel during the next exclusion cycle.
- The final exclusion list consisted of 10 companies; this marks a slight increase of six in 2019.

Climate: Our quantitative screen initially identified 216 companies. Following the closure of the response period, we reviewed 36 companies. Of the 36 companies under review, 27 were able to provide information in the public domain that demonstrated our third-party data was outdated and nine were not. Therefore, our provisional exclusion list consisted of 188 companies. During the process some of these companies had become private or bankrupt, resulting in a decrease to 175 companies on the final exclusion list. This is the same number as last year.

Cluster munitions and landmines: Our screen initially identified 32 companies. All companies with credible involvement were promoted to engagement. Following the closure of the response period, we reviewed two companies. Of the two companies under review, one provided sufficient information to avoid exclusion and one did not. Consequently, the final exclusion list consists of 31 companies. This marked a slight decrease, from 33 in 2019.

Prior to exclusion, the Investment Management team and the Railpen Investment Board are notified of – and required to approve – all companies on the final list.

When a company has been excluded, it will be eligible for re-inclusion in the portfolio if it is willing to begin a dialogue, or it can demonstrate an improved approach to managing the ESG controversies which triggered its exclusion.

External manager selection and appointment

As outlined previously, Railpen uses a mix of internal and external management, although we have significantly reduced the number of external managers over the last few years.

Railpen's own equity and government bond portfolio managers are encouraged to adopt a "buy and maintain" approach, minimising turnover and focusing on the long-term characteristics of holdings. We extend this "buy and maintain" approach to our externally managed equity and corporate bond portfolios, minimising turnover and aligning with our long-term focus on members' behalf.

Where new external managers are selected and appointed, we consider their ESG and stewardship policies, resources, integration into the overarching investment process, and the observable outcomes. We require the inclusion of ESG data in their investment analysis and in their client reporting. We expect managers to align with our exclusion lists. We set out our expectations in our Investment Management Agreements via our Statement of Investment Principles which are appended to all IMAs. Where necessary, we have worked with managers to enhance their integration of material ESG issues into the investment process and improve their client reporting.

Case study: **Updating our Request for Proposal (RFP) — Regional equities mandate**

Issue: Equities in this region typically have lower ESG disclosure and can face higher ESG risks. To ensure these risks were well managed in the search for an external manager in late 2020, we wanted ESG and stewardship to be a focus of the due diligence process, including the *Request for Proposal (RFP)*. We also tailored our due diligence according to the specific ESG risks of the region under consideration.

Approach: Instead of a separate section for ESG and stewardship we integrated relevant questions across several of the key RFP sections. We also ensured that instead of merely requesting information on policies and processes, we asked questions around outcomes and which required the use of examples as well the demonstration of a coherent and client-led rationale for a given approach. This was important to ensure that we picked managers whose approach aligned with our own and which were undertaking meaningful, material and impactful integration and stewardship.

The following questions are examples of the ESG questions for the regional equities mandate:

Investment process

- Describe your process for integrating financially material ESG data into your investment decision making and portfolio management. Please provide detail on which stages of the investment process you integrate ESG data, how you determine materiality and how you price ESG risk.
- Describe how your analysis and management of ESG risks and opportunities in this region's equities differs from your approach in other geographies.
- What are the main sources of information used in the research process, including use of any external research or forecasting services? Please include sources of ESG data and detail any recent changes.
- How do you review the reliability of your research resources and specifically ESG data sources?
- What are the outputs of the research process? Please indicate whether ESG analysis is a separate output and provide details.
- Describe your approach to company engagement and provide examples of recent company engagements, including a rationale for the engagement and results of the engagement.

Additional questions focused on resourcing, industry engagement, evidence, reporting and disclosures, voting and specific ESG risks, including climate risk.

Reputational risk (non-financial performance):

- Please provide detail of any firm-wide exclusions, for example investments made in the production of cluster munitions and land mines.
- Please indicate whether you are able to apply Railpen's exclusion policies to the portfolio, including revenue limits on carbon-intensive business activity and companies with markedly poor governance and conduct, and to further align the portfolio should our exclusion policies change.
- How do you make sure that your staff, consultants, service providers, intermediaries and investment managers are aware of your approach to sustainable investment, and that staff dealing with investments have access to relevant training and/or sources of specialist expertise?

Additional questions focused on diversity & inclusion, employee well-being and development, staff retention rates and incentive structures.

Outcome: Integrating ESG and stewardship questions throughout the RFP enabled us to establish our ESG expectations at the outset of the appointment process. Prior to appointment, investment managers were systematically assessed according to their RFP responses and a series of manager meetings.

While ESG personnel were invited to join the calls, our questions were primarily intended for the fund manager, other senior team members and analysts. We gained an understanding of ESG and stewardship performance at both the manager and the product level and an insight into how both ESG investment risks and reputational risks were managed.

We were pleased with the enthusiasm and level of detail provided in response to our questions by managers. At the time of writing, the manager has not yet been appointed but we will use the learnings from our due diligence process and outcomes to inform and shape our manager monitoring and review in the future.

External manager monitoring

Railpen is responsible for ensuring that our external fund managers invest scheme assets in line with the Trustee's investment policy and that the fund managers' stewardship, and sustainable investment policies align with the Trustee's own policies. This includes assessing how the relevant fund manager makes investment decisions based on the medium to long-term financial and non-financial performance of investee companies and engages with investee companies to improve their performance.

We monitor the ESG practices of a selection of our external managers at least once each year, on a rolling sample basis[5]. The managers are assessed as to how ESG is integrated into the investment process, on their active ownership activities and their approach to climate risks. Following the assessment, the manager is rated as either emerging, established or sophisticated. The exercise may also result in a specific request, e.g. that the Manager considers committing to a specific initiative such as the UK Stewardship Code.

The assessment of listed equity managers' stewardship capabilities is continuous. We contact managers to establish their views on proxy voting, corporate actions and governance issues at portfolio companies as and when they arise.

In 2020, Railpen held regular meetings with external managers to discuss their approach to ESG integration and stewardship, where relevant, and ensure that as far as possible their views align with the Trustee's own policies. Managers also report to us periodically on stewardship and engagement including data and case studies on priority themes[6].

Our external research providers

Railpen uses a range of research from external providers to support our ESG analysis, our stewardship work and as an input into our decision-making. Our providers include MSCI, ISS-Ethix and SASB. We acknowledge that each provider's approach will incorporate its own methodology – and some level of inbuilt bias. This is why Railpen consults different providers and data sources and why we take steps to verify key information with our own internal analysis.

A key example of this is for our climate and indiscriminate weaponry exclusions process. We recognise that data vendors report information from annual reports and 10-Ks but that occasionally this information may have changed since the reporting year closed. As a result, the Railpen team engages directly with companies identified as being at risk of exclusion to request the latest data. Where we identify a discrepancy, we engage with the service providers to help improve their own processes.

Using several different service providers also boosts overall coverage of companies - as different providers will have expertise across different regions or sectors – and ensures Railpen has access to more frequently updated analysis, as update schedules will vary across organisations.

Additional input to our analysis of source documentation comes from the Sustainable Ownership team's dialogue with companies and other stakeholders, as well as resources such as Bloomberg and Reuters. We continually review the quality of the service we receive from our providers and engage with them to ensure they remain market-leading and their approach is as aligned as possible with our own.

Case study: **Engaging with and delivering feedback to our service providers**

Issue: Accuracy of research.

Approach: We noticed a discrepancy between company data provided on the platform of one of our service providers and the company's articles of association. We contacted the provider about the discrepancy, and were put in touch with the relevant analyst, who explained the time lag on the data update. Additionally we contacted the company's investor relations team to verify the correct data point.

Outcome and Next Steps: Time lags can lead to our research providers showing contrasting data and this is something we are aware of and monitor. If there is a contradictory data point we will contact the company to verify the correct information and then liaise with our research providers to highlight the discrepancy. Inaccuracies identified in external research are recorded by the Sustainable Ownership team and will be considered during our next service provider review.

[5] We also arrange ad hoc meetings where we may have serious concerns regarding a specific incident.

[6] Please also see our section on Thoughtful Voting.

Case study: **Planning for the 2021 service provider review**

The Sustainable Ownership team did not conduct a service provider review during 2020 due to changes in personnel and re-prioritisation of projects amid the Covid-19 pandemic.

Therefore, we will undertake a review of our data and research providers, alongside proxy advisors and proxy implementation platforms, over the next twelve months.

- **Data and research providers:** Frequency of updates and accuracy of information, whether the methodology and approach to weightings is aligned with our own.
- **Proxy advisors:** Quality of judgement, timeliness and quality of advice across different jurisdictions, whether the approach to key issues is aligned with our own.
- **Proxy implementation platforms:** Timeliness of voting execution, the ability to provide training and ability to integrate key environmental and social issues into our custom policy.

Even in the last 12 months, the market has developed rapidly in light of recent regulatory developments and it is important that we use service providers who can ensure we remain at the leading edge.

Impactful engagement

Constructive engagement with portfolio companies supports our objective of enhancing the long-term investment return for our members. We will engage with companies when we consider it is in our members' long–term interests to do so, and will endeavour to identify problems at a sufficiently early stage to minimise any loss of shareholder value. This approach is primarily utilised in our fundamental equities portfolios, but is also utilised in index-tracking and quantitative strategies where appropriate and where we feel it will add significant value.

The in-house Railpen Sustainable Ownership team works both independently and alongside internal Investment Management teams, our external managers and other investors, including other major pension funds, to monitor investee companies and engage on both stock-specific and thematic issues Whether we undertake direct or collaborative engagement will depend in part on whether the nature of the risk is company-specific or systemic.

Direct engagement

We focus our direct engagement on those holdings that are most material to our portfolio i.e. where there is most potential value at risk and where engagement can have the greatest impact.

There are four priority engagement lists in the listed equities portfolio:

- **Fundamental equities** – companies which are held in our fundamental growth strategy. We seek to engage regularly with all these companies, of which there were roughly 70 as at Spring 2021.
- **Quantitative equities** – companies which are held in our quantitative strategy. We seek to engage with the largest holdings on an annual basis, covering a significant proportion of our assets under management in the portfolio.
- **Governance and conduct laggards** – problematic companies at risk of exclusion. During the last cycle, we wrote letters to 35 companies across the portfolios which we had identified as highest risk. We subsequently held calls with 20 of these.
- **Thematic** – although Railpen may engage directly with key holdings on thematic issues, we often undertake thematic engagement in collaboration with others. We prioritise our resources across those coalitions we believe are the most impactful. We are a member of several coalitions and will typically lead on one or two companies within each, while participating in the rest as a supporter.

Company dialogues and opt-ins to specific coalitions are regularly reviewed with the Chief Investment Officer and the Investment Management and Public Markets teams.

While the bulk of our company engagement takes place within listed equities, we do engage on an ad hoc basis with companies in other asset classes, specifically within private markets and fixed income. Typically these engagements will form part of our assessments of transactions, but we are looking to build out this programme as part of our ongoing monitoring processes.

Engagement process

Typically the Sustainable Ownership team will write to the company seeking either an in-person meeting or a phone call, either with management or the Board. We use the annual update of our public-facing voting policy as an opportunity to continue our dialogues, outlining our expectations on key issues for the year ahead and our thematic engagement and voting priorities – and how we will vote where these expectations are not met.

In advance of the initial discussion, a number of meeting aims are set, and various topics set as priorities. Most meetings are co-engagements alongside the Investment Management team, which enables access to a broader range of senior executives than if either team was engaging by itself. After the meeting, we consider post engagement targets, with input from the Investment Management team if the company is held in our Fundamental Equities strategy.

Short-term targets are typically aimed at relatively straightforward changes such as to disclosure or simple governance or remuneration changes which are centred around voting decisions. Medium- or long-term targets will be seeking a substantive change in practice. The longer-term targets are typically over a three- or five-year time horizon: we recognise that meaningful change on the substance of an issue, as opposed to just disclosure, does not happen overnight – and neither does the building of the effective relationships required to achieve positive impact.

Climate and multiple governance themes are part of both voting and engagement in listed equities. These issues will also be raised with companies held in other asset classes in a proportionate way. It is in our interest to enhance a private company's ESG practices given as a long-term owner we may hold it post-flotation in our Public Markets portfolio. Where we decide to exit at IPO, meaningful engagement can still lead to greater value at the time of our exit.

The following two case studies have been anonymised as these engagements are still ongoing and the issues discussed are sensitive.

Case study: **Direct engagement: remuneration and workforce safety**

Issue: Company A is a technology company and is held in Railpen's active strategy. Ahead of the May 2020 AGM, we identified concerns around the company's compensation report and the Board's approach to Covid-19. The company had also repeatedly been criticised for unsafe working conditions, linked to the inadequate provision of PPE and lack of transparency around the number of employees who have contracted Covid-19.

Initiative and Role: Members of the Sustainable Ownership team and the Investment Management team engaged with the company together, aiming to highlight our concerns and understand Company A's perspective.

Outcome and Next Steps:

- Discussions confirmed that the multi-million dollar bonus reported for a long-standing Named Executive Officer primarily related to the accounting effects of an amendment to their previously awarded restricted stock units. Therefore, we felt comfortable supporting the compensation report in line with 97.5% of votes cast.
- It became evident that Company A's efforts to protect its workforce were evolving and there had been multiple learning points. For example, company representatives noted that questions were sent to subsections of the workforce on a daily basis via the employee connection programme, with real time responses reported to management. Despite this, we continued to feel that there was disparity between the views expressed by management and those 'on the ground'.
- We also felt that disclosure on the impact of Company A's efforts to protect its workforce, alongside the effectiveness of Board-level oversight, would provide better insight to shareholders and reinforce accountability for worker safety. We therefore voted in favour of those 2020 shareholder resolutions aimed at improving disclosure on these issues.
- We have used our 2021 Voting Policy update – with its new lines on the importance of treating the workforce fairly both during Covid-19 and beyond – to prompt further dialogue with senior company executives in early 2021. Intelligence from this meeting will inform our vote in the 2021 AGM.

Case study: **Direct engagement: passenger safety**

Issue: Company B, a technology and transportation company, is held within our public markets portfolio through an externally managed passive equity fund. The company was linked to a number of controversies related to its employment model and passenger safety, which was of concern to the Sustainable Ownership and Investment Management teams.

Approach: Although this is not a part of our in-house fundamental equities portfolio, the Sustainable Ownership team was sufficiently concerned to arrange a call. This was organised with senior representatives from the company's ESG Strategy and Engagement team in May 2020 and discussed the topics outlined above alongside broader issues regarding Company B's sustainability approach and attitude towards its workforce.

Outcome and Next Steps: The company representatives outlined increased efforts on the topics highlighted. We were pleased to hear that they were dedicating significant resources to workforce wellbeing and their Covid-19 response but noted that we would be monitoring this issue.

Additionally, this call provided us with further context on Company B's approach to passenger safety. While outstanding questions remain, the company has proved itself willing to engage on this topic, and the team remains vigilant regarding news of incidents. Passenger safety and fair treatment of the workforce continue to be top priorities.

We continue to see a number of new stories surrounding Company B and we will continue to engage with the company on these issues in the future.

Collective engagement

Direct engagement can be a powerful tool for effecting change. However, combining Railpen's voice, influence and expertise with those of other investors and stakeholders, whose interests and objectives align with our own, can make our own engagement efforts more effective. This is particularly, though not exclusively, the case for thematic issues or system-wide risks[7].

We choose to participate in collective engagement activities, subject to any applicable laws and regulations in the relevant jurisdictions, where:

- The issue aligns with our core thematic engagement priorities;
- The objectives of the collective engagement participants are aligned with our own;
- There are clear targets, roles and responsibilities;
- There is a clear and well-defined process for escalation; and
- We believe we will achieve more impact as part of a bigger group.

This is why Railpen is an active and often lead participant in several national, regional and global investor networks, alliances and trade bodies. In addition to those listed in our section on Working to tackle market-wide risk, we are signatories to the following major sustainable investment initiatives:

- Principles for Responsible Investment (PRI)
- Transition Pathway Initiative (TPI)
- CDP (formerly Carbon Disclosure Project)

We are also a lead participant in a range of investor collaborative engagement initiatives.

Initiative	Railpen role (2020/21)	Alignment with core thematic priorities
Climate Action 100+	Lead or leading participant on four company engagements	The Climate Transition
Amsterdam Coalition (remuneration)	Lead on one company engagement	Executive Remuneration
30% Club Investor Group (gender diversity)	Lead on two company engagements	Board diversity
C6 (diversity at USA companies)	Participant	Board diversity
Cybersecurity coalition	Lead on two company engagements	Responsible Technology
Responsible Tax	Participant	N/A
Workforce Disclosure Initiative	Lead on one company engagement	Worth of the Workforce
FAIRR (ESG risks in the global food sector)	Participant	Biodiversity and deforestation

Railpen also participates in ad hoc investor initiatives such as collective letters. One example of this in 2020 included a letter in November 2020 to extractive companies on indigenous heritage risks, in the wake of the events at Juukan Gorge. We have since been monitoring with the coalition the responses received from companies and using the intelligence to inform our voting decisions in the 2021 AGM season. We recently voted against the remuneration and election of multiple responsible directors at a company where we considered there to have been egregious control and governance failures at the 2021 AGM.

[7] *Please also see Identifying material public policy debates and interventions.*

Case study: **Collective engagement: Ryanair – Workforce Disclosure Initiative**

Issue: The coronavirus pandemic has heightened investor attention on companies' treatment of their workforce and suppliers. However, there continues to be shortage of publicly available data on issues such as workforce stability, talent pipelines and supplier monitoring.

Initiative and Role: As members of the Workforce Disclosure Initiative (WDI), we work with other institutional investors to collect comparable data from companies through an annual survey.

Over the past two years we have participated in a collective engagement facilitated by the WDI, with the aim of encouraging Ryanair to respond to this survey. Additionally, we have engaged directly with the company on topics such as workforce relations, executive remuneration and auditor tenure.

In 2021, how a company treats and engages with its workforce is a priority thematic engagement issue for Railpen. We have therefore held further conversations with Ryanair in early 2021 to coincide with our updated 2021 Voting Policy lines on workforce issues.

Outcome and Next Steps: We are pleased at the willingness of the company to engage and have continued discussions with Ryanair on this topic in 2021; as at March 2021 the company continues to consider its ability to make the required survey disclosures.

Case study: **Collective engagement: Cybersecurity**

Issue: Railpen and NEST's 2019 report highlighted the materiality of cyber breaches and the importance of investor engagement on this issue. Since the report's publication, the global pandemic has contributed to shifts in the threat landscape and exacerbated the risk that cyber breaches pose. The majority of companies publish limited information on cybersecurity management, as they do not wish to disclose unnecessary details to potential adversaries. While we recognise the need for caution, shareholders benefit when companies are able to provide clear information on their oversight and mitigation of cybersecurity risks.

Initiative and Role: Over the past year, we have worked alongside the Brunel Pension Pool, NEST, Border to Coast and the Universities Superannuation Scheme (USS) in a collective cybersecurity engagement led by Royal London Asset Management (RLAM).

During the first phase of our engagement, 25 companies were selected and contacted by the group due to their high risk exposure. Subsequent discussions highlighted previously underexplored third-party vulnerabilities and enabled the group to refine its existing expectations on cybersecurity.

Railpen led one engagement with a high profile sportswear company and supported discussions with five companies that are smaller holdings within our portfolios.

Outcome: Companies were rated post-engagement according to the strength of their board oversight, risk management, disclosure and performance. We have since followed-up with companies that received a negative rating or did not respond to our initial letters. We have also initiated the second phase of our engagement, which was partly triggered by and has focused on the global pandemic's unprecedented effect on corporate activity, alongside investigations into significant cyber-attacks on US companies.

Next Steps: We continue to engage, update company ratings and develop our understanding of this increasingly complex risk. Using this knowledge, we intend to develop a best practice framework and encourage the adoption of these practices.

In 2021, a key thematic engagement priority will be "Responsible Technology", given the impact of Covid-19 on remote working and the rapid expansion of digitisation across major sectors. This will broaden our focus beyond cybersecurity and privacy to also look at content moderation, content governance and the corporate governance arrangements of technology firms.

Escalation

We seek to engage with companies in a confidential and constructive manner without publicity as we expect good management to reassure investors when faced with shareowners' concerns. However, we reserve the right to make public our concerns if the company fails to address adequately the issues which have been raised, and escalate as appropriate.

If portfolio companies fail to respond constructively, we will consider whether to escalate action, including the following approaches:

- Writing to the company to highlight our concerns
- Meeting with management specifically to discuss concerns
- Meeting with the Chair, senior independent director, or independent directors
- Expressing concern through the company's advisers
- Collaborating with other investors regarding our concerns
- Releasing a press statement, either singly or jointly with other investors
- In extremis, advising our internal or external managers to consider selling our shares in the company

The above options are available to us across our public markets portfolios, covering all geographies.

We may also vote against the relevant resolution at the company's AGM. We believe in the power of the vote to effectively and publicly express our dissatisfaction with the company's approach to key issues. We also believe in holding individual directors to account on areas for which we deem they have lead responsibility. This is in line with a growing body of evidence which demonstrates that voting in such a way is one of the most effective stewardship tools for achieving positive change.

Within other asset classes, we will approach escalation on a case-by-case basis alongside portfolio managers. The exercise of our vote is an escalation opportunity that comes up more rarely beyond listed equity so our preference is instead to focus on meetings with company management and co-engagement with the Railpen portfolio managers.

More details on our exclusions process are provided in our section on Negative screening and exclusion. A list of public statements made at company AGMs is publically available via our website's Active Ownership page.

Case study: **Escalation to a vote against Oracle**

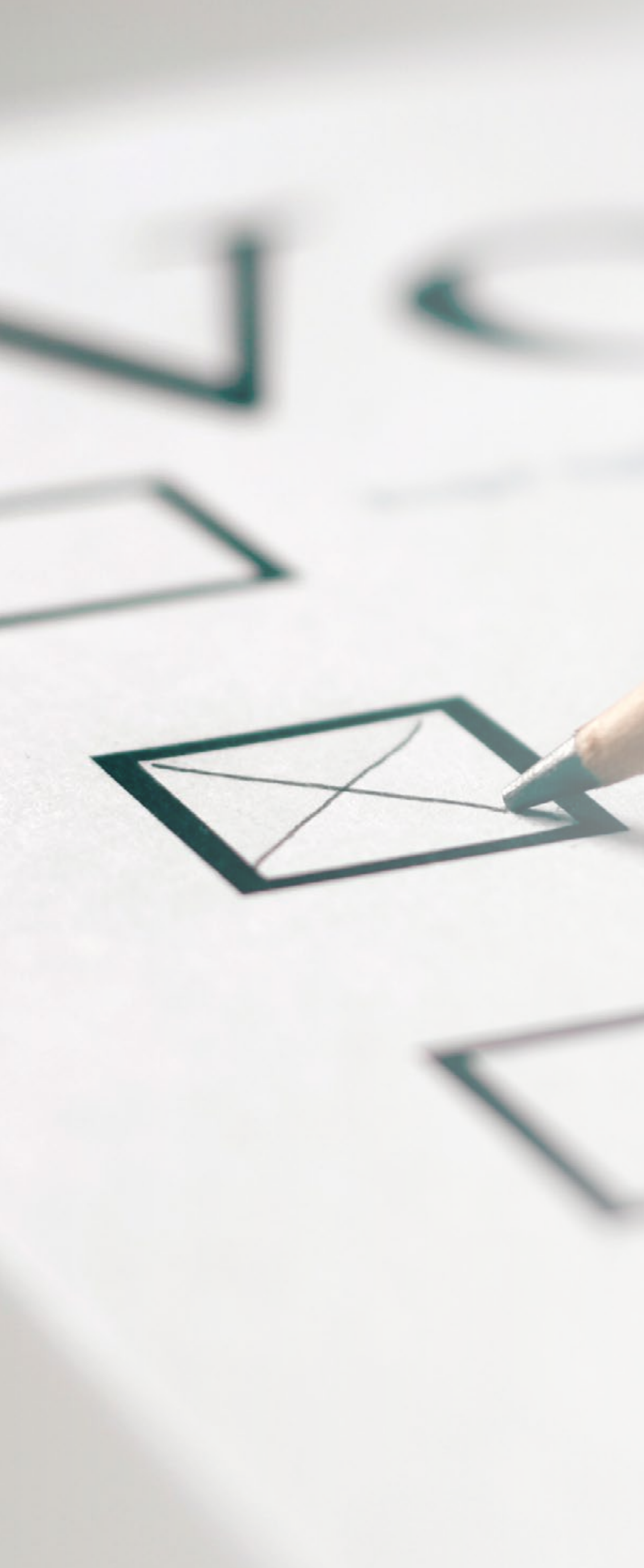
Issue: Excessive pay levels remain a matter of significant concern for Railpen, and we will vote against plans which do not align with our interests as shareholders. Executive remuneration (both quantum and approach) is also a priority issue of concern for our Trustee and beneficiaries.

US technology company Oracle has a history of pay controversies, with plans proposed to shareholders for pay that are often considered excessive and not aligned with the best interests of its shareholders or with its financial performance.

Initiative and Role: Alongside a group of similarly concerned investors, we began engaging with the company in 2018. Railpen was a co-lead of the company engagement. There have been three calls with company representatives since the engagement began, in which we discussed various issues including the quantum of pay, the high level of shareholder dissent for say-on-pay votes, and a need for increased disclosure in certain areas of the pay proposals.

Outcome and Next Steps: Despite some improvements made by the company in terms of disclosure, pay-for-performance concerns remain in relation to the bonus. Railpen therefore voted against the say-on-pay vote to ratify the named executive officers' compensation at Oracle's 2020 AGM.

We continue to see high levels of dissent on the company's say on pay resolutions (41.5% at the 2020 AGM). We will continue to vote against compensation packages at company AGMs where they do not align with the interests of our members. The engagement strategy and approach has been reviewed in light of the need for further impact to be achieved.



Thoughtful voting

We believe that thoughtful voting alongside constructive engagement with portfolio companies supports our objective of enhancing long-term investment returns for members and aligns with the Trustee's Investment Belief that "Active Ownership empowers investors to influence corporate behaviour and benefit from sustainable business practices." Our global voting policy allows us to exercise our voting rights systematically, consistently, and in a way that responds to our thematic and stock-specific engagement priorities – in members' best interests.

Where poor practice is identified on the issues highlighted within our voting policy, a negative vote will be considered. We believe in individual accountability and where we have serious and ongoing concerns on a specific issue, we may vote against the individual Director we deem responsible. Where companies choose to deviate from accepted market practice, we will consider their explanation and apply professional judgement and intelligence in recognition that the situation at a given company can call for nuance and pragmatism. Companies can expect local market and sector norms to be taken into account where reasonable.

Our preference is to engage with companies including, where necessary, exercising our voting rights to offer either support or sanction. However, where there appears to be a significant risk to the long-term value of the investment, we will consider selling our shares in the company.

Our Voting Policy

Our public-facing global voting policy reflects Railpen's key corporate governance and sustainability themes in a way that is accessible to our portfolio companies, our external managers and members. It builds on positions held in previous voting policies setting out our expectations for companies and on some of the themes outlined in the ICGN Global Governance Principles.

Railpen retains control of its voting policy, including where possible, over its underlying beneficial interests in pooled funds, and has centralised vote execution. The Sustainable Ownership team undertakes all voting and engagement activities including monitoring of the activities in our portfolios. The global voting policy is reviewed every year in a discussion between the Sustainable Ownership team and the CIO and the Investment Management team.

Case study: **2021 Voting Policy update**

Every year, the Sustainable Ownership team leads a post-season voting policy review, with a view to defining the implementation for the following cycle.

Updates to each year's voting policy is informed by the following inputs:

- The list of observed issues and suggestions from the recent AGM season;
- Any changes in our thematic engagement priorities;
- Updates to the benchmark positions of our proxy voting provider; and
- Market developments and trends.

The proposals, if taken forward, may require a change to the text of the voting policy and/or a change to the underlying voting policy application. We then publish the updated text on our website and send on to our external managers and our largest direct holdings, requesting a pre-AGM meeting to discuss our voting priorities.

The global voting policy for 2021-2022 was reviewed in Q4 2020. This year's voting policy, published in February 2021, includes new focus on the following topics:

Covid-19
We recognise that companies globally are operating under extraordinary circumstances in the wake of Covid-19. We will take this into account when voting in a way which seeks to promote companies' long-term success. However, we will be closely scrutinising corporate behaviour towards employees, customers, suppliers and other stakeholders and will exercise our voting sanction where we do not believe there has been fair treatment or a genuine commitment to delivering this treatment in future.

Workforce issues
We believe that how well a company ensures its workforce is engaged, motivated and supported is a vital ingredient for sustainable financial performance. We expect boards to be able to communicate the importance of the workforce, and board engagement with workforce issues, in the context of their business model and strategy. For 2021, this should include disclosures around work undertaken to support employees' wellbeing in the course of the Covid-19 pandemic. Where we deem that disclosure on these and related issues is inadequate, we may choose to vote against the adoption of the Report and Accounts.

Climate accounting
Railpen expects portfolio companies to appropriately incorporate material information about climate-related issues into their financial statements, as well as within narrative reporting. Where they have not done so, or where we find inconsistencies between narrative reporting and financial disclosures, we may vote against the report and accounts, the Audit Committee Chair or the reappointment of the auditor.

Voting beyond listed equity

As a Scheme with many open defined benefit sections, a significant proportion of Railpen's portfolio is invested in listed equity. Railpen's Sustainable Ownership team correspondingly dedicates significant resource to stewardship of our listed equity portfolio.

However, we also believe in exercising our stewardship responsibilities across the full portfolio. This includes playing an active role in any voting decisions in our fixed income and private markets portfolio, whether internally- or externally- managed.

Case study: **Fixed Income voting: Intu SGS**

Issue: Due to the complex nature and direct financial implications of bondholder resolutions, our proxy research providers are often unable to provide relevant analysis. Therefore, the Sustainable Ownership team formulates instructions for bondholder resolutions in collaboration with our internal Fixed Income team and external managers.

Approach: Over the past year, we have regularly engaged and liaised with our external manager on a series of consent solicitations at Intu SGS. The first consent solicitation was launched in August 2020 and sought to ensure that the Intu SGS structure could continue trading on a going concern basis. Following discussions with our manager, the Sustainable Ownership and Fixed Income teams concluded that a vote for the proposal would decrease the likelihood of Intu SGS going into administration and maximise potential recoveries. We were also supportive of the second and third consent solicitations, which allowed for planned liquidity injections and enabled Intu SGS' assets to be extracted from the broader PLC.

We have an arrangement with the relevant fixed income external manager whereby we receive analysis from our manager to supplement our own internal analysis and implement the vote ourselves.

Outcome and Next Steps: All of the aforementioned proposals received over 75% support from bondholders and thereby passed. The fourth consent solicitation was launched in February 2021 and the fifth is due to be launched in April 2021. We will continue to engage with our manager on the long-term financial restructuring of Intu SGS, with the aim of maximising its ultimate recovery value.

Case study: **Private Markets – Generate Capital**

Issue: Generate Capital, an investment company and operator of sustainable infrastructure, proposed candidates for election to the board to be voted on by At-Large shareholders in October 2020.

Approach: Railpen has a nominated individual from the Private Markets team which sits on Generate Capital's Board as an Observer. The Sustainable Ownership and Private Markets teams worked together to ask General Capital's leadership further questions around which of the core designed competency gaps it was felt that one of the proposed candidates filled. This is in line with Railpen's core 2020 voting policy theme of "Board Composition and Oversight".

Outcome and Next Steps: After engagement, we felt comfortable with the proposed candidates in question and understood that their experience in social infrastructure and strategy would be valuable to the Board. We also felt comfortable that the board evaluation had identified the appropriate gaps and that the process had been robust. We were therefore able to support all the proposed candidates.

External managers (voting)

Internalising the management of Railpen's assets has meant greater in-house control of stewardship and voting activities and decisions. However, we do use a number of external investment managers for some listed equity and fixed income mandates. The table below shows our use of external managers in 2020 for listed equity portfolios.

Manager	Pooled or Segregated	Voting approach
Legal and General (Passive Equity)	CSUF/Pooled	Railpen directs UK votes; LGIM Voting Policy ex-UK
AQR (Multi-Factor Equity)	Segregated	Railpen directs all votes
Blakeney (Frontier Equity – listed and private)	Fund	Blakeney Voting Policy

Where there are listed equity holdings in mandates or funds which are externally-managed, Railpen seeks as far as possible to direct votes or otherwise influence the voting approach of our providers. For instance, in 2020 we directed the votes for our AQR multi-factor equity mandate, as well as for the UK holdings in a passive equity fund run by Legal and General Investment Management (LGIM).

We seek to influence the voting approach of our providers in a number of ways:

- Using the annual publication of our global voting policy to kick-start a conversation with our external asset managers and other voting providers, ensuring they are aware of the expectations we have of our portfolio companies and the key governance and sustainability issues with matter to us;
- Incorporating discussion of voting practices into regular manager or proxy advisory meetings, as well as frequent, ad-hoc discussions in-between; and
- Working to influence the broader policy and industry environment, for instance proactively feeding into the PLSA's Annual Voting Guidelines and the Investment Association's Stewardship Reporting Working Group.

In 2021, we have also used the process for production of the Implementation Statement as an opportunity to dig further into the voting behaviour of our external asset managers where they exercise votes on our behalf. Railpen informed its external managers of those criteria which we considered to constitute a "most significant" vote to provide a framework for deciding which votes they would submit to us to use in producing the Implementation Statement section on their voting behaviour. This exercise has given us greater comfort regarding the alignment of our managers' voting priorities with our own given:

- Confirmation from the asset manager that many of our key 2020 (and forthcoming 2021) engagement and voting priorities are aligned with their own;
- That the asset manager voted in many instances in the same way as Railpen did on major shareholder resolutions;
- Their willingness to have a dialogue on their voting behaviour and our voting priorities for 2021

Our voting processes and use of proxy advisers

Due to the number of holdings Railpen owns, we are unable to attend every company shareholder meeting to cast votes. Railpen therefore votes by proxy through the Institutional Shareholder Services (ISS) voting platform 'Proxy Exchange'.

Railpen considers the recommendations provided by ISS in making its voting decision, as well as research and information from other providers, including Glass Lewis, ACSI and PIRC. However, Railpen makes all voting decisions and the Sustainable Ownership team works with the Investment Management team to apply professional judgement and intelligence, recognising that the situation at a given company can be nuanced.

Railpen also uses the intelligence it gains from individual meetings and engagements with the company to feed into the final voting decision. Voting is agreed with the Investment Management team for companies held in the Fundamental Equities strategy, along with any controversial, high-profile votes which are discussed with the CIO.

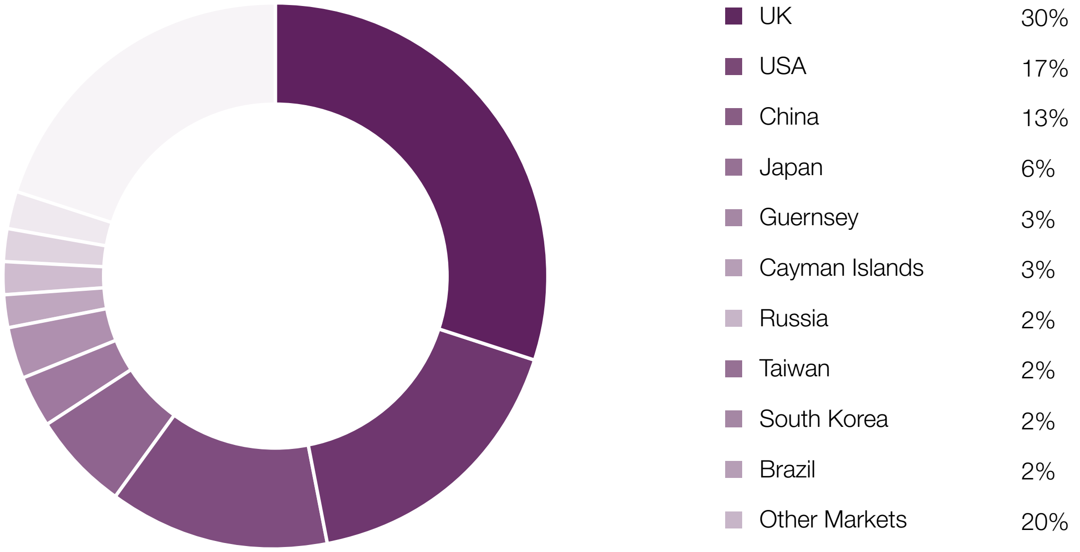
2020 voting statistics

Number of meetings voted	2,166
Percentage of meetings voted	99.7%
Percentage of meetings voted	63.2%

Voting outcomes

- Votes For: 85.4%
- Votes Against: 13.5%
- Votes Abstain: 0.5%
- Votes Withold: 0.5%

Meetings voted by market



Alignment with management

- Comparing vote cast alignment with management recommendations highlights similarities and differences between your governance philosophies and the investee's approach to key corporate governance issues.
- The votes cast on Railway Pension Investments Ltd ballots during the reporting period are aligned with management recommendation in 86% of cases, while the ISS Benchmark Policy recommendations are at 94% alignment with management recommendations.

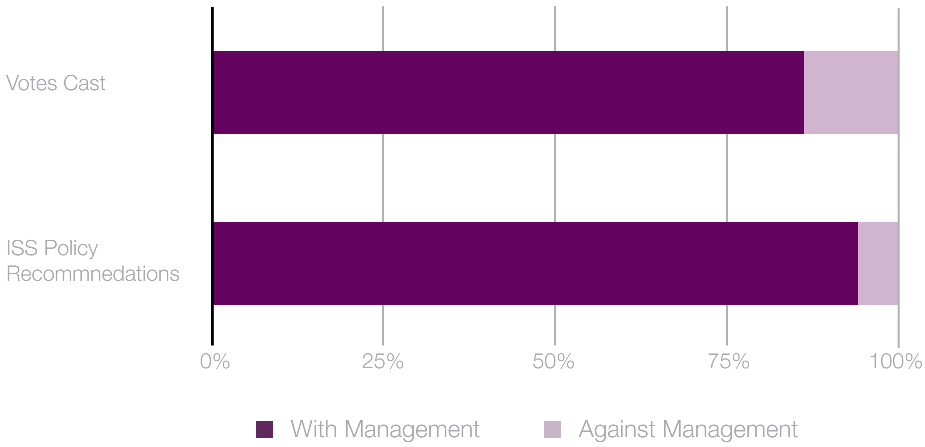


Figure 6 Votes cast in alignment with management (2020). Source: ISS

Votes cast on management proposal categories

- Comparing votes cast to management and ISS Benchmark Policy recommendations across the major proposal categories provide insight into the positioning of votes on proposals submitted by management against these benchmarks.
- Votes cast during the reporting period were least in line with management on Executive Compensation matters where only 61% of votes followed management recommendations.
- Across categories, votes cast on management proposals show the closet alignment to the ISS Benchmark Policy guidelines.

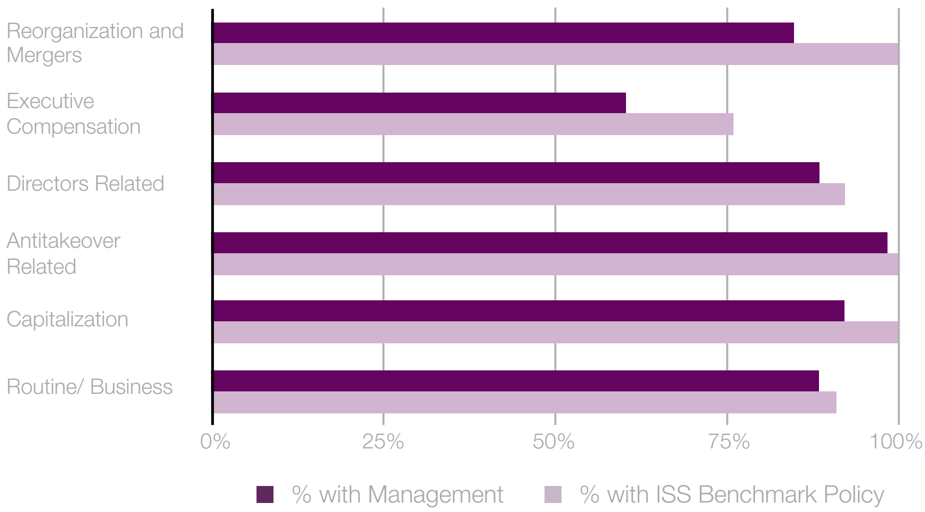


Figure 7 Votes cast on management proposal categories (2020). Source: ISS

Votes cast on shareholder proposal categories

- Votes cast on shareholder proposals, in operation to management, reflect Railway Pension Investments Ltd support for proposals submitted by shareholders.
- During the reporting period, Railway Pension Investments Ltd has shown the highest level of support for shareholder proposals related to Other/ Miscellaneous, Routine/ Business, at 64% and the lowest level of support for shareholder proposals related to Corporate Governance, with 18% of proposals supported in this category.
- Across categories, votes cast on shareholder proposals show the closest alignment to the ISS Benchmark policy guidelines

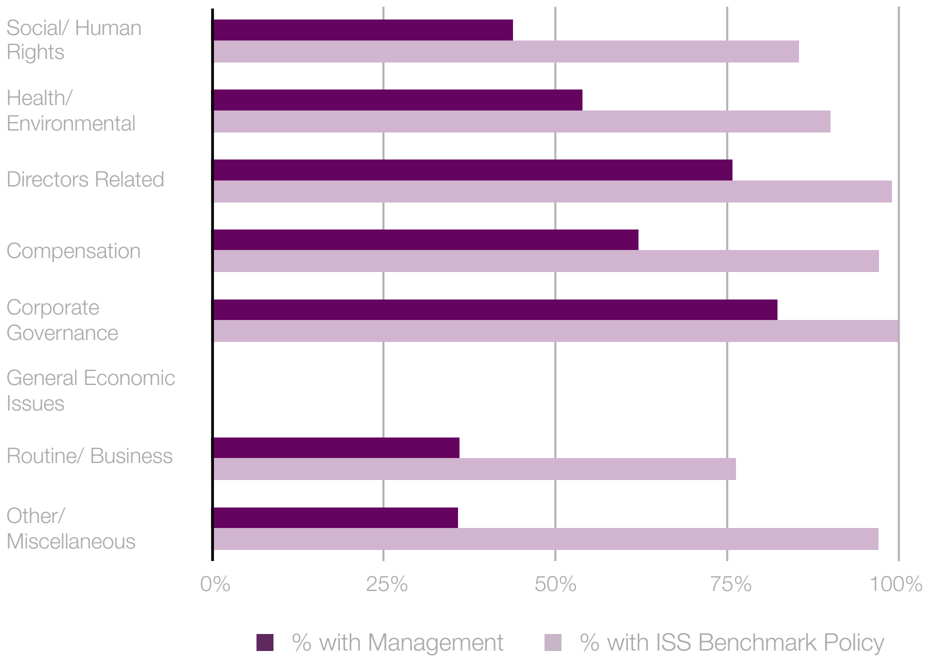


Figure 8 Votes cast on shareholder proposal categories (2020). Source: ISS

Most significant votes

Every voting decision is undertaken in a considered way, although we prioritise our analysis and resource on those votes which are the most material to the portfolio and where exercising our vote is most likely to influence corporate behaviour in a way which benefits members.

Some votes are particularly important. In determining what constitutes a most significant vote[8], Railpen considers criteria provided by the PLSA in its Vote Reporting Template but also its own and these include:

- Votes in companies where Railpen holds over 5% or the equivalent local reporting trigger;
- Votes at companies where the vote was escalated to the Chief Investment Officer (CIO) for decision;
- Votes on issues which have the potential to substantially impact financial or stewardship outcomes;
- Votes against the Report and Accounts/Chair of the Board;
- Votes aligned with Railpen's priority corporate governance or sustainability themes. For 2020, this included:
  - The impact of Covid-19 on companies, their workforce and their AGMs
  - Remuneration
  - Auditor tenure
  - Board Diversity
  - Climate disclosure and targets; and
  - Votes in support of high-profile shareholder resolutions.

Priority issue: Board composition and effectiveness

Considerations when voting for directors include independence, over-boarding and attendance.

In 2021, we are moving to more consistent gender diversity board thresholds for markets with established governance practices, raising our expectations in global markets. However, we still consider how board gender diversity compares with local market norms. We will vote against the chair of the Nomination Committee if the Board contains minority gender representation below our threshold level, which are:

- 33% in the UK
- 30% in Europe, the US, Canada, Australia, New Zealand
- 20% in Japan
- We require at least one minority gender representative for other global markets

[8] Under the UK implementation of the EU's Second Shareholder Rights Directive (SRD II), both asset managers and pension schemes are required to disclose annually an explanation of their "most significant votes".

Our 2021 Voting Policy update also noted that we would continue to engage with companies to highlight the importance of the need for measurable progress to improve the ethnic diversity of their boards and that we would look to vote in future against the responsible directors were our expectations have not been met.

Case study: **Directing the vote at IP Group's 2020 AGM**

Issue: IP Group, a UK-based intellectual property commercialization company, is held in Railpen's active strategy. At the May 2019 AGM Railpen voted against IP Group's remuneration policy and report, as the exceptional limit on the executive long-term incentive plan (LTIP) was considered to be excessive at 400% of base salary. In addition, we voted against the Chair due to low gender diversity on the Board.

Approach: As the company's largest shareholder, we seek to engage with Board members on corporate governance and sustainability topics. We have been in dialogue with Board members with a view to encourage remuneration practices and director appointments that we can support. The company was open to our views and we were able to reach a resolution.

Outcome and Next Steps: Over the year, we were pleased to see the introduction of a 300% cap on the LTIP and the appointment of two highly skilled female directors to the Board. Following IP Group's implementation of these positive changes, we were able to support all resolutions on the agenda at the June 2020 AGM. This example demonstrates the effectiveness of voting sanctions and constructive engagement when combined.

Priority issue: Remuneration

Where a company provides inadequate disclosure on remuneration, or adopts remuneration policies and practices that are not aligned with shareholder interests or experience, Railpen will withhold support for the remuneration policy or report and other remuneration-related resolutions as appropriate.

In 2021, Railpen expects boards to balance the need to appropriately compensate leaders who successfully and safely steer companies through Covid-19 with an awareness of the experiences of the wider workforce at this time. It is unlikely that we will support executive remuneration packages – including the structure of LTIPs and any awards under them – which are not aligned with the approach taken to employee remuneration more broadly.

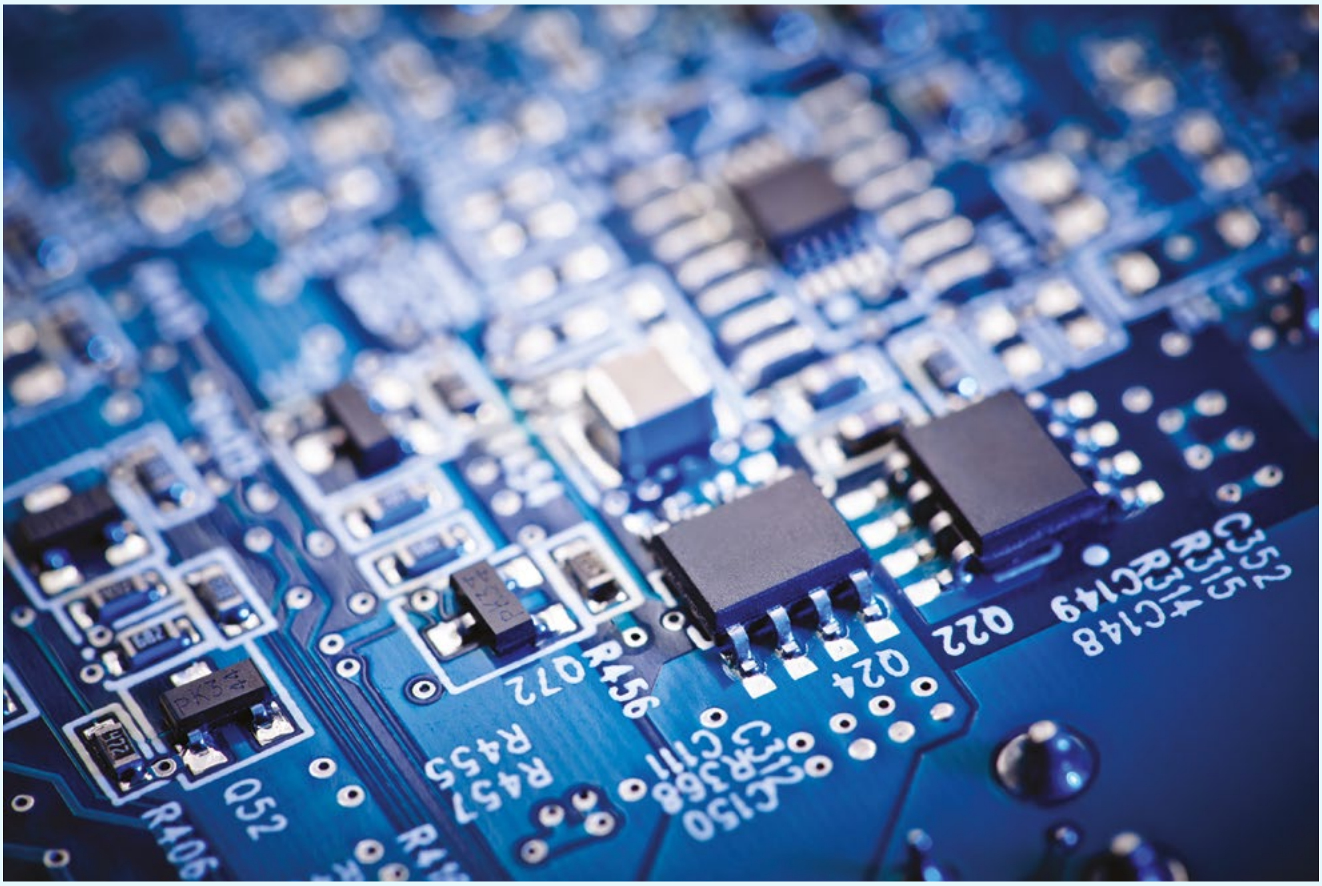
Case study: **Directing the vote at Tesco's 2020 AGM**

Issue: Due to the implementation of the Shareholder Rights Directive II (SRD II), we saw a heightened level of remuneration report and policy votes across European markets during 2020. Therefore, Railpen maintained a particular focus on remuneration trends over the most recent AGM season. Multiple UK companies faced high levels of dissent against their remuneration reports, amid wider scrutiny of executive pay due to the impact of Covid-19 on furlough and unemployment rates. For example, at Tesco's 2020 AGM, 67% of votes cast were against the remuneration report.

Approach: Like other investors, we were disappointed to see that Tesco retrospectively adjusted the comparator group attached to the Performance Share Plan's relative TSR performance condition, which is weighted at 50% of the award. We felt that the company's rationale did not justify the significant uplift to the outgoing CEO's payout. Consequently, Railpen voted against the report in line with our proxy advisors. Our vote was instructed uniformly across internally and externally managed shares.

Outcome and Next Steps: Tesco has since engaged with several large investors, and we hope that shareholder feedback will be considered when the company reviews its remuneration policy prior to the 2021 AGM. We will monitor announcements in relation to this issue.

Case study: **Directing the vote at Texas Instrument's 2020 AGM**



Issue: We had questions over the company's remuneration report and the CEO's base salary increase.

Approach: Since Texas Instruments sits within our Fundamental Equities portfolio, the Sustainable Ownership team make all voting decisions jointly with the portfolio managers. Therefore, after reviewing the company's proxy, we organised a call with company representatives and the portfolio manager. During the call, we discussed the company's approach to remuneration, pay for performance alignment and the CEO's base salary increase.

Outcome and Next Steps: We gained comfort that the salary increase was reasonable. Therefore, after further discussion with the portfolio manager, we decided to support the remuneration item at the company's AGM. We will engage with the Texas Instrument team in advance of their 2021 AGM to assess ongoing attitudes towards remuneration, as well as our other 2021 Voting Policy priorities such as around Covid-19 and employee wellbeing.

Priority issue: Shareholder rights, risk and disclosure

We expect boards to adopt a comprehensive approach to the oversight of risk, which includes material financial, strategic, operational, environmental, social and reputational risks. Where a risk has materialised, the company should set out how it has responded and what efforts have been taken to mitigate the risk going forward in the annual report. Inadequate reporting on environmental, social and reputational risks may warrant a vote against the annual report and accounts, the relevant Director or support for a shareholder resolution.

Case study: **Directing the vote at Total's 2020 AGM**

Issue: We are generally supportive of industry and policymaker momentum towards offering further opportunities for shareholders to explicitly express support for, or sanction of, corporate behaviour on climate change issues. In 2020, eleven investors co-filed a shareholder resolution at Total requesting the introduction and publication of GHG emission targets (scope 1, 2 and 3) aligned with the Paris agreement. This was the first climate resolution to be filed at a French company.

Approach: As with other resolutions, Railpen will consider on a case-by-case basis whether to support a climate resolution on criteria which include whether it conflicts with other climate resolutions, whether it clearly links to internationally agreed targets and agreements and whether the aspiration sought is consistent with the company's long-term success. In this case, we welcomed Total's ambition to achieve net-zero GHG emissions (scope 1 and 2) by 2050, but felt that a more detailed action plan - integrating clear intermediary targets and planned measures to achieve those targets - would enable investors to assess the company's progress. Consequently, Railpen voted for the shareholder resolution in line with 16.8% of votes cast.

Outcome and Next Steps: Although the resolution did not pass, it served as a strong signal of shareholder dissatisfaction to the Board. We will continue voting for climate resolutions where we feel companies' reporting on or management of environmental risks are inadequate. "The Climate Transition" will also be a key thematic engagement priority for Railpen in 2021 and we expect to support other climate-related shareholder resolutions where they fulfil the criteria above as well as leading climate engagements with companies as part of the Climate Action 100+ coalition.

Vote disclosure

We publicly disclose our voting records for all company meetings since 1 January 2016 via a link from the voting records page on our website. From October 2018 Japanese voting records have been disclosed via this service.

Disclosure is subject to a waiting period of three months from the end of the month in which the meeting is held so that we can provide transparency without undermining our dialogue with companies. Although the voting rationale is not disclosed publicly, it is available to the team internally and is used to review voting decisions, which we may choose to share with companies when necessary.

Our Implementation Statement report – to be published in Summer 2021 – will also outline our voting behaviour in greater detail, including our "most significant votes". We also regularly provide case studies of votes on key issues across our member-facing communications: we believe that doing so can help members' savings feel more "real" to them and could help boost engagement with their pension more generally.

Stock lending

We believe that members benefit from the additional income stream that derives from participating in stock-lending programmes and also that stock-lending has benefits for market liquidity and efficiency. Our funds participate in various stock lending programmes administered by our Middle Office.

The stock lending programme is governed by our Securities Lending Policy which is owned by the Sustainable Ownership team. Only securities which are very liquid are lent out and only in markets with more established governance procedures.

Our participation is subject to an overriding requirement that no more than 90% of our total exposure should be out on loan at any one time. This means that there will always be a residual holding that can be voted.

In addition we will recall stock to vote in exceptional circumstances where, for example, there is an important issue of principle or the voting outcome is believed to be close. We also have a standing instruction in place for a full recall of all Japanese stock out on loan ahead of voting season.

As Eumedion members, we recall our lent shares before the voting record date for a general meeting of a Dutch listed investee company, if the agenda for that general meeting contains one or more significant matters.

There are daily checks on our total exposure and weekly reports from Middle Office to the Sustainable Ownership team.

In 2021, we will start to recall all our fundamental equities holdings in advance of the AGMs as a matter of course. This is to enable us to use the full weight of our vote and influence on companies where we have a significant proportion of assets and where consequently we have significant value-at-risk.

Working to tackle market-wide risk

Our work on market-wide and systemic risk supports our work to manage the risks which are expected to materialise over the long-term time horizons which match the open nature of many sections of the RPS.

Our work to tackle market-wide risk includes our engagement and voting on thematic issues like climate change, Covid-19 and workforce issues – this often takes place through our collaborative engagements. We also recognise that one of the most effective ways of managing market-wide risks is to influence for market-wide solutions and this leads us to proactively engage on public policy issues both in the UK and elsewhere, to ensure a supportive regulatory and policy framework for sustainable investment and stewardship.

Our market-wide activity takes place through our "Longer-term risks and opportunities" and "Active Ownership" workstreams.

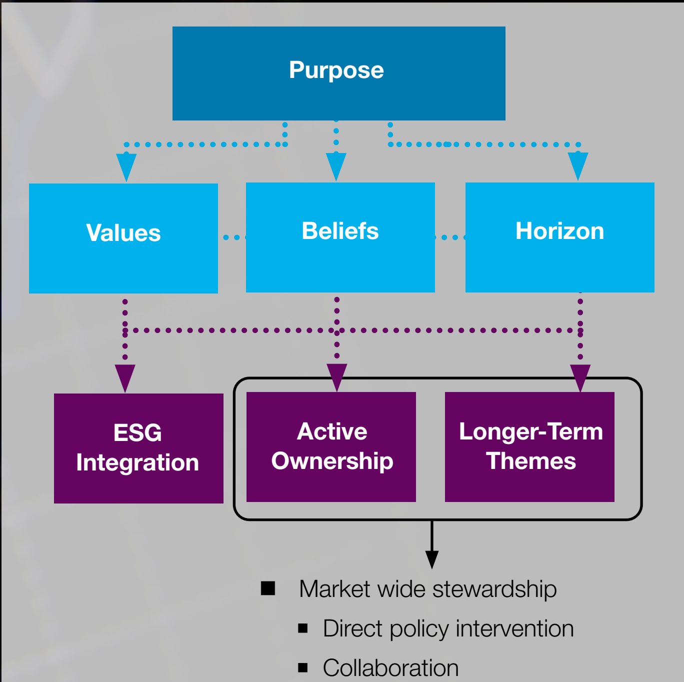


Figure 9 How our purpose, values and beliefs drive our market-wide work

Our participation in thematic engagement initiatives and public policy debates is underpinned by our core values of collaboration and acting as a pioneer, as well as the Trustee's Investment Belief that "being an influential investor demands a leadership role in the wider industry – both as an asset owner and as an investment manager."

Identifying material market-wide issues

The Sustainable Ownership team has a 'materiality matrix' whereby we work with others across Railpen, including the Investment Management team, Client Investment Services, Trustee Governance, Technical Services and Industry Affairs to consider those market-wide issues which Railpen should prioritise in our thematic engagement work.

The criteria for prioritisation include:

- Materiality of the issue to our portfolio;
- Alignment with trustee investment beliefs, or reputational risk to the Trustee;
- The potential impact on or importance to members; and
- Railpen expertise.

In 2020 our thematic engagement priorities were:

- The quality of the audit market;
- The Climate Transition; and
- The impact of Covid-19.

Case study: **Tackling Market-Wide Risk: Climate Engagement and Climate Action 100+**

Issue: Environmental impacts such as rising sea levels, ocean acidification, extreme weather and droughts are already evident across the globe and the IPCC report recommends limiting global temperature rises to 1.5 degrees Celsius to avoid the worst impacts. Railpen seeks to engage with investee companies, both individually and collaboratively to drive the alignment of the investment industry with the Paris Agreement and support the UK government's climate commitment.

Initiative and Role: Climate Action 100+ is an investor-led, engagement initiative where investors commit to engaging with at least one of 167 focus companies that are strategically important to the net-zero emissions transition and to seek commitments on the initiative's key asks:

- Implement a strong governance framework on climate change
- Take action to reduce greenhouse gas emissions across the value chain
- Provide enhanced corporate disclosure.

Railpen joined the initiative in 2017 and began engaging with CRH as the lead investors. Subsequently we led and participated in a number of engagement letters and calls with company management and investor relations.

Outcome and Next Steps: CRH has since:

- Become a public supporter of the Taskforce on Climate Related Financial Disclosures
- Set an ambition to achieve carbon neutrality along the cement and concrete value chain by 2050
- Set further targets on CO2 intensity reduction of their cement by 2030.
- Committed to disclosing its approach to climate lobbying and a 'map' of its direct and indirect lobbying activities in 2021

The coalition continues to engage with the company.

Aside from our activity on CRH, Railpen remains a leading participant in engagements with Nestlé and LafargeHolcim. In 2021, Railpen has become an active participant in the CA100+ and IIGCC work on Paris-Aligned Accounts. This includes becoming lead investor on climate accounting with two companies and engaging with firms to ensure better disclosure of the climate assumptions used in their financial accounts.

We have also included new lines on climate accounting and lobbying in our 2021 Voting Policy update and are raising in our engagements with those of our fundamental and quantitative equities holdings who are most exposed.

Case study: **The Covid-19 pandemic**

Railpen quickly recognised the risk Covid-19 presented to our portfolio not only from an investment perspective, but also its impact on a number of E, S and G issues including:

- Capital structure and allocation
- Treatment of the workforce, customers and suppliers
- Cybersecurity risks as many companies shifted quickly to remote working arrangements

In all of the direct engagements we conducted after March 2020, we asked our portfolio companies about how they were dealing with Covid-19 and the current and likely future impact on their people and operations. Covid-19 is also a key theme of our pre-2021 AGM engagements and our latest Voting Policy which provides the framework for our pre-AGM discussions has this year highlighted "workforce treatment during Covid-19 and beyond" as a core theme. We will vote against companies where "we do not believe that there has been fair treatment or a genuine commitment to delivering such treatment in the future".

Although it is too early yet to understand the longer-term impact of our intensive engagement activity, Covid-19 has encouraged us to deepen our focus on workforce issues, with one of our four key engagement themes for 2021 and beyond being "The Worth of the Workforce". Activities under this workstream will include leading engagement on more portfolio companies as part of the Workforce Disclosure Initiative (WDI) and working with the CIPD and the PLSA to explore what good corporate reporting on workforce issues looks like, and how it needs to evolve to provide useful information to investors.

In 2021 our thematic priorities have been updated to the following core issues, with key sub-themes below:

- **The climate transition**
  - Climate accounting and Paris-aligned accounts
  - Biodiversity and deforestation
- **Worth of the workforce**
  - Treatment during Covid-19 and beyond
  - Workforce reporting
  - Modern Slavery
- **Responsible technology**
  - Content governance and moderation
  - Governance of 'Big Tech
- **Sustainable financial markets**
  - The audit market
  - Minority shareholder rights

These core themes then guide us in deciding which collaborative initiatives we should participate in – or where it might be worth taking a leading role.

It also helps us ascertain where and how we should seek to influence the policy debate. When considering a public policy intervention, we consider the potential impact on how we undertake Sustainable Ownership or whether it would help or hinder the market for sustainable investment.

We also consider the resources available and possible avenues for influence and impact. This includes:

- **A direct response.** This could either be through informal conversations with government officials or regulators, or a formal written response.
- **A collective response.** This includes working with other investors whose views are aligned with our own, or seeking to influence and proactively feed through views to the relevant membership or advocacy organisations.
- **A proactive approach.** Initiating dialogue with the relevant policymakers and regulators, either individually or collectively.
- **A reactive approach.** Responding to a specific consultation paper or call for evidence.

Based on these criteria, in 2020 our public policy work focused on important debates such as The UK Listings Review and Mandatory climate risk reporting by pension schemes. Our responses can be found on our website.

Case study: **UK Listings Review**

Railpen responded to HM Treasury's Call for Evidence on the UK Listings Regime in late 2020 through producing our own formal written response, working with other investors to share ideas and draft responses, as well as feeding into the relevant trade associations including the PLSA to shape their responses. Our response was published on our website and outlined why we thought a move to dual-class share structures (DCSS) and reducing the free float proportion would be detrimental to minority shareholder rights.

We agreed that we would participate for the following reasons:

- It aligns with our core engagement theme of "Sustainable Financial Markets";
- We believe the diminishing the ability of minority shareholders to use voting rights as a tool to offer sanction or support for companies would have a material impact on the effectiveness of our active ownership work; and
- Railpen has expertise in, and a long history of, policy activism on corporate governance issues.

At the time of writing, the Hill Review's final proposals have been published. Although the proposals move ahead with dual-class share structures and reducing the free-float proportion from 25% to 15%, our proposals on potential corporate governance safeguards such as a mandatory sunset clause for DCSS and weighted voting only under certain circumstances have been taken up.

We will continue to seek to influence the FCA's work and consultation to implement the Hill Review proposals in 2021.

Case study: **Climate change and public policy — TCFD reporting**

Railpen responded to the Department for Work and Pensions' (DWP's) consultation Taking action on climate risk: improving governance and reporting by Occupational Pension Schemes in Autumn 2020. We produced our own written response, as well as feeding into the response produced by the PLSA in our role on the PLSA's Stewardship Advisory Group. We had also played a significant role in reviewing the accompanying final (voluntary) guidance for asset owners on TCFD reporting as part of the Pensions Climate Risk Industry Group (PCRIG) and had informal conversations with relevant government officials on this consultation as well.

We agreed that we would participate for the following reasons:

- It aligns with our core engagement theme of "The Climate Transition";
- We consider climate change to be material to nearly every holding across every part of our portfolio;
- It is a key consideration and issue for the Trustee;
- The way in which the requirement is placed upon the trustee board would have implications for the way in which we undertake our Sustainable Ownership Work;
- It complements our work as a lead investor on certain company engagements as part of Climate Action 100+ (CA100+).

The government published its response to this consultation and the next set of consultations in early 2021. We were pleased to note that all our suggestions around moving to a more pragmatic frequency for undertaking scenario analysis, and the particular situation for multi-employer (section) schemes were recognised.

We have decided not to produce a formal written response to the next stage of TCFD consultations (draft regulations and draft statutory guidance). Instead, we have fed through specific comments and thoughts on the draft responses produced by UKSIF and the PLSA.

Assessment of our effectiveness in tackling market-wide risk

We agree with the FRC that "it may be difficult to attribute an organisation's actions to an outcome as part of an initiative". On public policy, we use a number of Key Performance Indicators (KPIs) to try to help assess our influence. This includes whether any written response or view was mentioned in the government response, whether we had conversations with officials off the back of the response, whether our intervention was well-received by others in the industry or by media, and to what extent our specific proposals were incorporated into the final policy or regulations.

In addition to the outcomes mentioned in our case studies, we have also been pleased to note:

- Companies like Nestlé, where we have been part of the leading CA100+ investors group with the company, agreeing to a 'Say on Climate' vote in 2021, which we think is a positive step;
- LyondellBasell accepting two (non-voting) agenda discussion items on climate in response to a letter signed by us and 27 other CA100+ investors;
- More detailed reporting in 2020 Annual Reports on the steps our key portfolio companies took to protect and engage with their workforces in the wake of Covid-19;
- Proactive media and speaking requests for our views on climate accounting, workforce reporting and the final Hill response;
- Specific mentions of the Railpen perspective in the government response on TCFD reporting; and
- Incorporation of our suggestions on TCFD reporting and the Hill Review into our membership organisations' responses.

We publish our consultation responses online and list on our website some of the initiatives that we support. However, we think there may be merit in publishing information on all the membership bodies and initiatives in which we participate, as well as the processes and policies that govern our public policy work and will look at doing so over 2021 and 2022.

Railpen participation in relevant industry groups

Active participation – industry and regulatory bodies

Railpen actively participates in those industry and regulatory groups and committees whose objectives are aligned with our own and which we believe can have most impact on driving positive change in the market and policy environment for sustainable investment and effective stewardship.

Organisation	Acronym	Committee	Remit of committee
British Venture Capital and Private Equity Association	BVCA	BVCA	Discuss and advise on best practice in private market investing in the UK
British Venture Capital and Private Equity Association	BVCA	Impact Investment Advisory Group	Discuss and advise on best practice in private market investing in the UK
Financial Reporting Council	FRC	Investor Advisory Group	Discuss matters relating to accounting, audit, corporate governance, and stewardship, particularly in the UK market, presenting the investor perspective to the FRC.
Institute of Directors	IoD	Stakeholder Governance Working Group	Advise on corporate engagement with stakeholders (and disclosure)
Institutional Investor Group on Climate Change	IIGCC	Paris Aligned Investment Initiative Steering Group	Advise on a range of initiatives, including a Net Zero Investing Framework, that support investors' alignment with the Paris goals.
Investment Association	IA	Stewardship Reporting Working Group	Feed back on regulatory requirements and discuss best practice around stewardship reporting
NextGen	n/a	Main Committee (Vice Chair)	To provide strategic direction for group (objective: to promote fresh faces/perspectives in pensions industry)
Pensions and Lifetime Savings Association	PLSA	Stewardship Advisory Group	Advise PLSA on sustainable investment policy issues
Principles for Responsible Investment	PRI	Global Policy Reference Group	Discuss sustainable investment policy issues and feed back on PRI draft submissions
Scheme Advisory Board	SAB	Responsible Investment Advisory Group	Discuss LGPS RI issues
Sustainability Accounting Standards Board	SASB	Investor Advisory Group	Discuss developments in ESG standards globally, presenting the investor perspective on the strategy and approach of SASB.
Transition Pathway Initiative	TPI	Technical Advisory Group	Advise on methodologies and developments to the tools developed by LSE and FTSERussell
UK Pension Fund RI Roundtable	n/a	RI Roundtable	Discussion forum for ESG professionals working at UK pension funds to talk about developments in (and responses to) ESG in the UK

Other industry organisations – Railpen membership

Where resource and prioritisation constraints do not allow us to actively participate, we still believe there is merit in adding our voice to those sustainable investment initiatives whose priorities and objectives align with our own. Many such organisations also act as an important additional educational resource to contribute to the ongoing development of Railpen employees on sustainable investment and stewardship issues.

Organisation	Acronym	Geography
Council of Institutional Investors	CII	North America
Eumedion		Netherlands
International Corporate Governance Network	ICGN	Global
UK Sustainable Investment and Finance Association	UKSIF	UK
Asian Corporate Governance Association	ACGA	Asia
Australian Council of Superannuation Investors	ACSI	Australia
Montreal Carbon Pledge		Global
Farm Animal Investment Risk and Return	FAIRR	Global
Workforce Disclosure Initiative	WDI	Global
Global Institutional Governance Network	GIGN	Global

Appendix 1: Alignment with the UK Stewardship Code Principles

	Principle	Section of Report
1	Signatories' purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.	Our philosophy and approach Stewardship in the interests of members Appendix 2 – Trustee investment beliefs
2	Signatories' governance, resources and incentives support stewardship.	How our structures enable effective stewardship
3	Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.	How our structures enable effective stewardship
4	Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.	Working to tackle market-wide risk
5	Signatories review their policies, assure their processes and assess the effectiveness of their activities.	Foreword Appendix 3 – Internal Assurance Our philosophy and approach How our structures enable effective stewardship Working to tackle market-wide risk
6	Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.	Stewardship in the interests of members
7	Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.	Systematic ESG Integration
8	Signatories monitor and hold to account managers and/or service providers.	Systematic ESG Integration Thoughtful voting
9	Signatories engage with issuers to maintain or enhance the value of assets.	Impactful engagement
10	Signatories, where necessary, participate in collaborative engagement to influence issuers.	Impactful engagement Working to tackle market-wide risk
11	Signatories, where necessary, escalate stewardship activities to influence issuers.	Impactful engagement Thoughtful voting
12	Signatories, where necessary, escalate stewardship activities to influence issuers.	Thoughtful voting

Appendix 2: Trustee investment beliefs

Investment beliefs

1. **Valuation is an important driver of investment performance over the medium to long-term.**
   a. The price at which an asset is purchased has a significant impact on its return.
   b. Markets are not perfectly priced and therefore investing when assets seem to be attractively valued can lead to superior investment performance.
   c. We recognise that valuation is rarely the dominant return driver in the short-term and therefore we review strategic asset allocation annually with a medium-term view. However, it is important to identify significant dislocations in markets between strategic reviews.

2. **Risk is multi-faceted and not fully quantifiable, but must be managed.**
   a. Risk management is not an exact science. We combine informed judgment with quantitative analysis.
   b. Risks must be embraced in order to generate returns. We seek to increase risk when appropriately compensated and to mitigate unrewarded risk as part of a counter-cyclical investment style.
   c. It is important to plan for “bad times”. By managing risk effectively before and during challenging conditions our long-term perspective can be utilised to our advantage.
   d. In addition to market risk we monitor and manage other risks such as liquidity, counterparty, credit and legal risk.

3. **Diversifying portfolios improves investment efficiency.**
   a. Asset classes contain a variety of risk premia and it is important to decompose them accordingly and identify associated return drivers. Diversification across different risk premia can lower overall risk without reducing expected returns.
   b. Financial leverage is a useful tool when markets offer compelling diversification opportunities.
   c. Analysis of risk and return contributions are important for sizing exposures and building portfolios that deliver the most suitable risk-return trade-off.
   d. In investment, the risk of complexity is high and should be limited within an investment process. Investment strategies should only be implemented if they are fully understood and have the potential to improve meaningfully either investment efficiency or risk-adjusted returns.

4. **Environmental, social and governance factors materially impact long-term investment returns and must be taken into account.**
   a. Integration of environmental, social and governance factors improves investment decisions in the long-term.
   b. Active ownership empowers investors to influence corporate behaviour and benefit from sustainable business practices.
   c. Long-term themes expose our portfolios to substantial risks and opportunities which cannot be fully quantified but should be managed.

5. **Costs can significantly reduce returns and therefore must be accounted for in all investment decisions.**
   a. Hidden costs of investment go significantly beyond quoted headline fees. We disaggregate costs and take all into account when assessing expected returns.
   b. We apply strict standards to fee structures in terms of transparency and quantum. WE use our leadership role in this field to drive positive change in the industry.
   c. We will use our internal resources where it makes sense from either a cost or control perspective. We recognise it is often necessary or more cost-efficient to utilise external expertise.

Scheme beliefs

1. **Valuation Strong governance, leadership and culture are essential requirements for a world-leading investor of pension assets.**
   a. An effective governance structure has clear goals, authorities and accountabilities for all participants in the investment process. Lack of organisational clarity can result in poor decision-making.
   b. Investment choices are rarely straightforward. Fully engaged leadership is required to balance multiple inputs and to make difficult but necessary decisions.
   c. A healthy culture attracts and empowers high quality individuals and encourages behaviours that are consistent with our investment beliefs. Investment businesses with weak cultures are ineffective over the long-term.
   d. Being a world-leading investor demands a leadership role in the wider industry – both as an asset owner and as an investment manager.

2. **Clear investment objectives and accountabilities improve the likelihood of achieving superior net returns allowing for risk.**
   a. Investment objectives must be justified and realistic. The behavioural consequences of any target must be actively examined and understood.
   b. Section-specific characteristics such as an employers' c covenant and the nature of liabilities are analysed and taken into account. A rigorous return, risk and liquidity framework is required when setting investment strategy for each Pooled Fund and Section.
   c. The Scheme's Growth Fund is measured against both a long-term real return aspiration (RPI + 4%) and a market-based Reference Portfolio in order to balance what is required over the long-run and what can be better controlled over shorter periods. All the multi-asset funds have long-term real return targets.

3. **Alignment of interests across members, employers and all other stakeholders improves the prospects of achieving the Trustee's investment objectives.**
   a. The investment industry is plagued with agency issues, conflicts and perverse incentives. It is important to maximise the alignment of interests across all stakeholders around the Trustee's objectives.
   b. Our preferred partners are exceptional organisations that are principled and have high ethical standards. To maximise effectiveness we prefer a relatively small number of key relationships.
   c. People respond to incentives. Therefore, our reward structure is competitive and designed to motivate our staff to achieve the Scheme's long-term objectives.

4. **A long-term investment horizon is consistent with our liabilities and is a competitive advantage.**
   a. The long-term nature of the Scheme allows us to embrace risk in order to generate returns.
   b. Our long-term time horizon enables us to withstand significant short term losses in order to produce high long term real returns.
   c. We believe illiquid investments must offer a compensatory excess return over liquid equivalents. As a long-term investor we seek to exploit the illiquidity risk premium.

5. **Multi-asset funds are the most appropriate vehicles for Sections and the DC funds.**
   a. A multi-asset approach to investing reflects the importance of asset allocation to Scheme investment returns and ensures the widest possible opportunity set.
   b. The multi-asset Pooled Fund range should be as simple as possible. It should accommodate the full range of a Section's investment requirements but through a small number of Funds.
   c. Where appropriate, DC members should be able to access similar quality investment options to those available to Sections, subject to cost and liquidity considerations.

Appendix 3: Internal Assurance

In order to submit an early draft to the FRC as part of its Early Reporting Review, in February 2020 Railpen submitted a draft Stewardship Code response for review by Railpen's in-house Business Assurance team. This team is independent, objective and provides challenge and insights across the wider Railpen business in conformance with the International Standards for the Professional Practice of Internal Auditing ('the Standards') and the Chartered Institute of Internal Audit's guidance, 'Effective Internal Audit in Financial Services'.

We opted for an internal review of our draft disclosure and the underlying controls and processes in operation owing to the extensive expertise of our Business Assurance team. We felt this team was better able to understand the nature of the work we do and the expectations we are required to meet than the services currently available in the external assurance market.

The process and the findings

The Business Assurance team reviewed a limited sample of Principles in the early 2020 draft Stewardship Disclosure and performed the following procedures:

- Reviewed the Railpen disclosure against the chosen principles of the Code and assessed whether the 'reporting expectations' have been met or could be enhanced;
- Evaluated the statements made by Railpen in the disclosure and reviewed the evidence the organisation held to support making the specific disclosure against each Principle; and
- Reviewed a sample of Principles, to assess the underlying controls and processes in operation to support fair and transparent reporting under the Code.

There were a number of findings which were identified including: greater disclosure of voting behaviour; the need to inform readers of the limited scope of the exercise; and the need to disclose an assessment of their effectiveness.

Railpen undertook actions to implement some of the recommendations around outstanding information as identified by Business Assurance, into our March 2020 response which we submitted for early review.

There were also longer-term recommendations for implementation by 30th April 2021 – to align with the submission deadline for this report – to Management including:

- Performing a review of our active ownership policies to ensure they enable effective stewardship and explain how this review has led to continuous improvement of stewardship policies and processes; and
- Assessing Railpen's stewardship activities as required in Principles 1, 4 and 6.

Our response

Evidence of Railpen's implementation of these recommendations can be found in our responses here under "Our Philosophy and Approach", "Stewardship in the interests of members" and "Working to tackle market-wide risk". Although the dataset for this submission is different to that used for our early March 2020 submission, the underlying controls and processes remain the same.
As part of the usual Railpen Business Assurance process, there will be a review of activities and progress undertaken in 2022.

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