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## VOTING POLICY 2021

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This document describes Railpen's perspectives on Sustainable Ownership issues and how they are reflected in our global voting positions for the 2021-2022 AGM season.

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## OUR APPROACH

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The Railways Pension Trustee Company Limited (the Trustee Company) is a UK-based asset owner with a global, long term perspective and approximately GBP 30 billion in assets as at 31 December 2020. Its subsidiary, Railpen, manages the assets and employs an in-house Sustainable Ownership team which undertakes engagement and voting activities on behalf of the Trustee Company. This document outlines the voting positions which will be applied to the Trustee Company's equity holdings, whether UK or international, for the 2020-2021 AGM season.

We believe that thoughtful voting alongside constructive engagement with portfolio companies supports our objective of enhancing long-term investment returns for beneficiaries. Our global voting policy allows us to exercise our voting rights systematically, consistently, and in a way which is in beneficiaries' best interests.

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

The global voting policy reflects Railpen's three key corporate governance themes of **board composition and effectiveness, remuneration and alignment of incentives** and **risk, shareholder rights and disclosure** in a way that is accessible to our portfolio companies, our external managers, members and beneficiaries. It builds on positions held in previous voting policies setting out our expectations for companies and on some of the themes outlined in the ICGN Global Governance Principles<sup>12</sup>.

This year, our voting policy also further highlights our positions related to our core sustainability themes around **the climate transition** and **workforce wellbeing, engagement and motivation**. These issues are increasingly recognised as being financially material and this is reflected through incorporation throughout our voting guidelines, instead of as a standalone section. Both these issues have long been core parts of Railpen's engagement and voting activity, however the impact of Covid-19 and additional policy and regulatory momentum towards a Paris-aligned world make it more important than ever that Railpen is clear about our expectations of portfolio companies' behaviour on these issues and how we will vote if these expectations are not met over a reasonable time period.

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

Our preference is to engage with companies including, where necessary, exercising our voting rights to offer either support or sanction. However, where there appears to be a significant risk to the long-term value of the investment, we will consider selling our shares in the company. Any such decision will take into account how responsive the company is to minority shareholders' concerns, including its willingness to engage.

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<sup>1</sup> Further information on our engagement and voting approach can be found on our [website](#).

<sup>2</sup> We strongly support the work of the International Corporate Governance Network (ICGN) including the Global Governance Principles which can be found [here](#).

Railpen welcomes enquiries from portfolio companies on any aspect of our voting and engagement approach via [sustainableownership@railpen.com](mailto:sustainableownership@railpen.com).

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15 February 2021

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# BOARD COMPOSITION AND EFFECTIVENESS

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## **Role and responsibilities**

Railpen acknowledges that directors will be unable to pursue the objective of increasing long-term shareholder value without developing and sustaining broader stakeholder relationships to oversee the effective management of long-term risks and opportunities.

Given the important role a company's workforce plays in the creation of long-term value, this should include robust, effective and regularly reviewed mechanisms for engagement with its employees. We welcome clear disclosure of these mechanisms, how effective they are, and particularly how they have influenced board decision-making during the year.

## **Leadership and independence**

Non-Executive Directors (NEDs), or Independent / Outside Directors as they are known in certain markets, are a vital safeguard of the interests of shareholders. NEDs should work cooperatively with their executive colleagues and demonstrate objective and independent judgement.

We recognise that different markets set different norms for the definition of independence. Nonetheless, we have certain minimum expectations and expect that factors which impact a director's independence, including their length of tenure, should be disclosed. Excessive tenure may also be a cause for investor concern, and boards must make a persuasive case in the annual report for a NED's continuing independence and continued presence on the board in such cases.

A Chair should be independent on appointment. The appointment of a Senior Independent Non-Executive Director (SID) or Lead Director is also encouraged.

The combination of the Chair and Chief Executive roles is actively discouraged. The elevation of a company's Chief Executive to Chair will generally be discouraged unless it is part of a transitional period at the company or if the company can present a compelling justification for the move. The retirement of an existing Chair/CEO is often a good moment to separate the roles and we expect intelligent explanations where such an opportunity is not taken.

## **Composition and appointment**

The proportion of independent directors on the board should be in line with local best practice. However, at larger companies we generally expect that one half of the board at least should be comprised of fully independent, non-executive directors – not including the Chair. At smaller companies with smaller boards we look for a minimum of at least three such directors, and welcome an aspiration for more.

In markets where a three committee structure is local best practice, audit, nomination and remuneration committees should be established. The board should establish a majority independent nomination committee. The audit and remuneration committees should be fully independent. Members of all the committees must be identified in the annual report.

Full biographical details, including other directorships, should be disclosed for candidates for the board; this should include their prior education and training, professional qualifications and work experience including any assignments in a relevant sector, functional specialism or region given the company's operations and strategic priorities.

Detailed information should be provided on the recruitment process, and as evidence of consideration for board effectiveness and succession planning, an explanation of how the nominated candidates complement the existing board of directors.

All directors should be able to allocate sufficient time to the company to discharge their duties alongside their other commitments. Railpen will vote against the election or re-election of overboarded directors.

Railpen will vote against directors with poor attendance records where no satisfactory explanation is provided.

When analysing a contested election of directors, Railpen will generally focus on two central questions: whether the dissidents have proved that change is warranted, and if yes, whether the dissident board nominees seem likely to drive change to maximize long-term value.

### Diversity

Diversity is a key component of successful and high performing boards. It enables members to constructively challenge management decisions and to be more open to innovative ideas, reducing the risk of 'group-think'. The nominations committee, or the board where no such committee exists, is encouraged to widen the pool of talent taking into account aspects such as the age, gender, and ethnicity of candidates as well as their educational and professional experience.

Where a company provides inadequate disclosure on diversity, including omission of targets to be met, and/or diversity in all aspects has not been sufficiently addressed, Railpen will withhold support on the re-election of the Chair of the nomination committee, the Chair of the board or other directors standing for election.

In 2021 we are moving to more consistent gender diversity board thresholds for markets with established governance practices in our voting policy, raising our expectations in global markets. On ethnic and racial diversity, we will in 2021 continue to engage with companies to highlight the importance both of the measurement and disclosure of clear and consistent data to investors, and of the need for measurable progress to improve the ethnic diversity of their boards. In 2022 we will look to vote against the relevant Directors where our expectations have not been met.

### **Corporate culture and purpose**

Setting the right "Tone from the Top" is a critical leadership skill in leading and growing successful organisations.<sup>3</sup> The Board should adopt high standards of business ethics, ensuring that its vision, mission and objectives are sound and demonstrative of its values.

Where there is evidence of a director having displayed poor conduct or judgement, then Railpen may vote against their re-election.

Railpen expects its portfolio companies to operate within the parameters of widely-accepted business practices, such as the Ten Principles of the UN Global Compact<sup>4</sup> (UNGC.)

Where a company has undergone a severe controversy, which need not be limited to the areas covered by the UNGC, and the company has not shown sufficient responsiveness to shareholder concerns, Railpen may choose to vote against the re-election of the relevant committee chair, or other directors, depending on the nature of the issue.

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<sup>3</sup> [https://www.ibe.org.uk/userimages/pwc\\_tone\\_from\\_the\\_top\\_2013.pdf](https://www.ibe.org.uk/userimages/pwc_tone_from_the_top_2013.pdf)

<sup>4</sup> <https://www.unglobalcompact.org/what-is-gc/mission/principles>

## Workforce issues

Railpen believes that how well a company ensures its workforce is engaged, motivated and supported offers an important insight into its corporate culture, as well as being a vital ingredient for sustainable financial performance. We expect boards to be able to communicate the importance of the workforce in the context of the company's business model and strategy, and how they engage with their employees – including details of activities undertaken and any material outcomes. For 2021, this should include disclosures around work undertaken to support employees' wellbeing in the course of the Covid-19 pandemic.

Where disclosure is deemed inadequate or where we have concerns that employee relationships are being neglected, Railpen may choose to vote against the adoption of the Report and Accounts or the director we deem responsible.

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# REMUNERATION AND ALIGNMENT OF INCENTIVES

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## Executive remuneration

Railpen expects a company to operate an independent and effective remuneration committee.

The Pensions and Lifetime Savings Association's "Remuneration principles for building and reinforcing long-term business success" were published in 2013 in conjunction with Hermes EOS, BT Pension Scheme, Railpen and USS Investment Management. These principles – which we believe remain relevant today – set out a framework for remuneration committees to use when thinking through, devising and implementing their remuneration policies.

- Remuneration committees should expect executive management make a material long-term investment in shares of the businesses they manage
- Pay should be aligned to long-term strategy and the desired corporate culture throughout the organisation
- Pay schemes should be clear, understandable for both investors and executives, and ensure that executive rewards reflect returns to long-term shareholders
- Remuneration committees should use the discretion afforded them by shareholders to ensure that awards properly reflect business performance
- Companies and shareholders should have appropriately regular discussions on strategy and long-term performance.

A company should work within its remuneration policy, and only seek approval to go outside the policy in genuinely exceptional circumstances.

Remuneration practices which are likely to attract support include:

- The quantum is reasonable when compared to peers, and any increase in the level of certainty of reward is accompanied by a material reduction in the size of awards
- Annual pay increases and pension benefits are in line with those awarded to the rest of the workforce
- Performance conditions for all elements of variable pay are clearly aligned with the company's strategic objectives, including material ESG factors
- Details of the performance targets met during the year, and proposed for the forthcoming year are disclosed to shareholders
- Post-employment shareholding requirements are in line with the UK Investment Association's Principles of Remuneration.

Railpen expects long term incentive plan (LTIP) arrangements to be subject to shareholder approval when there is a new plan and where there is a material change to an existing scheme.

Performance metrics should be relevant and clearly aligned with business strategy, objectives and key performance indicators (KPIs) which link to long-term value creation. Railpen supports the inclusion of relevant non-financial performance criteria and at the appropriate level, including on material environmental, social and governance issues, in short- and long-term incentives.

Retention payments will attract significant scrutiny, and are unlikely to be supported. Excessive pay may be seen as motivating for the executive, but it risks demotivating the broader workforce. When so much value created is intangible, decreasing employee engagement is not in the interest of either management or shareholders.



Non-standard approaches may be supported, taking into account the situation of the company and the explanation provided. Restricted share schemes will be reviewed on a case-by-case basis, provided that an appropriate discount is applied. We believe that there is merit in terms of greater alignment with shareholder interests where shareholding guidelines are strengthened.

Change of control, good leaver and malus/clawback provisions should be in line with good practice in the local market. Malus and clawback provisions should not be restricted solely to material misstatements of the financial statements.

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

### **Fair pay**

Fair pay is a key element in ensuring a motivated and engaged workforce. Where there is a significant gender pay gap we would expect to see clear disclosures and rationales in addition to a robust and detailed plan for closing this gap. In the UK market, we expect to see the most forward-looking companies already taking steps to measure and disclose their ethnicity pay gap, in advance of government regulation.

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

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# RISK, SHAREHOLDER RIGHTS AND DISCLOSURE

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## **Risk oversight and internal controls**

The board should adopt a comprehensive approach to the oversight of risk, which includes material financial, strategic, operational, environmental, social and reputational risks.

Where a risk has materialised, the company should set out how it has responded and what efforts have been taken to mitigate the risk going forward in the annual report.

Inadequate reporting on environmental, social and reputational risks may warrant a vote against the annual report and accounts, the relevant Director or support for a shareholder resolution.

## The climate transition

Climate change affects all our portfolio companies and Railpen recognises the impact of climate change on our long-term investments and on the quality of the world our beneficiaries retire into.

We expect our portfolio companies to disclose their response to climate risk and other long-term trends which are material to the company's business model and operations. Railpen is a supporter of the Task Force on Climate-related Financial Disclosures (TCFD), and we encourage all our portfolio companies to provide enhanced corporate disclosure in line with this framework.

We use data from the Transition Pathway Initiative, Carbon Tracker and other sources to inform our analysis. Where there is insufficient evidence of a credible response, leading to concerns regarding the quality of oversight, then Railpen will vote against the re-election of the Chair of the Board, and/or the Chair of any appropriate committees.

## **Reporting and audit**

A high-quality audit is vital for ensuring shareholders are able to obtain a fair and true assessment of a company's financial health and sustainability. Railpen will vote against the re-appointment of the auditors if the tenure of the audit firm is greater than fifteen years. We will typically vote against the re-appointment of the Audit Committee Chair if the external audit firm tenure is greater than thirty years.

The non-audit fees paid to the company's statutory audit firm should not exceed good local market practice, in the absence of exceptional circumstances which must be clearly explained.

We are concerned by fee reductions for the audit, particularly when they seem to be driven by cost-cutting endeavours by companies (this may be particularly visible after a change of auditor). Such reductions raise issues about potential reductions in audit quality. We will carefully scrutinise instances where there has been a significant reduction in audit fees, including in the wake of a tender process. Unless there is a clear rationale for the fee reduction, the appointment and remuneration resolutions are unlikely to receive our support.

Where a company provides inadequate disclosure on audit, or adopts policies and practices that are not aligned with shareholders' interests as outlined above, Railpen will consider withholding support for the reappointment and setting of fees of the external auditors and/or the re-election of Audit Committee members.

## Climate and financial disclosures

It is vital that reporting accurately reflects the company's climate-related risks. Railpen expects its portfolio companies – particularly those in highly carbon-intensive sectors – to appropriately incorporate material information about climate-related issues into their financial statements, as well as within narrative reporting. Where they have not done so, or where we find inconsistencies between narrative reporting and financial disclosures, we may vote against the Report and Accounts, the Audit Committee Chair or the reappointment of the auditor.

## **Minority shareholder rights**

Bundling of matters for consideration that should be put to separate shareholder votes is strongly discouraged.

Railpen will normally support share repurchases provided local market regulations and relevant shareholder guidance are met.

Related-party transactions will be assessed on a case-by-case basis. Concerns may arise if the transaction does not seem to be subject to proper oversight, is not undertaken on fully commercial terms in the normal course of business, or the company has not clearly explained how the transaction is in the interests of the company and all shareholders.

- Companies should have clear dividend policies which set out the circumstances for distributing dividends and returning capital to shareholders.
- Railpen will vote case-by-case on mergers and acquisitions, taking into account the merits of the proposed transaction.
- Resolutions that seek to maintain, or convert to, a one-share, one-vote capital structure can expect support. Railpen will vote against requests for the creation or continuation of dual-class capital structures, or the creation of new or additional super voting shares without the inclusion of a time-based sunset provision.
- Railpen is not supportive of 'virtual-only' Annual General Meetings (AGMs). AGMs provide an important mechanism for the Board to be publicly accountable to their shareholders. Removing the in-person element of the meeting impairs the ability of investors to hold Boards to account. Where Covid-19 restrictions limit the scope for in-person meetings, technology should provide as full as possible a replication of the in-person experience, including the ability for any and all shareholders to ask questions and to expect a full and appropriate response. In instances where companies are seeking to provide for electronic-only meetings in a proposed change to their articles of incorporate, we expect companies to commit to returning to hybrid or physical meetings in normal circumstances.

## **Shareholder resolutions**

Shareholder resolutions can encompass a wide range of issues and be requisitioned by parties with varying objectives. Railpen will consider supporting proposals that contribute to the long-term sustainable success of the company.

Where there is a resolution relating to environmental or social concerns, the item will be addressed on a case-by-case basis taking into account the company's own practices, as well as the specific requirements of the resolution. Railpen typically votes for shareholder proposals requesting greater disclosure.

## Climate resolutions

Railpen is generally supportive of industry and policymaker momentum towards offering further opportunities for shareholders to explicitly express support for, or sanction of, corporate behaviour on climate change issues. As with other resolutions, Railpen will consider on a case-by-case basis whether to support a climate resolution on criteria which include whether it conflicts with other climate resolutions, whether it

clearly links to internationally agreed targets and agreements, whether it supports ongoing company engagement, and whether the aspiration sought is consistent with the company's long-term success.