RPMI RAILPEN

Sustainable Ownership Report 2018

Introduction

On behalf of RPMI Railpen (Railpen), I would like to introduce our 2018 Sustainable Ownership Annual Report for the railways pension schemes. This report provides you with a summary of our Sustainable Ownership activity during the year.

Richard Williams,
Chief Investment Officer

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

One of the highlights of my first year as Chief Investment Officer has been observing how closely our investment team works with our Sustainable Ownership colleagues. We have attended meetings together and often discuss shareholder votes on contentious meetings. I value the regular updates on the progress of live engagements and look forward to our future developments in this important area.

This report highlights how our investment team collaborates with our Sustainable Ownership team on integrating the Trustee's approach to sustainability into the investments we manage on behalf of our beneficiaries. I hope you find it useful.

This report summarises our Sustainable Ownership activities during 2018 in three areas:

1. Integration

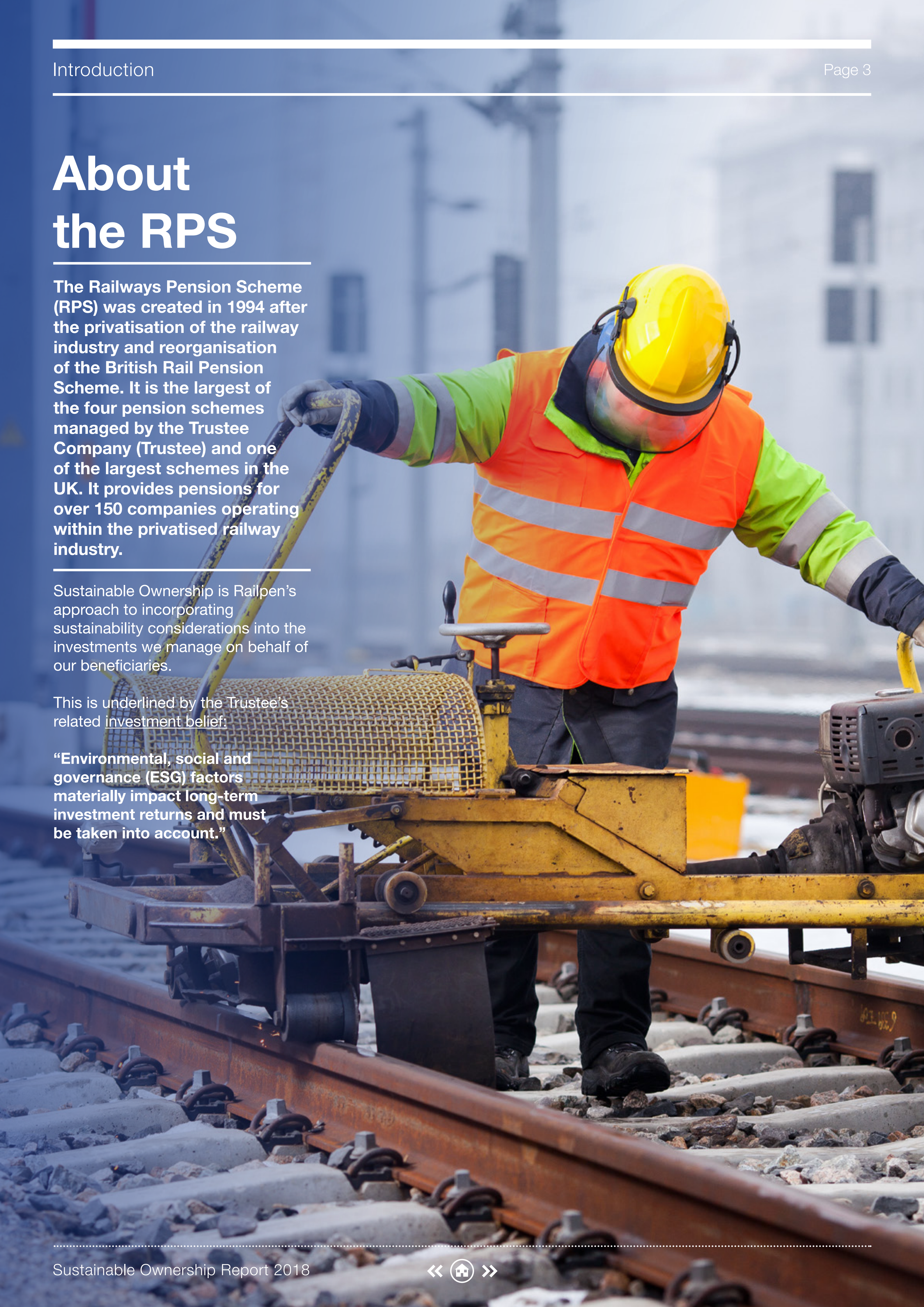
Our goal is to incorporate environmental, social and governance (ESG) considerations into the portfolios we manage on behalf of our beneficiaries.

2. Active ownership

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

3. Longer-term risks and opportunities

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



About the RPS

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

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

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

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

Integration

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

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

1. Improving investment returns
2. Reducing investment risk
3. Impacting Railpen's reputation as a responsible investor
4. Impacting the future world our beneficiaries retire into

We believe that incorporating these lenses into our investment process increases our chances of achieving our Mission to pay members' pensions securely, affordably and sustainably.

Integration by asset class:

Equities

Sustainable Ownership assessment carried out for all companies in our fundamental growth portfolio.

Exclusion of some companies on grounds of climate, cluster munitions and governance and conduct (see Longer-term risks and opportunities section).

External manager monitoring.

Private Markets

Sustainable Ownership assessment carried out for all transactions and Impact mapping against the United Nations Sustainable Development Goals was introduced.

Property

We have set a stretching target to improve the environmental performance of the assets in the portfolio.

Fixed income

External manager monitoring.

Exclusion of some companies on grounds of climate and cluster munitions.

Sustainable Ownership assessment for equities and private markets

Sustainable Ownership (SO) reviews are carried out for all investments in our fundamental equities portfolio and all private market transactions prior to investment. By assessing potential investments for relevant environmental, social and governance (ESG) factors, we believe that we can enhance our investment risk and returns. This process is integrated with our active ownership activities ensuring any concerns identified in the SO assessment will be reflected in our voting and engagement approach.

Improving the environmental performance of our property assets

A key focus area for our property portfolio is energy efficiency. We have set 10-year energy and carbon reduction targets of 20% from a 2017 baseline equivalent to a reduction of around 2.2% each year until 2027.

Over the year to March 2018, we reduced overall consumption by 4.4%, double our target. This trend continued through the following quarter to June 2018.

For our five biggest energy consumers, the multi-occupied office buildings, the target is set higher at 3.5%, but we actually achieved a 13.2% reduction. This performance has been delivered by running air conditioning systems more efficiently to match actual tenant needs, discouraging waste, modernising lighting and its controls, and building management system upgrades, together with new pumps and boilers.

The total value of the energy consumed by the portfolio last year was £2.5m, equivalent to 10,000 tonnes of CO2. We remain focused on driving these energy reduction programmes across our portfolio.

100% of electricity used at our property assets now comes from renewable sources.

Energy Reduction Progress

Target: 2.2%

Progress: 4.4%

What have we saved?

3,008,754 kWh

844 tonnes CO_2

£215,241

These target and performance statistics are adjusted to account for disposals and acquisitions within the portfolio.

Case Study: **Greener Gretna**

Gretna Gateway Outlet Village, one of our property assets, is a shopping outlet village located on the border between England and Scotland.

In November 2018, Gretna Gateway won the Best Waste Management Award at the JLL Responsible Property Management Awards.

The centre used to have 85 separate bins for general waste and mixed recycling. Now, a compactor is used to reduce the volume and the need for collections. In January 2018 alone, the centre diverted 30 tonnes of waste from landfill. This meant 33,000kg of carbon emissions were avoided which is the equivalent of more than 28 trees and 8,500 car miles. The centre is now zero waste to landfill and less reliant on sending waste to incineration.

This resulted in increased revenue streams and greatly reduced indirect carbon emissions. Revenue from recycling is now being pushed into other sustainability projects, including the purchase of four bee hives.

In further recognition of these wider sustainability efforts, Gretna Gateway Outlet Village was also recently awarded a Gold International Green Apple, for environmental best practice in the Scottish habitat & diversity category, at the Houses of Parliament.

> **"These awards bear testimony to the benefits of encouraging our property asset teams to embrace the Trustee's sustainability principles and empowering them to achieve, and in this case exceed them. We plan to promote and replicate this success across the various property asset teams in our portfolio."**

Anna Rule,
Head of Real Assets

Investing for Impact in Private Markets

In our 2017 report we highlighted the work that was being carried out to track the impact of private market investments against the United Nations' Sustainable Development Goals (SDGs). Over 2018 we continued this work to understand more about what impact we are having through our investments.

In 2018 we developed an Impact Mapping tool to identify the positive and negative impacts of our investments on people, the environment and society. This helps us to better manage our investments to increase positive impacts and reduce negative impacts.

Case Study: **Community Fibre**

Community Fibre designs, builds and operates superfast, pure fibre broadband networks in the multi-dwelling unit housing market in London. It works with both social and private landlords.

Railpen first invested in Community Fibre in 2017.

By providing fibre broadband infrastructure, Community Fibre positively contributes towards SDG 9 to build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation.

Broadband access makes a significant contribution to the economy by helping to promote local economic development and providing access to a range of services including healthcare and education.

External manager monitoring in public and private equities and fixed income

In 2018, we sent a questionnaire to our external equities managers on their portfolio monitoring, engagement and voting activities. We compared their responses with their PRI and Stewardship Code public disclosures and other material on their website.

We then met with each manager to discuss their ESG approach, and in one case followed up to clarify why a particular manager was not a signatory to the UK Stewardship Code. We also highlighted certain key climate-related shareholder resolutions, and drew their attention to the ongoing remuneration controversies at a US technology portfolio company ahead of the 2018 AGM.

Following the exercise, we identified this as a potential channel for future collaborative engagement. This was put into practice later in the year when we began a new collective engagement with one of our managers with two Korean portfolio companies due to governance and conduct concerns.

We conducted a similar exercise for fixed income.

In private markets, the external managers' approach to governance and sustainability is assessed on a year round basis by our investment managers, with any controversies escalated at the regular meetings attended by the Sustainable Ownership team.

Monitoring of our external equities managers

20% Of equity managers were rated as emerging

40% Rated as established

40% Were sophisticated in their ESG integration and active ownership activities

The higher scoring managers could clearly explain how ESG is integrated in their investment process, had dedicated resource and undertook a disciplined yet comprehensive approach to monitoring, engagement and voting.

Case Study:

Capital Constellation

Railpen is a founding member of Capital Constellation, a joint venture between three asset owners. It provides investment capital to investor entrepreneurs.

We worked closely with Capital Constellation on the design of their ESG policy. Capital Constellation was awarded the Institutional Investor Allocators' Choice Award for Partnership of the Year in 2018.

> **Through collaborative initiatives such as Capital Constellation we aim to ensure governance and sustainability considerations are fully embedded in the investment decisions of up and coming private equity and alternatives managers.**

Paul Bishop,
Head of Private Markets

Active ownership

As a responsible asset owner, we believe that companies with robust corporate governance structures will manage their risks and opportunities effectively and are more likely to achieve superior long-term financial performance.

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

Voting

We are proud supporters of the International Corporate Governance Network (ICGN), whose mission is to promote effective standards of corporate governance and investor stewardship worldwide. The eight ICGN Global Governance Principles serve as a primary standard for well-governed companies, and we have adopted these as the baseline for our global voting policy, which can be found on our website.

Our global voting policy reflects Railpen's three key voting and engagement themes:

1. Board composition and effectiveness
2. Remuneration
3. Shareholder rights and disclosure

The policy presents these in an accessible way to our portfolio companies, our external managers, members and beneficiaries. Railpen's three key themes are mapped to the eight ICGN principles. Poor practice by a portfolio company under any of the principles may lead to a negative vote.

Board composition and effectiveness

When it came to voting on the election of directors, we voted against 11% of proposals electing directors in 2018.

Of those we voted against, roughly a third were due to independence concerns. Non-Executive Directors (NEDs) or Independent Directors are a vital safeguard to protect the interests of shareholders.

Board diversity remained a focus in 2018, and of those we voted against, roughly a third were due to inadequate gender balance on the board.

The remaining third were due to other concerns, such as where directors held an excessive number of other Board seats, which raises doubts about whether they can dedicate the required time to the role. We also voted against a number of directors for poor attendance, or for oversight concerns related to their board or committee position.

In our updated voting policy for 2018-2019, we strengthened our focus on culture. Setting the right "Tone from the Top" is increasingly viewed as a critical leadership skill, and where there is evidence of a director having displayed poor conduct or judgement, then Railpen will vote against their re-election.

> **"In our Active Ownership Monthly meetings, we review the progress of all companies under engagement in our global equities portfolio.**
>
> **Our fund managers contribute to the setting of those engagement targets, and to Sustainable Ownership initiatives such as the annual update of our global voting policy."**

Craig Heron,
Head of Public Markets

Our 2018 voting activities

Number of meetings where we cast votes	3,204
Percentage of meetings where we cast at least 1 vote Against, Withhold or Abstain	68%[1]

[1] Voted through our ISS Custom Policy.

Case Study: **Barclays plc**

At the May 2018 AGM we voted against the re-election of Barclays CEO James (Jes) Staley.

In May 2018 the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) fined Mr Staley a total of £642,430. The FCA said that Mr Staley failed to act with due skill, care and diligence in the way he acted in response to an anonymous letter received by Barclays in June 2016. This was the first case brought by the FCA and PRA under the Senior Managers' Regime.

We also toughened our position on climate risk where there is insufficient evidence of a credible response to how the company manages climate risk. If we hold concerns over the quality of oversight, we will now vote against the re-election of the Chair of the Board, and/or the Chair of any relevant committees.

Remuneration

In 2018, a third of all companies received a vote against their remuneration practices. We were particularly concerned by excessive pay that introduced a disconnect with performance, mis-aligned incentives and poor disclosure.

Case Study: **Persimmon plc**

Persimmon, a FTSE 100 housebuilder, saw nearly two-thirds of investors vote against their remuneration report or abstain on this item.

We voted against the remuneration report at the 2018 AGM. The cause of the investor revolt was an excessive payout from the Long Term Incentive Plan (LTIP) which was approved by 85% of shareholders in 2012. Railpen voted against the LTIP in 2012.

The rewards under the LTIP are widely considered excessive, and the impact of the UK Government's Help to Buy scheme of 2013 has been a considerable factor, which was not foreseen when the LTIP was designed. The strong response by shareholders led to the resignations of Nicholas Wrigley (former Board Chair) and Jonathan Davie (former Senior Independent Director and Chair of the Remuneration Committee), who both belatedly recognised that the LTIP should have included an upper limit. In November 2018, the company announced that CEO Jeff Fairburn would also step down from his role in light of the reputational damage to Persimmon.

In our revised voting policy for 2018-2019, we will start voting against all new share option plans globally.

Shareholder rights and disclosure

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

Case Study: **Alphabet, Inc**

At the 2018 AGM of the parent company of Google, we supported a shareholder resolution calling for a recapitalisation plan for all stock to have one-vote per share.

Under the company's current dual-class voting structure, company co-founders Page and Brin control over 51 percent of the company's total voting power, while owning less than 13 percent of the stock.

We also seek to enhance the quality of publicly available reporting. Railpen is a signatory to the CDP, which facilitates companies' disclosure of their environmental impacts, and the Transition Pathway Initiative (TPI), which assesses companies' preparedness for the transition to a low carbon economy. We voted against 486 companies who did not respond to the CDP disclosure request or who were scored by TPI as 'Level Zero', the lowest grade possible.

In 2018 we voted against the re-appointment of the auditors, and the approval of their remuneration at 185 companies where the tenure of the audit firm appears excessive, or their tenure is not disclosed.

According to the United Nation's Principles for Responsible Investment (PRI), active ownership is generally regarded as one of the most effective mechanisms for investors to reduce risks, maximise returns and have a positive impact on society and the environment.

Engagement

In 2018, we engaged with around 400 companies. These included face-to-face meetings, calls with companies, letters and emails.

Throughout the year we held over 100 detailed discussions with company representatives face-to-face or by phone.

What we engaged on…

Just under half of our meetings and calls were discussions with companies held in our internally-managed fundamental equity portfolio. These were mainly individual engagements, attended by the fund managers and the Sustainable Ownership team.

The majority of our communications with companies were usually in relation to the three priorities, the most recent company meeting or an explanation of our voting decisions.

Case Study: **Diversity**

2018 saw the first year of mandatory reporting in the UK on the gender pay gap for companies with more than 250 employees.

Using these disclosures, we challenged companies on how they are developing their pipeline of female talent across the workforce.

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

Diversity is, of course, much broader than gender and companies should reflect other demographic characteristics, such as age and ethnicity, in their diversity and inclusion strategies.

We believe that diversity reduces the risk of group think and ensures that a range of views are heard, leading to better decision-making by companies to the benefit of their shareholders.

Collective engagement

Railpen is a lead participant in a range of investor networks, alliances and trade bodies, such as the UK Investor Forum. By working with other leading investors, including bondholders, we can exert more influence on the issues that we care about. We engaged with a group of European investors with companies in the US and Europe who had problematic remuneration practices.

We are a signatory to the United Nations Principles for Responsible Investment (PRI) and are part of the current PRI-coordinated engagement on Cyber Security. We participated in over 70 collective engagements with companies over the course of the year.

Signatory of:

Policy engagement on corporate governance topics

In 2018 we responded to the Financial Reporting Council's consultation on the UK Corporate Governance Code and presented during the PRI webinar on the consultation.

We co-signed a letter with other European investors in support of the petition from the Council of Institutional Investors (CII) to NYSE and NASDAQ.

Railpen was also a member of the GC100 Investor Group which published the updated Directors' Remuneration Reporting Guidance.

UK Stewardship Code

We were a launch supporter of the UK Stewardship Code for investors, and were proud to receive a Tier 1 placing by the Financial Reporting Council for our reporting against the Code, the highest grade possible.

AGM statements

While our discussions with companies are usually private, we will occasionally make public statements.

In May 2018, we spoke at the Reckitt Benckiser plc AGM, noting that we had voted against the remuneration report as it was hard to see how total compensation of nearly £12.5 million for the CEO for 2017 could be justified in a year where the share price had declined by 30%.

Longer-term risk and opportunities

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

We expect the companies we invest in to take a long-term strategic view of potential risks and opportunities. In 2018 climate change, governance and conduct themes were key focus areas.

Exclusions

As a long-term asset owner we value the opportunity to engage with portfolio companies to deliver better financial outcomes for our beneficiaries. We also recognise there may be limits to what can be achieved through engagement. This may be due to the company's underlying business model, the sector within which it operates, its responsiveness to engagement or its record on controversies.

Where there appears to be a material risk to the long-term value of the investment or significant reputational risk we will consider selling our shares in the company. Any decision will take into account how responsive the company is to shareholders' concerns, including their willingness to engage.

In 2018 we implemented two types of exclusions on climate and on governance and conduct.

Governance and conduct

How companies treat their employees, supply chain and wider stakeholders can have a significant impact on their business. However, long-term risks associated with social issues are often difficult to quantify and assess. One reason is the lack of standardised, comparable data. To address this, in 2018 we signed the Investor Statement on Corporate Accountability for Digital Rights which refers companies to the Ranking Digital Rights Corporate Accountability Index. We also supported the Workforce Disclosure Initiative.

WDi Workforce Disclosure Initiative

The Workforce Disclosure Initiative brings together institutional investors to request more comparable data from companies through an annual survey.

It encourages investors to engage on workforce topics to ultimately drive better performance in companies' operations and supply chains.

In 2018 we excluded companies on the grounds of poor governance and conduct from our equity portfolios for the first time. Our view of governance risk takes into account local market and sector norms. Companies may be excluded for their conduct in relation to bribery and corruption, human rights, labour relations or environmental issues.

We wrote to the worst outliers that demonstrated both non-standard governance practices and severe conduct controversies, asking them to begin a dialogue. To date we have identified 7 companies for exclusion from our portfolio and continue to engage with 28.

Where excluded companies demonstrate a real willingness to engage and provide evidence of improved practices, they may be removed from our exclusion list in 2019.

Information on the climate exclusions can be found on page 18.

Climate

In 2017 the Task Force on Climate-related Financial Disclosures (TCFD) released its recommendations for improved transparency by companies and their investors with respect to how climate-related risks and opportunities are being managed.

As a public supporter of TCFD, we are taking steps to incorporate climate change into our investment process and encourage all of our portfolio companies to provide enhanced corporate disclosure in line with this framework.

This first disclosure against the TCFD framework describes how we work today and our approach will continue to evolve over time.

Governance

TCFD Recommended Disclosures	Railpen Initiative
Recommended Disclosure (a) Describe the board's oversight of climate-related risks and opportunities.	The Railpen Investment Board is updated on climate-related issues which are discussed in the context of the Sustainable Ownership four lenses as described on page 4. The Board's quarterly update includes progress on climate-related targets and goals.
Recommended Disclosure (b) Describe management's role in assessing and managing climate-related risks and opportunities.	All proposals to modify investment processes to reflect climate risks and opportunities are agreed with the Chief Investment Officer (CIO) and approved by the Board.

Strategy

TCFD Recommended Disclosures	Railpen Initiative
Recommended Disclosure (a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium and long-term.	Railpen is primarily concerned with the exposure of our portfolio companies to financial risks arising from the transition to a low carbon economy. These fall under the following broad categories: regulatory risks, physical risks, changing consumer preferences and the impact of innovation.
Recommended Disclosure (b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning.	We have undertaken research and analysis to assess climate change risk within our portfolios. As a result, we concluded that climate change poses a complex and material financial risk to long-term investment returns and should be managed. The results of the exercise were discussed with the Railpen Investment Board including how we should manage our exposure to portfolio companies which are most exposed under the transition to a low carbon economy.
Recommended Disclosure (c) Describe the potential impact of different scenarios, including a 2C scenario, on the organisation's businesses, strategy and financial planning.	We modelled our listed equities portfolio using the Paris Agreement Capital Transition Assessment or PACTA tool, which analyses exposure to transition risk over multiple scenarios. The analysis found that our portfolio has lower exposure to transition risks in the oil & gas and automotive sectors compared to the broader equity market, but higher exposure to transition risks in the power sector. This is a first step in assessing how our portfolios are exposed to climate-related risks and we will continue to work on assessing our portfolios' resilience next year.

Risk management

TCFD Recommended Disclosures	Railpen Initiative
Recommended Disclosure (a) Describe the organisation's processes for identifying and assessing climate-related risks.	As a first step to managing climate risk in our portfolios, we have divested from companies which derive greater than 30% of their revenues from the thermal coal and tar sands sectors. Data was sourced from a third-party provider and we wrote to the companies to verify the analysis and engage on their plans to transition to a low-carbon economy. We also signed the 2018 Global Investor Statement to Governments on Climate Change, which called on national governments to renew their commitment to the goals of the Paris Agreement. A number of policies were proposed including phasing out thermal coal power worldwide.
Recommended Disclosure (b) Describe the organisation's processes for managing climate-related risks.	Oversight of climate risk is assessed as part of our active ownership work stream. Railpen is a supporter of three key climate engagement initiatives: the Taskforce on Climate related Financial Disclosures, the Transition Pathway Initiative and Climate Action 100+. We collaborate with a range of global asset owners and managers and these initiatives inform our voting and engagement approach which informs our investment process. We wrote to over 200 of our most significant holdings in January 2018 urging them to support the TCFD framework. We wrote to another 100 companies in September 2018 when our Voting Policy for 2018-19 was published. We also supported an open letter to global power companies published in the FT, asking them to accelerate their decarbonisation efforts and support ambitious climate policy. We are a supporter of the Just Transition, and have committed to take account of the social dimension of the transition to a low carbon economy. Where there is insufficient evidence of a credible response to climate risk, leading to concerns regarding the quality of oversight, Railpen will vote against the re-election of the Chair of the Board, and/or the Chair of any appropriate committees. Railpen is also a signatory to CDP. We have engaged with companies to encourage them to complete the CDP's climate change and water questionnaires, and we will vote against companies who do not respond to their disclosure requests.
Recommended Disclosure (c) Describe how processes for identifying, assessing and managing climate-related risks are integrated into the organisation's overall risk management.	The Investment Business Risk Committee oversees Railpen's investment risk management framework relating to Reputational Risk, Market Risk, Liquidity Risk, Counterparty Risk and Legal Risk. These are expected to be appropriately considered throughout all investment activities. The Head of Public Markets, Head of Private Markets and Head of Real Assets are responsible for overseeing the short, medium and long-term risks relating to the portfolios for which they have responsibility, reporting to the CIO. The Sustainable Ownership team works closely with the investment teams to determine which climate related risks and opportunities could have a material impact on portfolios.

Metrics and Targets

TCFD Recommended Disclosures	Railpen Initiative
Recommended Disclosure (a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.	In 2018 we continued our monitoring of climate risk in our equities portfolio, completing our fourth carbon footprinting exercise under the Montreal Pledge. We disclose the emissions intensity of our portfolio, which is the carbon emissions relative to the money invested, relative to a benchmark.
Recommended Disclosure (b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.	We have assessed our equity portfolio to have a weighted average carbon intensity of 366.1 tCO2e/GBPm as at 30 November 2018. This compares to a weighted average carbon intensity of 338.8 tCO2e/GBPm for the MSCI All Country World Index (ACWI) at the same date.
Recommended Disclosure (c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	The investment team are responsible for identifying appropriate targets for their portfolios with support from the Sustainable Ownership team. Our Head of Real Assets has set a target of a 20% emissions reduction over the next 10 years from a 2017 baseline. Using the results of our ongoing work on scenario analysis and carbon footprinting, we will look to set targets in other asset classes in future.

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