DRIVING THE CHANGE WE WANT TO SEE

Railpen's Sustainable Ownership Review 2020 – prepared for members of the railway pension schemes

RAILPEN

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FOREWORD FROM CHRIS HANNON AND JOHN CHILMAN

We are delighted to present the 2020 Sustainable Ownership Review. This report gives you a flavour of what we have been doing on Sustainable Ownership.

Sustainable Ownership is our approach to incorporating sustainability issues, like climate change or executive pay, into the investments Railpen manages on your behalf.

You and your employer both pay contributions while you're an active member of the railways pension scheme. These contributions are then invested in different ways, including in companies and brands you care about. We do this to achieve the investment returns needed to give you an income in retirement.

We believe in investing these contributions in companies that are well-run and seek to address all the risks and opportunities related to their business model. We think this is the best way to protect and increase the value of your savings, giving you a good retirement outcome. These risks and opportunities include environmental, social and governance (ESG) issues. These could be things like climate change, such as the impact of extreme weather events on food production, or a company's approach to the health and safety of its employees.

Buying stakes in a company gives us rights, but we believe it also gives us responsibilities. This report helps you understand:

- Why we think about ESG issues in our investment decisions and activities;
- How we act to improve company behaviour on these issues; and
- The impact we have had on your behalf.

This report gives you an insight into ESG issues, and what we did on your behalf in 2020, but if you want to learn more, you can find links to other Sustainable Ownership documents, such as our detailed plan to achieve Net Zero greenhouse gas emissions, on page 14. We've tried to make this report as easy to understand as possible, but there may be some unfamiliar words or terms, so we've explained these in the glossary on page 13.

We hope you enjoy reading about our Sustainable Ownership activity on your behalf.

Chris Hannon
Chair of the Trustee Board

John Chilman
Chief Executive Officer, Railpen

We want to hear from you

We produce reports like these because we know you're interested in hearing about how we invest sustainably. But we want to do even better: what would you like us to talk about? How would you like us to talk to you? Let us know at SO@railpen.com

2020 IN NUMBERS

175
Number of companies excluded from our portfolio on climate change grounds

10
Number of companies excluded from our portfolio on governance conduct grounds

31
Number of companies excluded from our portfolio under Railpen's cluster munitions and landmines screen

2165
Company meetings voted

1348
Meetings where we voted against management

72%
Proportion of company meetings where we voted against company management, withheld support or abstained on at least one resolution

65%
Proportion of Railpen's investment portfolio covered by the first phase of our Net Zero plan

YOUR PENSION SCHEME AND YOU

There are four railway 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. It provides the pensions for over 150 companies operating within the privatised railways industry.

The railway pension schemes are managed by the Railways Pension Trustee Company Ltd, known as the Trustee, which always acts in members' interests. There are 16 Trustee directors. Eight are nominated by employers and eight by members. The Trustee is responsible for deciding how the schemes' assets will be invested and ensuring there is enough money in the schemes to pay members' pensions.

Although the Trustee is responsible for making strategic investment decisions, it gives responsibility for the management of £35billion of scheme assets to Railpen (Railway Pension Investments Limited) while retaining oversight of its activities. The Trustee is Railpen's only client, which means all investment management activities are designed to secure our members' future.

There are over 350,000 members in the railway pension schemes, with the average member being a 45-year-old man. We offer both Defined Benefit (DB) and Defined Contribution (DC) arrangements for members, and the fact that we have so many new and young members joining our schemes every day means we need to invest with their long-term interests in mind.

WHY DO WE INVEST YOUR MONEY SUSTAINABLY?

The Trustee's mission is to pay members' pensions securely, affordably and sustainably, and we do this by investing to protect the value of members' assets.

We believe that well-run companies treat their suppliers, customers and workers fairly. These companies can change their business models to deal with major threats or issues, such as the coronavirus pandemic, climate change or an ageing population. We believe these companies are best-placed to succeed in the long-term.

To make an investment return, we need to take risk. We believe we get better risk-adjusted returns on our investments when these companies succeed.

'Sustainable Ownership' is what we call the way we think about, and act on, environmental, social and governance (ESG)[1] issues in our investment decisions. We are one of the few UK pension schemes with a specialist in-house team, at Railpen, dedicated to 'doing' Sustainable Ownership on your behalf.

The Sustainable Ownership team follows the Trustee's beliefs, principles and objectives for investments. We work across every asset class, from listed equity to infrastructure or private debt.

[1] *You will hear about "ESG" or "ESG investment" a lot in the personal finance pages of most newspapers. We also provide a glossary at the back with this and other frequently-used terms.*

OUR IMPACT ON YOUR BEHALF IN 2020

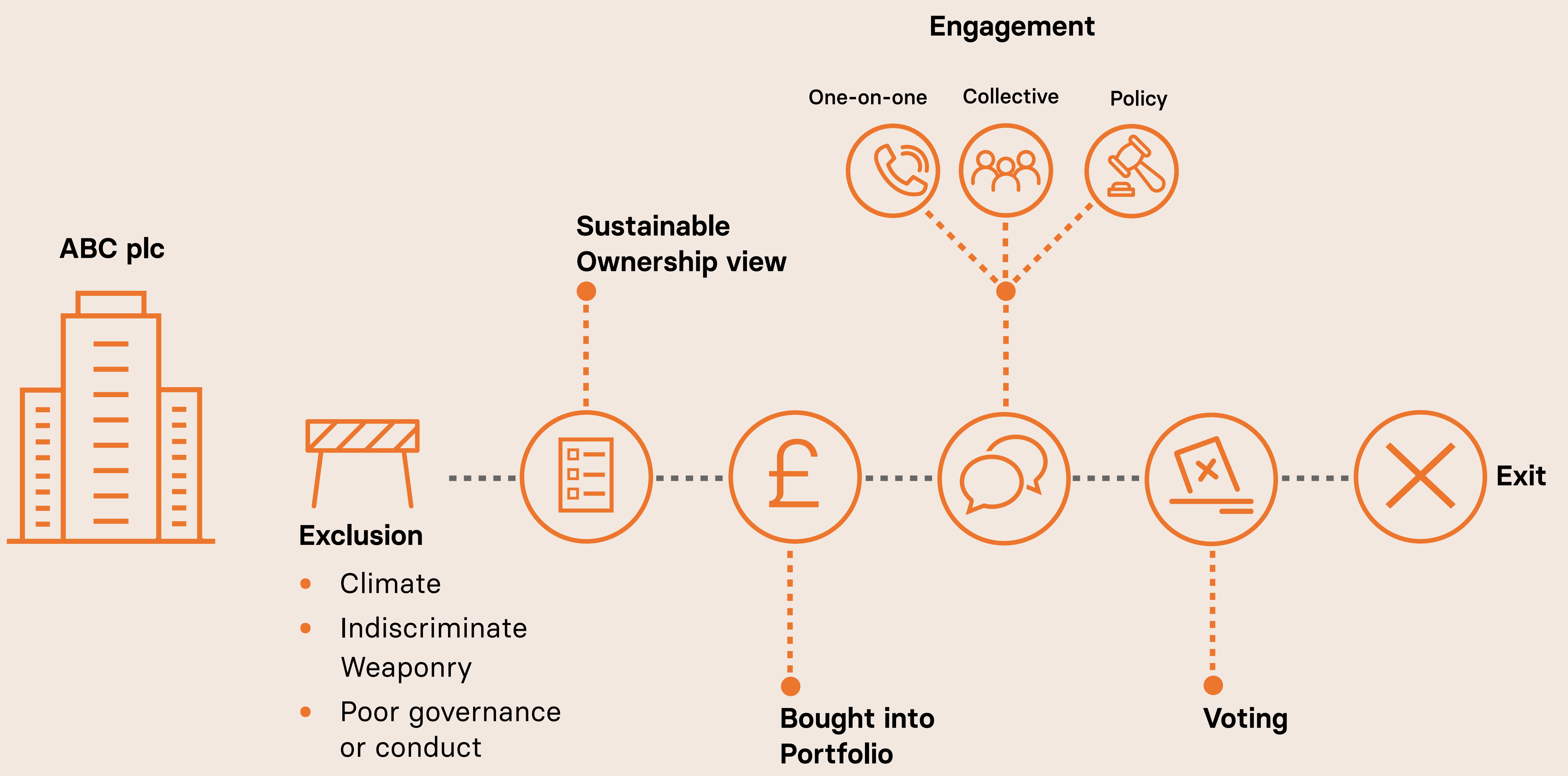
We use every tool at our disposal to encourage companies to act responsibly and address the impact of governance and sustainability issues, not only on their business operations, but also on the world our members retire into.

We do this in a number of ways:

- We can speak to companies privately, either individually or together with other investors. Investors call this "engagement"[2].
- We can make our concerns public. We can do this, for example, by using our vote at company Annual General Meetings (AGMs), to publicly express either support for or disagreement with a company's senior management or board.
- We discuss our views with politicians, government officials and regulators. We do this to understand how laws and regulations might be changed to support companies and individuals to make the right choices.
- We can remove companies from our portfolio, if we're already invested in them. We might do this if we feel that their behaviour is not improving as quickly as we'd like. Or, we might think the level of environmental, social or governance risk posed to the portfolio is too big to manage. This is known as 'divestment' or 'disinvestment'. We can also refuse to invest in the first place. This is known as 'exclusion'.

In the rest of this section, you'll find some case studies on the issues that we know matter most to you. Further details and more case studies can be found in our 2020 Stewardship Report.

The life cycle of an investment at Railpen



[2] *Please also see our Glossary on p14.*

Climate change

Climate change is not only a risk to the security of the investments we manage on your behalf, but to the kind of world we all hope to retire in. The effects of climate change, such as rising sea levels, ocean acidification, extreme weather and droughts, are already having an impact on people's lives and livelihoods around the world. Experts recommend limiting global temperature rises to 1.5 degrees, to avoid the worst impacts. It is a priority for us to work towards this 1.5 degree, or lower, world.

We prefer to remain invested, where possible, to give us a stake and a voice to improve companies' behaviour. However, we were also one of the UK first pension schemes to divest from companies on climate grounds[3].

Case study - Climate Engagement with Climate 100+ (CA100+)

The issue

The cement industry contributes around 6% of global greenhouse gas emissions. So it is very important for investors to engage with companies in this sector to support a shift to net zero and more rapid decarbonisation. CRH is a company that manufactures and distributes building materials including cement production.

What we did

Climate Action 100+ is an investor-led engagement initiative. Investor signatories like Railpen commit to engaging with at least one of 167 target companies that are strategically important to global decarbonisation efforts. Railpen has been engaging with CRH on behalf of CA100+ as lead investor, including leading in a number of engagement letters, meetings with company management and the investor relations team.

What has changed as a result

CRH has:

- Become a public supporter of the Taskforce on Climate Related Financial Disclosures (TCFD);
- 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 the direct and indirect lobbying activities in 2021.

Railpen has also been a lead engager on behalf of CA100+ with both Nestlé and LafargeHolcim. We are also a lead investor on climate accounting with two companies as part of the coalition, engaging with firms to improve disclosure of climate assumptions used in the financial accounts.

[3] *Further information can be found in our December 2020 Climate-related Disclosure.*

Treating workers fairly

We believe that how well companies treat their employees is a massive part of their long-term success. The global pandemic has put workforce health and wellbeing very much in the spotlight.

However, Railpen has worked with companies to understand how they look after their employees and make sure they're motivated, skilled and happy. We know that this is a very important issue to you and our Trustee Board.

Case study - The Covid-19 pandemic and workforce treatment

The issue

Railpen quickly recognised the risk Covid-19 presented to our portfolio. This included its impact on environmental, social and governance issues such as how employees, customers and suppliers are treated. There were also increased cybersecurity risks, as many companies shifted quickly to remote working arrangements.

What we did

In each of our direct engagements since March 2020, we have asked portfolio companies how they were dealing with Covid-19, and the current and likely future impact on their people and operations.

Covid-19 was also a big theme of our updated Global Voting Policy. We publicly stated that we would "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".

What has changed as a result

Covid-19 has encouraged us to focus even more on our company engagement, voting and public policy work on workforce issues over the next five years. We will be leading engagement on more portfolio companies as part of the Workforce Disclosure Initiative.

We will also be carrying out research with investor and company membership bodies in the UK to explore what good corporate reporting on workforce issues looks like, and how it needs to evolve to provide useful information to investors.

Executive pay

How much, and how, a company's senior management are paid can be a powerful force in shaping both their behaviour and the decisions they make. We believe that company executives should be paid in a way that matches their interests with those of their stakeholders. This includes shareholders like Railpen, but also employees, customers and suppliers.

We also think that paying the workforce fairly is vital if they are to continue to be motivated and engaged in their jobs. We raise our concerns privately and publicly if we see big pay gaps across characteristics such as gender. We'll also do this if senior management's bonus packages and salaries have been protected from poor performance in a way the rest of their employees' have not[4].

Case study - executive pay

The issue

One of our holdings is a UK-based intellectual property commercialisation company. At the May 2019 Annual General Meeting (AGM), we voted against their pay and reward approach. We felt the limit on the executive long-term incentive plan (LTIP) was too much, at 400% of base salary. We also voted against the Chair of the Board, due to low gender diversity.

What we did

As the company's largest shareholder, we engaged with Board members on pay and reward practices and director appointments. The company was open to our views and we were able to reach a situation that we were happy with.

What has changed as a result

We were pleased to see a lower cap of 300% on the LTIP, and the appointment of two highly-skilled female directors to the Board. We were therefore able to vote in favour at the 2020 AGM season.

[4] *We chose to warn companies of our expectations on fair treatment of workers during Covid-19, including how they are paid, in our 2021/22 public Global Voting Policy update. We will report more on our activity on Covid-19 in our 2021 Stewardship Report.*

OUR PLANS FOR THE NEXT 12 MONTHS

Although Railpen is an acknowledged leader in Sustainable Ownership, we are continually trying to do better and work harder on your behalf. This section gives you an insight into some of what we are working on in 2021 and 2022.

Aim for Net Zero

Railpen has publicly committed to managing its investment portfolio in line with achieving Net Zero greenhouse gas emissions (GHG) by 2050, or sooner. We believe that doing so is in line with our core purpose to secure our members' future.

You can find out more about our roadmap for achieving Net Zero through decarbonising our portfolio, investing in climate solutions and influencing policymakers and the broader market in our Net Zero Plan.

Fund level	Portfolio-level
GHG reduction targets 2030: 50% reduction in financed emissions 2025: 25-30% reduction in financed emissions	**Engagement targets** Today: 70%* either aligned to Net Zero or under engagement 2030: 90% either aligned to Net Zero or under engagement
Climate solutions Increased investment in the climate solutions required to meet Net Zero by 2050 or sooner	**Alignment targets** 2040: 100% of AUM in 'material' sectors either already Net Zero, aligned to Net Zero, or aligning to Net Zero

These proportions are measured by the % of financed emissions from companies in material sectors. This ensures we focus engagement on the companies with the greatest climate impact.

Focus (more) on the issues which really matter

As well as climate change and our Net Zero commitment, there are some other major governance and sustainability issues. These are so significant they affect either every company or project we invest in, in some way, or have a consistently major impact on key sectors in our portfolio.

For 2021-2025, we have decided to focus our engagement, voting and public policy activities across the following four themes.

Climate Transition

- Net Zero
- Biodiversity

Workforce

- Covid-19 and and fair workforce treatment
- Remuneration
- Eliminating modern slavery

Responsible Technology

- Artificial intelligence
- Media content control

Sustainable Financial Markets

- Shareholder rights
- Audit quality and disclosure

Speak directly to you

We have several different ways that help us understand members' views on Sustainable Ownership issues. This includes speaking to our Trustee directors or to employer and member representatives on Pension and Management Committees and our Sustainable Ownership Client Forum[5].

However, we also want to hear from members directly: what are the Sustainable Ownership issues that matter most to you, and how do you want us to talk to you about them? To help answer these questions, we'll be talking directly to members through late 2021 and early 2022. We'll let you know via your regular newsletters and member websites how you can get involved.

[5] *Further details of how and when we speak to these different bodies can be found in our 2020 Stewardship Report.*

GLOSSARY

- **Advocacy (or public policy).** Activities undertaken to influence policymakers and regulators. This includes meetings, roundtables, or responding to government requests for evidence, either individually or through a membership body.
- **Defined Benefit (DB).** A scheme where the amount you're paid is based on how many years you've worked for your employer and the salary you've earned.
- **Defined Contribution (DC).** A scheme where you build up a pot of money that you can use to provide an income in retirement. The income you get depends on factors such as the amount you pay in, the fund's investment performance and the choices you make at retirement.
- **Divestment (or disinvestment).** The process of an investor selling all a company's debt or equity instruments, if already invested.
- **Debt (or credit).** If an investor buys a debt instrument, they loan capital to a firm. This entitles them to interest from the debtor company over a fixed term until the loan is repaid. Debt can be **listed** i.e. bought and sold on an exchange or **private** (private debt) i.e. it is a loan to a private company that is not listed on an exchange.
- **Engagement.** Communicating with a person or organisation with the aim of raising an issue or achieving change.
- **Equity (share).** Buying a share (or equity instrument) gives the owner (shareholder) an ownership right/stake in the firm in return. The owner has the right to vote and a claim on future profits, for example through dividends. An equity instrument can be **listed** (or public) i.e. bought and sold on a stock exchange or **private** (private equity) i.e. it is a stake in a private company that is not listed on an exchange.
- **ESG.** The collective term for referring to "environmental, social and governance" issues. Some examples are given below:

  Environmental
  - Climate risk
  - Carbon emissions
  - Energy usage
  - Raw material sourcing
  - Supply chain management
  - Waste and recycling

  Social
  - Community relations
  - Employee relations
  - Health and safety
  - Human rights
  - Product responsibility
  - Workforce diversity

  Governance
  - Board structure
  - Executive remuneration
  - Bribery and corruption
  - Separate Chair and CEO roles
  - Shareholder rights
  - Vision and business strategy
  - Voting procedures
- **ESG Integration.** Incorporating environmental, social and governance (ESG) considerations into investment decisions regarding, and analysis of, the companies we invest in.
- **Exclusion.** Not allowing the purchase of any of a company's debt or equity instrument and its inclusion in an investment portfolio.
- **Financed Emissions.** The level of greenhouse gases associated with a financial institution's investments and loans.
- **Infrastructure.** The essential physical systems that support companies or individuals, regions or countries (economies). Examples include: communication networks; transportation systems such as roads and rail; water and sewage systems; and electricity plants.
- **Risk-adjusted returns.** A measure that takes into account how much risk is taken to achieve a particular return.
- **Shareholder.** The owner of shares (equities) in a company.
- **Signatory (signatories).** An organisation that has signed up or committed to an initiative.
- **Stewardship.** Monitoring, understanding and looking to influence the behaviour of the companies we invest in. Stewardship involves using tools such as engagement, voting and advocacy as ways to shape corporate behaviour.
- **Voting (a vote).** Being a shareholder in a company (usually) gives us the opportunity to vote on company matters at meetings such as an Annual General Meeting (AGM). The issues we can vote on include executive pay, the election of board directors, a climate change plan, and the financial report and accounts.

FIND OUT MORE

You can find further details of Railpen's work across Sustainable Ownership in the following documents:

- 2020 Stewardship Report. A detailed look at our stewardship activities over 2020.
- Net Zero Plan. Our roadmap to achieving net zero greenhouse gas emissions by 2050 or sooner.
- Climate-related Disclosure 2020. An overview of our approach to climate change across our governance, strategy and approach to risk management.
- Global Voting Policy 2021/22. Our approach to voting on key governance and sustainability issues for the 2021/22 voting season (updated annually).
- Active Ownership webpage. Contains links to our UK voting records, questions we have asked at company AGMs, our policy responses and much more.

You can also find many of these reports in the dedicated section on Sustainable Ownership on your pension scheme member website.

We hope this has helped you understand a little more about who we are and what we do, but we welcome any questions.

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