Climate Change and Responsible Investment Team

Department for Work & Pensions

Caxton House, Tothill Street

London, SW1H 9NA

6th January 2022

E-mail: pensions.governance@dwp.gov.uk

Dear Anne Kennedy, Melanie Jarman, Emma Walmsley, Tom Rhodes, Mark Rogers and Vanessa Calvache,

Railpen and Railways Pension Trustee Company Limited (RPTCL) response to *Climate and investment reporting: setting expectations and empowering savers*

About us

Please find below a joint response from the Railways Pension Trustee Company Limited (RPTCL) and Railpen. 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 railways pension schemes and is responsible for the management of around c. £37 billion of assets on behalf of over 350,000 members. We also operate as an authorised master trust in respect of our Industry-Wide Defined Contribution arrangement that operates for the benefit of members with c. £1.7bn of DC funds included in our total assets under management.

Railpen's purpose is to secure our members' futures and we welcome the opportunity to respond to this important consultation. Both the Trustee Company and Railpen undertake responsibilities attributed to asset owners and asset managers, and we have answered the issues raised in the consultation in a way which reflects the breadth of our responsibilities.

Sustainable Ownership is Railpen's approach to incorporating sustainability considerations into the investments it manages on behalf of members. Railpen's work is enabled by the Trustee's related investment belief: "Incorporating and acting upon climate risk and other environmental, social and governance factors are significant drivers of investment outcomes and part of our fiduciary duty".

We think it is important to talk to, and hear from, members regarding the sustainable ownership work we do on their behalf and produce a wide variety of dedicated reports. You can find out more about our work, including through our 2021 Net Zero Plan, our 2020 Stewardship Report and our 2020 Sustainable Ownership Member Review – created to be as accessible to members as possible – on our website.

Introduction

As one of the largest UK pension funds, and one of the few remaining occupational pension schemes with open Defined Benefit (DB) sections, we recognise the impact of climate change on our long-term investments and contribute positively to the kind of world into which our members retire. As well as having long encouraged our portfolio companies to report against the TCFD framework, we were also one of the first UK pension schemes to voluntarily do so ourselves from 2019. We look forward to producing our first full TCFD report in 2022.

We are also committed to being effective stewards of our assets. We were one of the first UK occupational pension schemes to publish a voting policy, and to introduce voting for all UK equities, in 1992. We now work to vote our entire portfolio globally. We are also proud to have been a supporter of the UK Stewardship Code since its inception and to have been accepted as one of the first wave of signatories to the updated 2020 Stewardship Code. We believe that by actively engaging with portfolio companies and exercising voting rights, it is possible to have a positive influence on corporate behaviour, which in turn leads to sustainable financial performance and helps secure our members' futures.

We have therefore supported this government's work to encourage more schemes to i) incorporate climate change risks and opportunities in their investments and ii) act as robust stewards. We recognise that schemes are required to produce significant levels of disclosure on their sustainable ownership activities and we therefore welcome the government's proposals in this paper to clarify and streamline schemes' reporting on climate change and stewardship, in a way that aids member understanding of what can be complex topics.

Our response highlights some additional considerations for the government in its proposed regulations on portfolio alignment reporting and its draft guidance on stewardship reporting. We have split the response into Sections A (climate change and portfolio alignment) and B (stewardship reporting).

Our response builds upon previous consultation responses[1] [2] [3] on related matters. We welcome the commitment of DWP officials to maintaining an ongoing dialogue with the industry. We look forward to further conversations on these important issues.

Our response

Section A – Climate Change and Portfolio Alignment

In this section, we provide i) a summary of our views on portfolio alignment metrics and then ii) answers to some of the specific questions asked. Where the consultation questions themselves summarise the proposals, we have condensed to aid readability.

i. Summary

We support the intention to use portfolio alignment metrics to help trustees understand how investee companies are placed to weather climate transition risks and inform stewardship and voting activities on companies not well-placed to benefit from transition or exposed to key risks.

We support the approach to put measurement and reporting of a portfolio alignment metric on a statutory footing, mandating it as a fourth metric in scheme TCFD Reports. We also support the proposal for schemes to be required to measure and report on portfolio alignment in addition to the existing requirements under those regulations.

We outline further here our holistic thinking on portfolio alignment, starting with our belief that there is a need for further discussion, awareness, education, and standardisation of portfolio alignment frameworks. While

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[1] Railpen's response to FCA's Consultation Paper CP21/17 can be accessed here: Railpen-Response-FCA-Climate-Disclosure-Consultation_vFinal.pdf

[2] Railpen co-signed a Transition Pathway Initiative (TPI)-led letter on alignment metrics accessible here: https://www.transitionpathwayinitiative.org/publications/86.pdf?type=Publication For full disclosure, Railpen has a position on the Steering Committee of the TPI.

[3] The Railways Pension Trustee Company Limited (RPTCL) responded to the DWP consultation Taking action on climate risk: improving governance and reporting by occupational pension schemes, response accessible here: https://www.railpen.com/wp-content/uploads/2018/05/TCFD-Response.pdf

we see the alignment metric as important, we highlight the need for clarity, rigour, and transparency in identifying and communicating climate risks and alignment to trustees, members and in engaging with portfolio companies.

We also argue below that reporting an alignment metric based on the proportion of assets that have set a Paris-Aligned target – a so-called “binary metric” – is a robust and straightforward foundation which can be supplemented and improved over time. We think this has advantages over other types of metric – though we recognise no single metric is without flaw – as we set out below.

In addition to incorporating bottom-up climate transition assessment of companies or assets, a simple measure provides:

- the ability to incorporate standardised alignment assessment as outlined by TPI and Climate Action 100+ (CA100+)[4],
- the ability to add features from the benchmark divergence approach by company, including company and sector specific decarbonisation challenges and opportunities, and a transparent way to encourage an ongoing, iterative, and robust feedback loop from climate-related engagement and stewardship, in alignment assessment for companies and portfolios.

We acknowledge and appreciate the power of an implied temperature rise (ITR) measure to provide a single standardised output. However as highlighted in the TPI’s consultation response from June 2021 (which we co-signed), we continue to have reservations on the approach of condensing a complex set of sector and company level risks into a single portfolio level measure, which incorporates assumptions on future policy, regulation, GDP and other such estimates. In particular, we remain concerned that:

- the implied precision in the metrics may result in an over-interpretation, potentially hampering (i) trustees’ understanding climate risks and (ii) the potential for positive outcomes from engagement
- there are risks of increased variability and opaqueness around the metric over time
- A “good” ITR score could mask climate tail risks in the portfolio, and over-reliance on ITR could lead to under-emphasis on addressing such tail risks
- An ITR metric could potentially oversimplify the still complex link between company alignment (or portfolio alignment) and stewardship, and possibly lead to a lack of emphasis on the powerful role of stewardship in portfolio decarbonisation and climate risk management

We cautiously support mandating minimum standards on portfolio alignment. However, the pension ecosystem needs to ensure the credibility of such standards, acknowledging methodological limitations and gaps in company disclosure. We caution against an approach that advocates urgent implementation of singular metrics that might convey an unwarranted sense of precision. When faced with gaps and uncertainties, we favour the use of simple and transparent assumptions (and improvements over time), and caution against the use of assumptions that might be highly engineered or opaque.

By mandating the reporting of new and novel climate metrics, policy-makers are growing the market for ESG data, currently occupied almost exclusively by for-profit third-party data vendors. We encourage the DWP to support an environment in which the robustness, usefulness, transparency of such metrics are prioritised, with practitioner-led frameworks (and asset owner-led frameworks in particular) being valued for their lower propensity to contain conflicts of interest.

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[4] And likely to feature in the forthcoming IIGCC Net Zero Stewardship Toolkit. For full disclosure, Railpen co-Chairs the Net Zero Stewardship Toolkit Working Group.

In our responses to the consultation questions below, we describe our thinking and approaches to (i) portfolio alignment including climate risk and Net Zero alignment assessment and (ii) using a milestone-based approach for ongoing portfolio alignment, engagement, voting and the iterative feedback loop between these. We would welcome the opportunity to discuss and review the approach in more detail if there is interest.

ii. Answers to consultation questions

Q1. We propose to amend the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 to require trustees of schemes in scope to measure and report their scheme's Paris alignment by adding a requirement for them to select and calculate a portfolio alignment metric and to report on that metric in their TCFD report. Do you agree with this policy proposal?

Although, as previously stated, we support the intention to use portfolio alignment metrics to aid trustee understanding and inform stewardship and voting activities, we do not support this proposal as currently formulated, because more work is required.

Under regulations currently in force, schemes are required to report total emissions and emissions intensity. These are backward-looking measures, and provide only a static snapshot of portfolio climate risk. This snapshot does not account for sector specific decarbonisation challenges and opportunities, nor company-specific Net Zero commitments, transition plans, adaptation potential, and long-term exposure to the low-carbon transition. It is this information that is needed to guide scheme strategies for real-world impact on climate change.

Robust, ongoing company- and portfolio-level alignment assessments are important supplements to the backward-looking metrics. There is a need for a standardised framework for assessments of net zero alignment and decision-useful alignment metrics, incorporating certain common criteria (such as company adaptation potential, decarbonisation targets and activity, sector decarbonisation trajectory, actual data on emissions progress and performance) alongside feedback from stewardship and voting activity.

However, concerns around (i) lack of a standardised methodology, (ii) accuracy and (iii) decision-usefulness do not seem to have been addressed to an extent where we feel wholly comfortable with making such a metric a mandatory requirement.

We reiterate our feedback from July 2021 in contributing to the TPI response to the TCFD's forward-looking financial sector metrics consultation in relation to portfolio alignment. While a single portfolio ITR metric can drive a sense of precision in year one, over the longer term we are concerned about:

- the metric's potential to introduce more variability and opaqueness in portfolio alignment over time,
- its reduced focus on the still complex link between company, portfolio alignment and stewardship, which we believe has a powerful role in portfolio decarbonisation and climate risk management,
- its reduced use in identifying and addressing key climate tail risks in portfolios,
- the potential for unintended consequences including trustee and investor focus on the importance of lowering the headline implied temperature rise, versus using it to identify climate risks and facilitate effective decarbonisation– which could be contrary to the words of the draft regulations to "identify and assess the climate-related risks and opportunities which are relevant to the scheme".
- the proprietary, expensive and inconsistent nature of ITR metrics, making it difficult for stakeholders and members to compare and contrast performance between companies, portfolios and schemes.

We note that the TCFD in its final guidance acknowledged the challenges to implementing portfolio alignment methodologies, including the resources involved, and encouraged organisations to disclose qualitative and quantitative information given existing data and methodologies.

Anecdotally, we have been made aware of analysis showing the same portfolio can achieve very different ITR scores depending on which model and provider is contracted: this could lead to “model shopping” where reporters choose the model that gives the best score, rather than the model with the greatest utility for managing climate risk.

A benchmark divergence measure can allow for greater detail and analysis of the extent of Net Zero alignment across companies and sectors and highlight tail risks better. However it is not free of challenges.

- The benchmark alignment methodology needs standardisation. Publicly available and free-to-use standardised alignment benchmarks such as TPI and Climate Action 100+ are improving but still have relatively low coverage of the public equities universe
- Third party benchmark providers with higher coverage are largely passive snapshots of future transition risk, based on inconsistent estimation methodologies across companies and sectors, significant risk of assessment variability over time, no assumption of liability in case of errors, minimal links to engagement and stewardship progress and high costs similar to ITR.
- Some long term-investors are agnostic to market benchmarks offered by index companies (performance may be expressed on an absolute basis or relative to inflation or risk-free measures).

A binary measure, based on the proportion of assets that have set a Paris-Aligned target, is the most straightforward measure. We acknowledge, however, that it could be a weak guide to the forward-looking climate risk of the overall portfolio. For example: A portfolio with 20% of the fund assets being net zero aligned, can appear superficially superior to another where only 10% is aligned, whilst the degree of misalignment for the remaining 80% of the first portfolio may be significantly worse.[5]

We agree with DWP’s view that no single alignment metric is perfect, as all of them have their own challenges and benefits. The landscape is evolving very quickly where, over time, free-to-use ITR metrics may emerge alongside improved coverage in the TPI and CA100+ benchmarks.

We have summarised our views of the areas of strength and weakness of the proposed metrics in Table 1 below. References to “Binary Plus” and “Benchmark Divergence Plus” connote the room for Binary and Benchmark Divergence metrics to improve over time.

Table 1: Summary of strengths and weaknesses of competing portfolio alignment metrics

[5] At this point in our consultation response we wish to note the distinction between “alignment” and “risk”. While in many cases, the greatest climate risks in a portfolio arise from the companies that are non-aligned or misaligned, an assessment of net zero alignment is distinct from an assessment of climate risk. A portfolio with a “good” level of 1.5C alignment may still be exposed to climate tail risks, and portfolios with very low climate risk may not always be ones that contribute positively to a 1.5C outcome. Therefore investors would be advised to make distinct observations and measurement of (i) climate risk and (ii) net zero alignment.

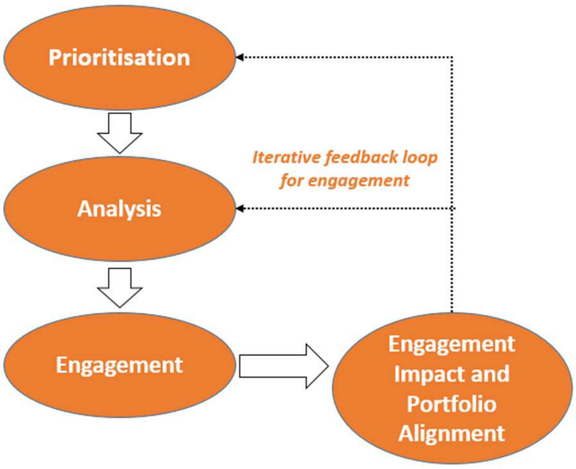
	Binary Targets Approach	Binary Plus Targets Approach	Benchmark Divergence	Benchmark Divergence Plus	Implied Temperature Rise	ITR Plus
Forward Snapshot of Climate Risks	Weak	Moderate	Moderate	High	High	High
Transparency	High	High	Moderate	High	Weak	High
Consistent and Standardised Framework	Moderate	High	Moderate	High	Weak	High
Identification of Climate Tail Risks	Moderate	High	Weak	High	Weak	High
Links to Engagement and Voting	High	High	Moderate	High	Weak	High
Reduction of unintended consequences*	Moderate	High	Moderate	High	Weak	High
Monetary value for trustees and members	Moderate	High	Moderate	High	Weak	High

*reducing headline temperature rise alone

We cautiously support mandating minimum standards on portfolio alignment frameworks and metrics.

Building on our Net Zero Plan, Railpen has been working with the Institutional Investor Group on Climate Change (IIGCC) to develop a "Net Zero Stewardship Toolkit". Fundamental to such a toolkit are (i) an ability to assess the current extent of net zero alignment of portfolio companies (ii) to bring stewardship outcomes and alignment analyses into a single feedback loop. A schematic illustrating this concept is provided in Figure 1. Given the importance of investment stewardship in bringing about a just transition to a low carbon economy, we think the feedback loop between an alignment metric and stewardship priorities/ activities is essential.

Figure 1: Schematic illustrating component stages of net zero stewardship, including feedback loop with net zero alignment analysis. ***For illustrative purposes only.***



In the first year of reporting an alignment metric (i.e. 2023), the data quality and completeness supporting a "binary targets" approach might still be developing and the methodology rudimentary. However, enhancements can be made over time, allowing for additional binary-plus type enhancements from key emitter engagements, improvements in company coverage from TPI, and other developments in the data provider landscape (in terms of robustness, standardisation and pricing). Using this evolving approach will, we believe, allow asset owners to:

- Focus on key portfolio emitter engagements and meaningfully incorporate the engagement impact over time into the binary-plus type targets
- Contextualise the identification and alignment of climate tail risks unique to their portfolios
- Capitalise on the evolution in the data and benchmark provider landscape to enable selection of the best combination of robust methodology, framework, coverage and costs
- Retain internal control on the framework, assessment and choice of metrics data and over time migrate from a binary-plus to a benchmark divergence-plus approach given the targeted benchmark alignment standardisation, engagement feedback incorporation, control and lower costs

We would welcome the opportunity to discuss and review the approach in more detail and its long term merits of simplicity, flexibility and foundationally robust portfolio alignment, if there is interest.

Q2. Do you agree with these policy proposals [regarding the timescales and scope of application][6]?

Yes, though we would welcome additional clarity.

Our understanding of the implications of the proposals are that the requirement for the 4th (portfolio alignment) metric would apply to authorised master trusts and corporate schemes with effect from the scheme year which is underway on 1 October 2022. Whilst this is a relatively rapid introduction, in practice it means that the earliest date on which schemes might need to report a portfolio warming metric is 31 July 2023, for schemes with a scheme year cycle of 1 January to 31 December. Given the urgency of action on climate change risk, and the flexibility in the initial range of portfolio warming metrics, we support this proposal in principle.

Given the efficiencies across schemes, minor differences in asset allocation and the umbrella governance structure across RPS schemes, we would be likely to bring all schemes into scope at the same time.

As drafted, the effect of the regulations is to require schemes to calculate their portfolio alignment metric within the first scheme year end after 1st October 2022 in which the requirements apply. In our view, this allows for schemes to start with a simple binary targets approach and build on it using either proprietary, or third-party frameworks and technologies to evolve it to a binary-plus and benchmark divergence approach.

We would welcome additional clarity as to whether disclosures of the portfolio alignment metric have the same timescale – within 7 months of scheme year end - as the first three metrics.

Q3. We propose to incorporate the requirements to measure and report a portfolio-alignment metric into the existing Climate Change Governance and Reporting Regulations so that the requirements are subject to the same disclosure and enforcement provisions as the other metrics requirements. Do you agree with this policy proposal?

Yes, though we welcome further clarifications as detailed below.

We agree that this metric along with brief disclosure around the alignment framework should form part of the TCFD report. There are already a number of existing disclosure requirements for schemes, including the SIP, Chair's Statement, SIP implementation report and TCFD report, in addition to voluntary disclosures such as those required of the UN PRI and the FRC Stewardship code. It would be confusing for stakeholders if a new report is mandated and hence we support new disclosure requirements being merged into existing disclosure duties. We would welcome a review of sustainable investment reporting requirements in the round in 2023 to identify duplication and unnecessary complexity which can be stripped out, whilst maintaining a strong and effective overall regime. We agree with the other disclosure requirements, and that the penalty regime should be the same for the rest of TCFD. However, given the lack

[6] Shortened.

of standardisation and significant variation in tools and data availability, we welcome greater clarity on how this metric will be considered by TPR in the penalty regime.

In the first year of adoption, we believe TPR should take a relatively light-handed approach to supervision and enforcement of TCFD reports, while both schemes and the regulators' supervisors themselves are settling into a new regime (this would align with DWP's pragmatic "as far as trustees are able" approach and TPR's own recent climate change guidance).

Finally, we would welcome confirmation that the portfolio alignment metric counts not as "statutory other information" but rather "other information", and that auditor requirements in respect of the qualitative and quantitative information found in TCFD reports (including the alignment metric) follows from this definition.

Q4. (a) Do you have any comments on the draft amendments to the Regulations?

We have no comments – other than our comments on the definition of a portfolio alignment metric, which we cover in our answer to 4(b)

(b) Do you have any comments on the draft amendments to the statutory guidance? Please include in your answer any comments you have on whether you consider that they meet the policy intent stated in this chapter. We particularly welcome comments on the definition of a portfolio alignment metric and whether respondents think it reflects the policy intent?

We agree with most of the statutory guidance.

We are in broad agreement with the draft definition in regulations of "a metric which gives the alignment of the scheme's assets with the climate change goal of limiting the increase in the global average temperature to 1.5 degrees Celsius above pre-industrial levels". A concern, if the definition were to be loosened to allow alignment with "well below 2 degrees" or "2 degrees", is the lack of consistency across disclosures. Even with the same methodology an engaged trustee or member will struggle to make effective comparisons between 3 schemes, each reporting a portion of their portfolio being aligned with 1.5 degrees, well below 2 degrees, and aligned with 2 degrees respectively.

We would encourage DWP to review the definition and link it to commonly used frameworks including the Net Zero Investment Framework (NZIF) and engage the Paris Aligned Investing Initiative (PAII) to discuss further. In addition, we would recommend the DWP update these as appropriate in light of any new international policies, taxes or agreements, updated understanding of climate science, and the transparency, standardisation and robustness of the models available.

We would suggest – perhaps in paragraph 174, or elsewhere – that schemes are encouraged and expected to disclose:

- the methodology used to calculate their portfolio warming metric, to encourage standardisation between schemes, or between sections within schemes,
- the percentage of the assets in each section (or, if the reporting is by asset class, sector, geography or on some other characteristic), on which the scheme is reporting,
- the percentage of company reported versus estimated emissions data in each section (by asset class, sector, geography or on some other characteristic), on which the scheme is reporting

Finally, we would welcome a clear definition of "alignment". We are aware of various definitions in use by investors, ranging from alignment to 1.5C as being "resilient to a 1.5C outcome", to alignment as "positively and intentionally contributing to the likelihood of 1.5C occurring", to alignment as "investing in a set of companies each of which is committing to stay inside a 1.5C pathway".

Q5. Do you have any comments on the new regulatory burdens to business and benefits of requiring schemes to measure and report their Paris alignment?

The regulatory burdens will depend on the type of approach taken. We have invested a significant amount of internal resource, and incurred external costs, in order to develop our approach to managing climate risk and publishing a Net Zero Plan. Having invested so far, the production of an alignment measure, though it will take time to generate and verify, is not a significant marginal cost. However, we urge the DWP to take account of the likely resources available to the average scheme in-scope of the new requirements, rather than an outlier like the RPS/ Railpen. For those coming from more of a standing start, the regulatory burden is likely to be non-trivial.

It should be noted that if there were to be a mandatory requirement for schemes to develop or purchase an ITR, or a benchmark divergence figure in relation to a much wider range of firms than allowed by TPI and CA100+, this would incur significant costs.

As mentioned in our response to Q1, reviewing portfolio alignment and its holistic purpose and applicability to "identify and assess the climate-related risks and opportunities which are relevant to the scheme", we believe that starting with the binary targets approach and progressing to a binary-plus approach in subsequent reporting years, and eventually getting to a benchmark divergence approach will allow for a robust, consistent, transparent, simple and cost-effective solution for trustees and stakeholders.

In relation to section 1.6 of the consultation document ("Review and Impacts"), we would welcome further impact analysis including quantification of the likely cost to schemes in generating additional metrics. It is not our experience that third-party vendors will provide additional metrics for free/ as part of one's existing subscription to ESG data. In our view providing quantitative analysis, perhaps updating the analysis undertaken as part of the January 2021 consultation, would provide welcome reassurance to trustees undertaking this kind of work for the first time.

Section B – Stewardship and the implementation statement

Our response in this section focuses on broader considerations which we believe should be included in DWP's draft statutory guidance and approach to stewardship reporting.

Although we have welcomed the work from industry bodies to support schemes in producing their first round of implementation statements, we support DWP's commitment to producing its own guidance and encouraging trustees to take ownership of stewardship, including where much or all of the activities are undertaken on their behalf. We think that this will be helpful in giving confidence to schemes, including those with fewer governance resources. We also hope that this will help resolve some of the current conversations between trustees and their external managers over who "owns" the definition of most significant votes, although we would welcome continued engagement from the DWP with the asset manager community on this issue to ensure the message is consistently heard.

We note that a review is anticipated in 2023, but would caution against further regulation at what is still an early stage in many schemes' responsible investment journeys and where the recent (and plentiful) regulatory changes have yet to fully bed in.

We particularly welcome the proposed clarification that schemes will be able to use sections of other disclosures in their implementation statement process, which aligns with Railpen's approach in practice. We also think that encouraging schemes to outline their stewardship priorities is a proportionate approach that gives trustees the flexibility to choose what best suits their portfolio and the nature of their investments.

We also agree with the proposal that implementation statements should set out how the approach taken was "in savers' interests". We think that in so doing, the guidance should support trustees of different scheme types – notably DB vs DC – in providing an explanation that is suitable to their own context.

Although we believe that most scheme trustees and managers, like RPTCL and Railpen, already undertake those stewardship activities which they believe are most likely to achieve good member outcomes, we think that making this explicit will help additionally position the implementation statement as a document which should aim to be of use and interest to members. We note in passing that our experience of implementation statements and stewardship reporting generally is that the mandated reporting rarely leads to a publication that is accessible by the average scheme member: Railpen has in 2021 augmented its suite of stewardship reports with a concise, accessible *Sustainable Ownership Review* targeted specifically at scheme members.

However, we believe that there are ways in which the current draft guidance could be strengthened and clarified to better support trustees, including those of smaller or less well-resourced schemes, to meaningfully undertake and report on their stewardship activities. We outline some specific suggestions below, which build upon our own extensive experience of considering and reporting our active ownership work.

1. **Highlighting the difference between thematic and idiosyncratic stewardship priorities**. We think that the guidance is a powerful opportunity to provide additional guidance for schemes not just on reporting on stewardship but also how to think about stewardship (and hold their managers to account accordingly). To this end, we think that the guidance should be up front in its definition of stewardship and explicitly highlight the difference between thematic and idiosyncratic stewardship.

   Most schemes will be universal owners i.e. they will have highly diversified portfolios that are broadly representative of global capital markets. This means that their portfolios are exposed to system-wide or thematic risks such as Covid-19 or climate change – and is the basis for Principle 4 of the Stewardship Code on “Market-wide risks”. This means that some of their stewardship priorities (and therefore most significant votes) should be thematic in nature and they should pick some priority system-wide issues for engagement with their managers[7].

   However, schemes’ portfolios will also be exposed to some extent to idiosyncratic or stock-specific risk i.e. a particular ESG risk which is specific to a priority or major holding. Scheme trustees should – to the extent they are able – have at least a high-level grasp of their very largest holdings or sector exposures and the inherent ESG risks. Understanding this should then help guide their choice of stewardship priority (and therefore most significant votes) and potentially their engagement with, and challenge of, their asset managers[8].

2. **Clarifying in what ways stewardship goes beyond engagement (with issuers) and voting**. The guidance rightly notes that engagement with issuers (both collective and direct) and voting are important, but not the only, mechanisms for influencing corporate behaviour in members’ best interests. However, we believe that your guidance should also explicitly mention “public policy engagement” as an important weapon in the stewardship arsenal. This is particularly the case for thematic or system-wide issues such as climate change or workforce rights, where the most effective solutions are system-wide i.e. through regulatory or policy change. Individuals at Railpen will be working, in their capacity as a member of the ICGN’s Global Stewardship Committee, on practical guidance for investors on how to effectively use public policy advocacy as a stewardship tool and would be happy to discuss this further with officials, if helpful.

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[7] We also think that schemes may find useful guidance on how to ascertain their thematic priorities. At Railpen, we use a proprietary materiality matrix, the details of which are contained in our 2020 Stewardship Report (p.52).

[8] We note that the draft guidance helpfully suggests industry resources available to trustees. On engaging with asset managers specifically, we would recommend including a reference to the 2020 joint Investor Forum and PLSA guide Engaging the Engagers.

3. **Including a vote reporting template.** While encouraging trustees to take ownership of their stewardship reporting is important, they are ultimately reliant upon high-quality and consistent stewardship reporting (including vote reporting) from their managers. Although Railpen and RPTCL are in the privileged position of having sufficient governance resource to expect and receive the necessary information from our asset managers, we are conscious that other schemes have had greater challenges in receiving from their managers the expected number of high-quality "most significant vote" examples that are relevant to their portfolio.

   We used the PLSA Vote Reporting Template to gather responses from relevant asset managers and found few issues in doing so. It effectively provided us with the information we needed to produce our own implementation statement. We recognise that asset managers would prefer that the scheme community make consistent requests for vote disclosure and think there is merit both in DWP including a vote reporting template based on the PLSA template in its non-statutory guidance, and in asset managers being required to use or build upon this standardised template for their reporting to clients – including guidance on what their clients are expecting regarding number and quality – or to explain why they have used an alternative approach[9].

   We think that the approach taken should stop just short of mandating the template as is for asset owners and managers, to allow the template to be tweaked as may suit the scheme or manager (e.g. across different asset classes) or to evolve over time in response to developments in the market.

4. **Further information on the definition of "most significant votes".** We agree that most "most significant votes" will be linked to a scheme's thematic and stock-specific priorities. However, we think that there are other examples of votes that are of importance to our portfolio or which, when reported, give members and other stakeholders a clearer insight into how the Trustee approaches stewardship. We outline our own approach to "most significant votes" in our 2020 Stewardship Report and Implementation Statement[10]:

   - 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 sustainability or corporate governance priorities[11]; and
   - Votes on high-profile shareholder resolutions.

   We think that the above all closely align with the original intention of policymakers when initially considering "most significant votes" and that therefore it would be helpful for trustees if DWP expanded and clarified potential definitions of most significant votes to include some or all of the indicators above.

5. **Providing more and clearer case studies (beyond climate change).** We strongly welcome the inclusion of case studies in the guidance as we think this brings it to life for trustees. We would welcome the inclusion of further case studies in the final guidance, on issues beyond climate

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[9] This would go beyond the current COBS requirement to report on signatory status to the UK Stewardship Code (which includes a Principle on vote reporting to clients) on a "comply or explain" basis.

[10] Our implementation statement can be found in our 2020 Annual Report and Accounts.

[11] In 2020 this included: the impact of Covid-19 on companies, their workforces and their AGMs; Remuneration; Auditor tenure; Board diversity; Climate disclosure and targets.

change: while climate change is an important systemic risk, we think this is already relatively well-covered by e.g. the guidance produced by the *Pensions Climate Risk Industry Group (PCRIG)* and others.

6. **Explicitly noting the role of investment consultants.** Investment consultants have a role to play in supporting smaller schemes to consider what good stewardship looks like and in holding managers to account on this issue. We think this should be emphasised in DWP's draft guidance and an explicit link could usefully be drawn between this guidance and TPR's guidance on the CMA objectives for investment consultants.

7. **More clearly delineating the difference between statutory and non-statutory guidance.** Although we recognise that efforts have been made to state at the top of each section whether the guidance is statutory or non-statutory, we think it may be clearer to bring together all the statutory guidance in one section, and the non-statutory guidance in another. We also think that work should be undertaken to consider whether what is "good practice" appropriately sits in statutory guidance and, similarly, whether what is a regulatory requirement should continue to be situated in the non-statutory guidance.

We hope that this response has been of interest, and would welcome the opportunity to discuss further any of the issues raised above.

Yours sincerely,

Chris Hannon

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