RPMI RAILPEN

# Climate-related Disclosure December 2020

# About RPMI Railpen

RPMI Railpen ("Railpen") acts as the investment manager for the Railways Pension Scheme, and is responsible for managing c. £30 billion of assets. Railpen is a wholly owned subsidiary of the Railways Pension Trustee Company Limited, the trustee body ("the Trustee") for the Railways Pension Scheme.

The Trustee's mission is to pay the pensions of its 350,000 members securely, affordably and sustainably. Railpen is wholly dedicated to this purpose. Railpen is authorised and regulated by the Financial Conduct Authority (FCA).

More information about Railpen, including about our Sustainable Ownership activities is available at **rpmirailpen.co.uk**

# About this document

The purpose of this Climate-related Disclosures document is to communicate Railpen's current approach to managing the risks and opportunities brought about by climate change. It supplements our reporting against the TCFD[1] Recommendations which can be found in our 2019 Sustainable Ownership Report. At present our focus is on integrating climate change factors into the different investment processes that apply to the asset classes we manage on behalf of our clients. We will provide an updated Climate-related Disclosure in 2021.

# Introduction: The growing urgency of climate change

The latest report from the Intergovernmental Panel on Climate Change (IPCC) details the impact of increasing carbon and greenhouse gas emissions on global temperatures. 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.

In November 2016, the Paris Agreement was ratified by 184 nations and focused global leaders and policy makers on the urgency of transitioning to a low-carbon economy. In 2018, the UK government committed to being net zero carbon by 2050 in line with the Paris Agreement.

Railpen strongly supports the Paris Agreement and has signed the Global Investor Statement on Climate Change, urging policy-makers around the world to adopt carbon reduction targets that deliver the Paris goals.

[1] *Taskforce on Climate-related Financial Disclosures*

# Our work in context

Like most long-term responsible investors, Railpen continues to enhance its understanding of the complex ways in which climate change can come to impact our investment portfolio. As shown below, Railpen was quick to recognise the importance of climate change, and has been building its analytical capabilities while supporting important global initiatives:

## 2000

- Joined Carbon Disclosure Project

## 2011

- Joined Institutional Investors Group on Climate Change
- Signed the Global Investor Statement on Climate Change

## 2015

- Signed the Montreal Carbon Pledge

## 2016

- Integrated climate change into the investment process

## 2017

- Implemented climate-related exclusions (coal and tar sands)
- Became a founding supporter of the Transition Pathway Initiative
- Joined Climate Action 100+

## 2018

- First reported against TCFD recommendations
- Re-affirmed support for the Global Investor Statement on Climate Change

## 2019

- Introduced Transition Pathway Initiative voting rule
- Conducted scenario analysis

## 2020

- Published Climate-related Disclosure

Railpen has been on a journey to improve the way in which we deliver our Trustee's purpose. A key focus for the organisation has been the enhancement and internalisation of the investment management function. More recently Railpen has taken the natural next step of creating a Fiduciary Team to help explicitly link clients' needs and expectations to asset management decisions.


Railpen's approach to embedding climate risk management has developed correspondingly. Our Phase I priorities have begun with integration of climate risk management into our bottom-up, investment processes. The objective in Phase I has been to organise our investment processes and portfolio positioning so that downside climate risks (such as asset stranding) are managed and climate opportunities (such as investing in renewable energy) are exploited where appropriate. Phase II will involve making our approach more holistic, bringing the management of climate risk and strategy setting into our recently formed Fiduciary Team. Certain Phase II activities have already begun, such as the consideration of climate risk in covenant analysis.

## Continual improvement

Whilst the tools and datasets investors need to manage climate risk are improving all the time, we do not have all the answers today. As a long term investor with a strategic commitment to Sustainable Ownership, Railpen's investment team is committed to accessing and utilising the best available information as we manage the risks and opportunities associated with climate change.

Shortly before the publication of this Climate-related Disclosures document, the Institutional Investor Group on Climate Change (IIGCC) published a Draft Net Zero Investment Framework, and is currently incorporating feedback into a final version of their proposed framework. The draft framework seeks to define what it is to be a 'net zero investor', with a focus on how this translates into different asset classes. We are currently evaluating the IIGCC's framework, and are continuing to participate in this evolving research area.

**We will update this document in 2021.**

# Railpen's climate beliefs and governance

In line with the Trustee's investment beliefs and Statement of Investment Principles (SIP), Railpen recognises the impact of climate change on our long-term investments and on the quality of the world our beneficiaries retire into.

**Investment Belief Four**

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

The Trustee's SIP recognises that climate change has a financially material impact on investment returns. The Trustee expects Railpen to take climate risks and opportunities into account in investment decision-making and stewardship activities. The Trustee undertakes annual training on ESG[2] issues (including climate change), and is regularly engaged by Railpen's Sustainable Ownership Team.

The Trustee's investment beliefs and SIP provide Railpen's mandate for managing climate risks. Railpen's mission is to pay our members' pensions securely, affordably and sustainably, and we therefore seek to align our portfolio with the low-carbon transition of the global economy.

We seek the views of our clients on our climate work and engage on this issue at Pension Committee meetings, and other fora. We regularly communicate to our members on our Sustainable Ownership activities both directly and via our website.

In 2020, Railpen set up an internal Climate Working Group with members from different teams across the Investment and Fiduciary Businesses. The purpose of the Climate Working Group is to drive continual improvement in the management of climate risk across our different asset classes and that our approach to climate is fully integrated to our investment decision-making.

All proposals to modify investment processes to integrate climate risks are agreed with our chief investment and chief fiduciary officers and approved by the Railpen Investment Board and Trustee Board.

[2] *Environmental, Social and Governance*

# Applying our Sustainable Ownership strategy to climate change

Railpen's approach to Sustainable Ownership issues, including climate change, flows from our Trustee's investment beliefs. We approach the investment process with four lenses:

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

The application of the four lenses to our investment process relies on three types of activity, which are common to all our pooled funds:

- Integration
- Active Ownership
- Transparency & Disclosure

Reflecting our fiduciary responsibilities, our primary climate-related concern is the potential financial impact to our investment portfolio. From the perspective of being an investment manager of diverse asset classes, our goal is to ensure climate risks and opportunities are managed in each portfolio in a manner that supports our investment objectives.

We have identified that our climate investment risks are both physical and transitional:

- Physical risk – extreme weather events, water availability, flooding (direct assets, company assets, company supply chains)
- Transition risk – public policy, carbon pricing (including stranded assets), stricter emissions laws and higher penalties

We also recognise a link between climate impact of companies and their social licence to operate. A company that is failing to anticipate the low-carbon transition may reflect poor management quality and the company may struggle to grow its customer base or to attract the best talent.

# Integrating climate risks and opportunities into the investment process

Given the important idiosyncrasies of the different asset classes in which we invest, our bottom-up management of climate risk is bespoke to each portfolio. A commonality is the relevance of climate-related risk management through the investment cycle:

**INTEGRATION**

- Screening
- Sourcing
- Analysis
- Due diligence
- Legal terms and covenants
- Value at exit

**ACTIVE OWNERSHIP**

- Risk monitoring
- Improving asset quality
- Engagement and Voting
- Tenant engagement
- Collaboration

**TRANSPARENCY AND DISCOLURE**

- Industry participation
- TCFD
- Stewardship Code
- Montreal Carbon Pledge

Material ESG factors including climate change are considered before an investment is made, are part of portfolio monitoring, and may be part of the decision to sell.

# Integration

## Screening

Although our preference is to engage with companies and drive a shift towards lower carbon business models, some activities remain fundamentally unsustainable, and present risks to our portfolio that we believe should be avoided by tightening our investment universe.

In 2018 the Railpen Investment Board approved our climate exclusion policy and we have since divested from all listed companies which derive greater than 30% of their revenues from thermal coal or tar sands. This resulted in the exclusion of 175 companies from our portfolios at the end of 2019.

In the event that companies transition their business activity and lower their high carbon revenues, they become eligible for our investment universe.

## Sourcing low-carbon opportunities

The transition to a low carbon economy requires large-scale investment in renewable energy and renewable infrastructure. Recognising the potential for superior long-term risk adjusted returns, our Real Assets Team allocates to low carbon themes, including investments in several wind farms, a biomass plant and a smart metering company. As at Q2 2020 investments in renewable and low carbon energy account for 34% of the Long Term Income Fund.

### Case Study: **Carraig Gheal Wind Farm**

In January 2020 Railpen purchased 90% equity stake in Carraig Gheal Wind Farm Ltd with the remaining 10% owned by GreenPower, who is the asset manager. The farm, consisting of twenty 2.3 megawatt turbines, is operational since 2013 and saves an estimated 62,270 tonnes of $CO_2$ a year.

### Case Study: **Biomass plant**

In 2020 we invested alongside Greencoat Capital in an operational biomass plant in Lincolnshire, UK. The biomass plant saves an estimated 50,000 tonnes of $CO_2$ a year and contributes to the UK's renewable energy mix. Ensuring a mix of renewable energy supplies is key to the establishment of a resilient and sustainable energy system.

The biomass plant uses a blend of sustainably sourced straw and woodchip to generate renewable power and heat. Located within the 'Grain Belt', in Lincolnshire, the plant provides a reliable route to market for straw, an agricultural by-product which can represent an additional income source for local farmers. Heat generation by the plant is provided to the local swimming pool and other community facilities and the plant has recently signed a new community funding agreement with the council.

Through our private markets innovation and communications strategies, we have had an explicit focus on sectors that benefit from the transition to a digital and low-carbon economy.


## ESG analysis and portfolio construction

Our portfolio managers work side by side with the Sustainable Ownership Team to assess all investments, and highlight companies for engagement. This includes stock analysis, due diligence of private market transactions, and identifying opportunities that can be realised later in the investment cycle.

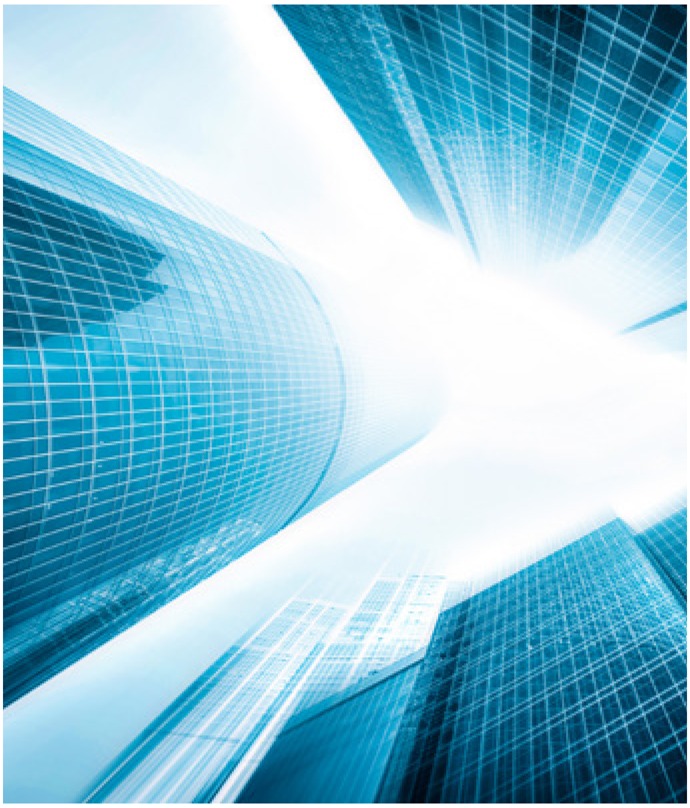
Partly as a result of this process, our fundamental equity portfolio is weighted towards typically low-carbon sectors such as healthcare and technology, and as at end December 2019 our wider equity portfolio has a carbon intensity 12.5% less than the MSCI All Countries World Index[3].

In recent years our private markets investments have naturally had a low-carbon bias as we found the most attractive opportunities in sectors such as services and technology, for example.

[3] *We use the Weighted Average Carbon Intensity (WACI) metric Source: ISS ESG.*

# Active Ownership

Our long-standing active ownership work stream is based on our belief that engagement improves asset quality and is therefore a driver of long-term investment value.



## Improving asset quality

A key focus area for our property portfolio is energy efficiency and carbon reduction. We set 10-year energy and carbon reduction targets of 20% from a 2017 baseline and have achieved double the annual target so far. The Railpen property portfolio uses 100% renewable energy and targets for tenant usage have been set, aiming for a 40% reduction in electricity and a 50% reduction in gas consumption by 2030. We will engage closely with our tenants to achieve these goals and tenant energy use will be fully tracked by this time also.

Since the tenant engagement process can prolong the improvement in building energy efficiency, Railpen's property team is seeking real estate development projects, where we can lock in our carbon efficiency goals in the design phase.

## Company engagement and shareholder voting

We engage with investee companies, both individually and collaboratively, with our external managers and with industry initiatives to drive the alignment of the investment industry with the Paris Agreement and support the UK government's climate commitment.

In line with our climate voting policy, Railpen will vote against the re-election of the Chair of the Board, and/or the Chair of any appropriate committees, if we have concern over the quality of climate risk oversight. We will also vote against Chairs or other senior directors at companies who are ranked 0, 1 or 2 (median or below) for management quality by the Transition Pathway Initiative.

Railpen has led several of the CA100+ engagements including with HeidelbergCement and CRH in 2020 and targets include disclosure, political lobbying and alignment with the goals of the Paris Agreement. In 2019, HeidelbergCement became the first in the sector to develop a goal to achieve carbon neutrality by 2050, and to set an approved Science-Based Target to 2030. CRH is one of the largest global building materials suppliers and in 2020 it also set out aims to achieve carbon neutrality along the cement and concrete value chain by 2050.

Railpen is a signatory to CDP (formerly "Carbon Disclosure Project"). 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.

We collaborate with a range of global asset owners and managers on climate-related issues and these initiatives inform our voting and engagement approach, which informs our investment process.

## External manager monitoring

Assessing the skill with which climate risks are identified, priced, and managed is part of our external manager selection and monitoring processes. For example, our corporate bond investment manager is Insight Investment, whose approach includes applying a proprietary ESG risk model, engaging widely with bond issuers, and using its industry voice to promote systemic change. Insight Investment engage portfolio companies through the Climate Action 100+ initiative, and have been TCFD supporters since 2018. They currently achieve our highest internal rating for the management of ESG and climate risk.

## Wider public policy engagement

Railpen recognises that system-level change is needed to mitigate climate change. Our proactive collaboration with both investors and policymakers enables us to promote the harmonisation of industry and policy frameworks, and shape the environment in which we invest. We have signed the Global Investor Statement on Climate Change, urging policy-makers around the world to adopt carbon reduction targets that deliver the Paris goals. Our Trustee recently responded to the UK government's consultation on TCFD reporting, offering support for progressive disclosure requirements.

We therefore proactively contribute to policy organisations like the Pensions and Lifetime Savings Association (PLSA), the International Corporate Governance Network (ICGN), the British Venture Capitalist and Private Equity Association (BVCA), and the Financial Reporting Council.

## Risk monitoring

To inform our climate risk management we use several global third-party data providers, in addition to our own research via company engagement. In 2019 we introduced climate scenario analysis as a means to better understand climate risks in our portfolio. In Q4 we employed a third party to undertake an analysis of our portfolio in 1.5C, 2C and 4C+ scenarios. The analysis revealed that Railpen's portfolio returns would likely be resilient to different climate scenarios. The expected resilience is due to diversification across sectors and regions, as well as a currency hedging strategy. The worse the temperature outcome, and the less co-ordinated the global policy response, the worse the economic outcome with returns faring better respectively in the 'Orderly 1.5C' and 2C scenarios than the 'Disorderly 1.5C' and 4C scenarios. With climate scenario analysis models improving all the time, we look forward to further embedding climate scenario analysis in our top down and bottom up risk management processes.

In 2019, we continued our monitoring of climate risk in our equities portfolio, completing our fifth carbon footprinting exercise under the Montreal Pledge. The results showed our equity portfolio to have a weighted average carbon intensity of 247 $tCO_2e$/GBPm as at 4 December 2019. This compares to a weighted average carbon intensity of 283 $tCO_2e$/GBPm for the MSCI All Country World Index (ACWI) at the same date[4]. Monitoring the carbon intensity of our portfolios assists our management of climate risk, and helps the Sustainable Ownership Team to identify engagement opportunities.

[4] *We use the Weighted Average Carbon Intensity (WACI) metric Source: ISS ESG.*

# Transparency and Disclosure

When it comes to transparency and disclosure we set very high standards both for our portfolio companies and for ourselves. Railpen was an early supporter and adopter of the TCFD recommendations and we published our first TCFD report in 2018. As part of the Montreal Carbon Pledge, which we signed in 2015, we disclose our portfolio carbon footprint each year. We also disclose the outcome of all the votes we cast at company AGMs – including on climate-related shareholder resolutions – on our website. We endorse the updated UK Stewardship Code, and in particular its inclusion of climate change in its principles, and intend to report against the new code at the earliest opportunity.

## Engaging with industry initiatives

Railpen's approach to climate change is supported by our membership of a range of key climate initiatives:

The TCFD develops consistent climate-related financial risk disclosures for companies to report to investors. The Task Force considers physical, liability and transition risks associated with climate change.

As a public supporter of TCFD, we have taken 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. In 2018 and 2019 Railpen disclosed against the TCFD framework, describing how we work today and how our approach will continue to evolve over time.

The TPI is a global initiative led by asset owners which rates the carbon performance and carbon management quality of +4k global companies. Railpen uses the TPI carbon management ratings to inform our climate voting activity.

CA100+ is an investor initiative targeting the 100 largest emitters (accounting for two thirds of global emissions) alongside 60 others with significant opportunity to drive the clean energy transition.

The CDP requests information on climate risks and low carbon opportunities from the world's largest companies on behalf of over 515 institutional investor signatories with a combined US$106 trillion in assets and 147 major purchasers with over US$4 trillion in procurement spend.

We have been a signatory to the United Nations-supported Principles for Responsible Investment (PRI) since 2010. We are a supporter of the Sustainability Accounting Standards Board (SASB) and a member of the Institutional Investors Group on Climate Change (IIGCC).

**We have structured this document in line with the recommendations made by the Financial Standards Board (FSB) Taskforce for Climate-related Financial Disclosures (TCFD). For additional guidance we have used:**

- International Centre for Pension Management (ICPM) "Climate Change for Asset Owners",
- Institutional Investors Group on Climate Change (IIGCC) Net Zero Investment Framework;
- IIGCC "Addressing climate risks and opportunities in the investment process".

## Our future priorities

We view our approach to managing climate risk as an ongoing cycle of implement-review-improve. We do not believe that any investor knows all there is to know about the relationship between climate change and investment outcomes. Our future priorities include:

- Build a better understanding of our climate risk exposure at the Total Fund level.
- Develop our climate governance in response to the expectations of our Trustee Board.
- Integrate relevant climate risks in our asset-liability management.
- Develop our climate communications strategy to our members and other stakeholders.
- Consider setting additional climate targets.
- Further understand the IIGCC Net Zero Framework.
- Continued development of climate scenario analysis.

7th Floor, Exchange House ▪ 12 Exchange Square London ▪ EC2A 2NY
@ contactus@rpmi.co.uk
020 7330 6800