

Local Authority Pension Fund Forum

Annual Report of Activities 2002

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1.0 Introduction

1.1 This 2002 Annual Report provides an overview of the activities of the Local Authority Pension Fund Forum during the year. It covers the Forum's various campaigns and shareholder engagement initiatives undertaken in relation to companies and the progress made on these campaigns, together with other Forum initiatives and activities. In addition it provides a complete list of all the agenda issues dealt with at regular Forum meetings.

1.2 2002 has been a very busy year for the Forum and our activities have been undertaken in the context of unprecedented international concerns about corporate governance standards and also continuing interest among investors and companies in corporate social responsibility. However, the backdrop to this has been fundamental stock market weakness and volatility. These conditions have not only raised serious questions about funding within the pensions industry as a whole, but have also led to debate about how the mistakes of the late 1990s in terms of corporate valuations can be avoided in future. In turn this has led to a new emphasis on the roles and responsibilities of investors. In this context, the mission of the LAPFF is more important and relevant than ever:

□The Local Authority Pension Fund Forum (LAPFF) exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest, commensurate with statutory regulations.□

2.0 Campaigns

2.1 The February Forum meeting agreed a Work Programme with corporate campaign priorities that extended action on the Forum's focus issues of environment, directors' remuneration and overseas labour standards

Environment

2.2 The December 2001 business meeting received a research report benchmarking reporting on greenhouse gas emissions among all FTSE100 companies and comparing this to guidelines produced by the Department for Environment, Food and Rural Affairs. Among its findings were that only five companies reported according to the eight minimum DEFRA requirements and 55 companies provided no disclosure at all which would satisfy any of the essential eight DEFRA criteria for reporting emissions.

2.3 The Forum shared the results of this research with the Institutional Investor Group on Climate Change (IIGCC), a network of investment managers and pension

funds originally brought together under the auspices of the Universities Superannuation Scheme (USS), in which LAPFF has been participating.

2.4 Following this, the Environment Agency Pension Fund, another IIGCC member, agreed to co-sponsor an engagement initiative with LAPFF aimed at companies that did not report in line with DEFRA guidelines.

2.5 Over the course of the year, the Forum has written to the chairmen of 85 FTSE100 companies about their reporting, seeking explanations for omissions and encouraging fuller reporting. A third of companies contacted have subsequently published annual or environmental reports which contains disclosures in line with DEFRA guidance. Only a handful have not committed themselves to any form of improved reporting on this issue. Correspondence continues.

2.6 Along with participation in the IIGCC, the Forum has also supported the Carbon Disclosure Project (CDP), an alliance of international institutional investors which has written to the largest 500 international companies with a checklist of greenhouse gas reporting issues. The intention is to be able to benchmark policies in these companies on how they are managing risks associated with climate change.

Directors' pay

2.7 The December 2002 meeting also discussed a policy paper on the subject of directors' service contracts. This recommended an engagement initiative aimed at those companies that retained directors on contracts with notice periods of longer than one year on the grounds that lengthy notice periods were a main cause of excessive compensation paid to some directors.

2.8 In January, the Secretariat identified 123 companies within the FTSE350 where one or more director had a longer than one year contract, as at the last annual report. The overwhelming number had two year rolling contracts. The chairmen of these companies were contacted to set out the Forum's position. The letter made clear that the companies' responses may inform voting positions.

2.9 Over the course of the year a third of companies have informed LAPFF that they have either reduced their contract periods for existing directors or that the director with the longer notice period has retired or resigned. This leaves 86 companies with a director on a longer than one year notice period.

2.10 An increased number of companies still have an ongoing policy of new appointments on one year contracts. 84% have this position so it is reasonable to assume that over a period of time, there will be hardly any directors left with notice periods longer than one year. Following this outcome, the Forum decided to consider any remaining concerns on the contracts issue in the context of developing best practice guidance on remuneration reports as a whole (see below).

2.11 The Forum has continued to identify new share schemes which fail to meet its minimum performance criteria. The most significant was Selfridges where a new share option scheme had a single vesting point of real EPS growth of 3% per annum. LAPFF issued a press release and attended the AGM. The company

announced some minor concessions at the meeting at which there was a 25% vote against the scheme. The Secretariat subsequently met the company chairman and finance director who committed the company to reviewing its remuneration policies as whole before the 2003 AGM.

2.12 Following its October 2001 announcement that it would be bringing forward legislation to improve disclosure and to require an annual vote on remuneration committee reports, the DTI finally implemented this legislation in July 2002. The September meeting took the decision to develop a new best practice policy position on directors' remuneration as a whole, given the new opportunity for voting presented by the regulations.

Overseas Labour Standards

2.13 LAPFF's campaign, which began in 1999, focuses on encouraging retail sector companies to adopt appropriate codes of conduct dealing with employment standards among their overseas subsidiaries and suppliers.

2.14 The current phase of the campaign follows from the benchmarking exercise undertaken in 2001 looking at the quality and scope of policies adopted by FTSE100 companies. The approach has been to seek to have in-depth discussions with companies to explore how they implement policies in terms of such issues as targets, audits and monitoring. Such meetings have been held with Marks & Spencers, Kingfisher, GUS and Safeway.

2.15 In addition a seminar was held in conjunction with Sainsbury's in March. This provided an opportunity for LAPFF members to hear at first hand about the practicalities involved in managing human rights and labour issues within a complex and diverse supply chain.

2.16 The Forum has also been pursuing engagement with Dixons, which in spite of its status as a major FTSE100 company, does not have a published group-wide policy on labour standards. The Secretariat met with the company prior to its AGM and also attended the AGM in September to ask about the issue. A further meeting is planned in December. The company has been put on notice that the Forum expect to see publication of a policy, together with the start of reporting by the next annual meeting.

2.17 The decision was taken at the September meeting to build on the knowledge built up over the year about the practical issues involved in implementation of labour standards policies by undertaking a further research study with FTSE100 companies via structured interviews. This will be available in Spring 2003.

2.18 As part of the Forum's membership of the Responsible Investor Network (RIN), the Forum vice-chair and Secretariat made a presentation to the RIN meeting in September about the Forum's work on labour standards with a view to seeking wider support for our work.

2.19 We also assisted the Ethical Trading Initiative (ETI) in putting together a seminar for institutional investors on supply chain issues in October. This also provided an opportunity to discuss the LAPFF approach with other institutions.

3.0 Responses to consultation documents

Company Law Review

3.1 Following the Company Law Review, the DTI published its white paper on Company Law in July. LAPFF has made a full response to this document.

3.2 Issues emphasised included: the need for a more integrated approach to OFR content that ensures consistent reporting on both performance and stakeholder issues on a mandatory basis; support for the concept of an independent Companies Commission charged with bringing together the various company regulatory functions, and determining detailed rule making; support for longer notice periods for general meetings and proposals for various changes to voting procedures for AGMs, most importantly the need for ownership thresholds for submitting a shareholder resolution to be lowered.

3.3 It does not appear likely that a new Companies Bill will find time in this legislative session.

Higgs Review

3.4 A review of the role and effectiveness of non-executives directors was established by the government under Derek Higgs. The Forum made a submission to this review highlighting the need for non-executives to take a more active role in monitoring executive directors. LAPFF proposals included more independent directors, more professional nomination procedures and selection from a wider pool of candidates.

EU green paper on CSR

3.5 The Forum made a response to the European Commission's discussion paper on corporate social responsibility.

4.0 Participation in investor networks

4.1 LAPFF has continued to participate in meetings of the Institutional Investor Group on Climate Change (IIGCC) (see above), which offers the opportunity to discuss common initiatives to promote awareness of the risks of climate change among the investment community. The Forum was a member of the initial steering group that defined the aims and objectives of the group, and subsequently part of a working group looking at investor activities.

4.2 LAPFF has also joined the Responsible Investor Network (RIN), a body comprising fund managers and pension funds interested in SRI issues broadly. This has met three times since LAPFF joined, twice in London and once in Manchester. As well as business meetings at which a variety of issues are discussed, RIN members have also organised meetings with individual companies on particular issues. For example, RIN members met Exxon Mobil in April to discuss various shareholder resolutions on SRI issues being proposed at its AGM, including on the company's attitude to climate change.

4.3 LAPFF has also been represented on an ad hoc grouping of investors concerned about investments in Burma. LAPFF helped to draft the terms of reference for this group, which issued a statement of institutional investor concern during the year. The main UK investor in Burma, Premier Oil, withdrew from the country in September.

5.0 Global Public Funds Initiative

5.1 In February, the Forum agreed a draft statement on cross-border collaboration and has subsequently been contacting public sector pension funds internationally to explore the possibilities for creating closer co-operation on issues of SRI and corporate governance. It is anticipated that this work will continue.

6.0 Conference 2001

The last annual conference was held in Bolton on 5/6/7 December 2001 and was very successful, over 80 delegates attended over the three-day period.

Guest speakers included Dr Robert Massie, Chair, Global Reporting Initiative and Executive Director of CERES (Coalition for Environmentally Responsible Economies) who gave a talk on "the future wealth on earth: opportunities and risks for investors, corporations and activists in a changing global climate." Brian Pearce, Head of the Centre for Sustainable Development at Forum for the Future who joined the panel on "Shareholder Engagement Issues: from form to substance". Dominique Be, Deputy Head, Unit for Social Dialogue and Adaptation to change, European Commission spoke on "Promoting a European Framework for Corporate Social Responsibility".

Forum members who spoke on various panels were, Ian Talbot, LB Croydon , Directors Pay Panel, Cllr Darrell Pulk, Nottinghamshire CC, Global Warming panel, Peter Morris, Tameside MBC, Overseas Employment Standards, Brian Bailey, Wolverhampton CC, Shareholder Engagement Issues, Stuart Imeson, Bradford MDC, Community Investment & Public Private Alliances, and the Company Law Review.

7.0 Company Meetings

7.1 As part of the various campaigns, meetings have been held with the following companies: Dixons, Kingfisher, Selfridges, Safeway, Iceland (Big Food Group), Sainsburys, Marks & Spencer, GUS,

8.0 AGM attendance

8.1 The following company annual general meetings have been attended by Forum representatives: Selfridges, Vodafone, Dixons.

9.0 LGPS developments

9.1 During the year the Forum considered various developments in the Local Government Pension Scheme (LGPS), and is currently reviewing the various discussion documents issued by the Local Government Pensions Unit of the Office of Deputy Prime Minister in the autumn.

10.0 LAPFF internal review

10.1 Following a proposal from members in the early part of the year, the Forum decided to establish a working party to review LAPFF organisation and structure. The working party reported in June and a detailed development plan is currently under discussion. This plan includes greater organizational transparency and additional resources for taking the work of the Forum forward in the new year.

Appendix

List of written reports and items discussed at LAPFF meetings since last annual report

5 December 2001

Analysis of Carbon Emissions Disclosure in FTSE 100 companies
Directors contracts
Burma campaign
Local Government Pension Scheme
Business meetings 2001

15 February 2002

Overseas Labour Standards – campaign update
Carbon Emissions Disclosure in FTSE 100 – campaign update
Directors' service contracts – campaign update
CSR Green paper consultation
Burma campaign
Local Government Pension Scheme
Review of the organizational structure of the Forum
Cross Border Public Fund collaboration - Making Alliances between Public Pension Funds
Annual Conference

7 June 2002

Overseas Labour Standards- campaign update
Carbon Emissions, company responses
Directors Pay, company responses
Responsible Investor Network
Higgs enquiry – non-executive directors
Review of Organisational Structure of the Forum: Report of Working Party
Hedge Funds

20 September 2002

Responsible Investor network
Burma Statement
Global Public Funds Alliance
LAPFF Annual Conference
Directors Remuneration initiatives: New regulations, Share Options and Directors' Service Contracts – campaign update
Reporting on Greenhouse Gas Emissions: Company Response – campaign update
Overseas Employment Standards: Campaign update

Higgs Review of the role and effectiveness of non –executive directors: LAPFF submission

Modernising Company Law White Paper: LAPFF submission

Initiatives on financial reporting and audit regulation

Review of Organisational Structure of the Forum