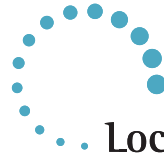


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Local Authority
Pension Fund
Forum

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Surrey joins the Forum

The Local Authority Pension Fund Forum (LAPFF) is a voluntary association of 49 public sector pension funds based in the UK. LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders in promoting corporate social responsibility and high standards of corporate governance amongst the companies in which they invest.

For more information about the Forum, contact Forum Officer, Keith Bray on 07811 800612.

Alternatively, you can email postmaster@keithbray.plus.com or visit our website at www.lapfforum.org

LAPFF membership as at 1 March 2009

- Aberdeen City Council
- Avon Pension Fund
- City of Edinburgh Council
- City of London Corporation
- Clwyd Pension Fund
- Derbyshire County Council
- Devon County Council
- Dorset County Pension Fund
- Dyfed Pension Fund
- Falkirk Pension Fund
- Greater Gwent Fund
- Greater Manchester Pension Fund
- Lancashire County Pension Fund
- London Borough of Brent
- London Borough of Camden
- London Borough of Croydon
- London Borough of Hackney
- London Borough of Haringey
- London Borough of Harrow
- London Borough of Hillingdon
- London Borough of Hounslow
- London Borough of Islington
- London Borough of Lewisham
- London Borough of Newham
- London Borough of Southwark
- London Borough of Tower Hamlets
- London Borough of Waltham Forest
- Lincolnshire County Council
- London Pension Fund Authority
- Merseyside Pension Fund
- Norfolk Pension Fund
- Northamptonshire County Council
- Northern Ireland Local Government Officers Superannuation Committee (NILGOSC)
- North Yorkshire County Council
- Nottinghamshire County Council
- Rhondda Cynon Taf Pension Fund
- Shropshire County Council
- Somerset County Council
- South Yorkshire Pensions Authority
- South Yorkshire Integrated Transport Authority
- Surrey County Council
- Teesside Pension Fund
- Tyne and Wear Pension Fund
- Warwickshire County Council
- West Midlands Pension Fund
- West Midlands PTA Pension Fund
- West Yorkshire Pension Fund
- Wiltshire County Council
- Worcestershire County Council

The banking crisis – engagement with UK banks and fund managers

Remuneration, audit committees, voting disclosure and stocklending.

The problems of the banking sector are very clearly at the centre of the financial crisis; they are, in fact, the epicentre to which many other elements of the current instability are linked.



Dramatic declines in bank share prices and their knock-on effect on other companies have had an immediate impact on scheme funding. In addition, there is a reputational issue here for institutional investors. Some commentators have queried whether shareholders have been acting as

effective stewards of the companies that they collectively own. Therefore, if the Forum is to set an effective course going forward, how it approaches the UK-listed banks in particular is a crucial question.

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At a roundtable discussion held at the start of last year's annual conference, it was agreed that the Forum should engage with the banks and Government to push for governance improvements, and that individual funds should also engage with their fund managers to see how governance issues had been addressed in the run-up to the crisis.

A major governance question in the financial crisis is the extent to which remuneration policy at the banks worked to incentivise inappropriate behaviour. Whatever the final outcome regarding the controversy about Sir Fred Goodwin's pension, engaging with financial institutions over their remuneration policies must be a key theme in LAPFF's response to the crisis as part of the Forum's 'Incentivising Executives' workstream.

Another question that investors have to consider in the wake of the crisis is the question of the role of auditors and audit committees. Engaging over audit is a long-standing campaign for the Forum. In this context, member funds are encouraged to ascertain from fund

managers what action (if any) had been undertaken in respect of this governance issue at the banks.

Forum members will also be aware that the Government has, for a number of years, been encouraging institutional investors to publicly disclose their voting records, and took a reserve power in the Companies Act 2006 that would enable them to mandate disclosure. LAPFF carried out research in 2007 into the disclosures made by fund managers and found that although an increasing number of managers had made voting data available, disclosure was patchy.

In the wake of the crisis, there has been renewed interest in how institutional investors have used their ownership rights to encourage good governance at the banks. Furthermore, although it is now widely believed that remuneration policy was a driver of excessive risk-taking at the banks, voting data suggests that banks have actually been put under very little pressure by their investors over remuneration policy, even as late as last year.

Forum members are encouraged to engage with their fund managers on these issues and the LAPFF will undertake further analysis of fund manager voting and engagement with the banks over the period leading up to the crisis. We will also seek meetings with the Treasury Select Committee, FSA and HM Treasury to discuss these issues.



Passive manager audit

At the October 2008 business meeting, the Forum approved commissioning Responsible Investment Metrics (RImetrics) to carry out research into passive managers' ESG competencies.

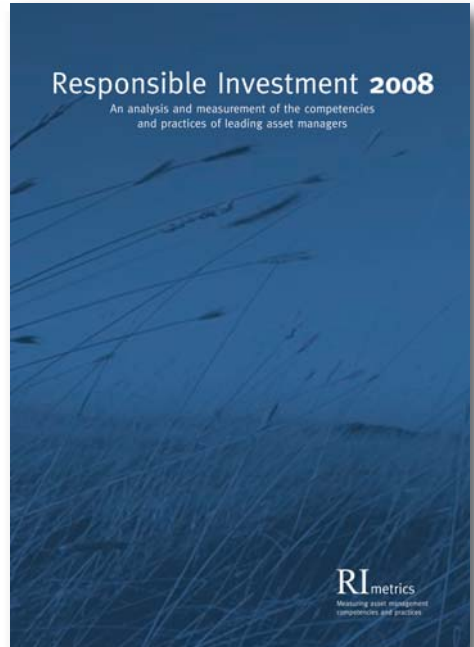
Having identified those passive managers used by local authority funds by surveying the membership, the Forum asked RImetrics to assess BGI, Legal and General, State Street and UBS. Unfortunately, BGI declined to participate in the research despite LAPFF's formal request that it do so.

Key findings

- All three managers vote proxies but do not do so consistently across the world. We estimate €200 billion of assets are not regularly voted.

- All three managers engage with companies to some degree but, again, this is not consistent across the world. We estimate €400 billion of assets are rarely, if ever, engaged.

- Resources are limited. In total, we identified five individuals who are responsible for the implementation of ESG/responsible investment policies for these €780 billion of assets, held in upwards of 3,000 companies across the world. Additional resources are provided in the case of UBS and SSgA by mainstream active management



teams and all three managers make use of voting service providers.

- There was no evidence that any of the managers felt clients wanted passive asset managers to either improve ESG/responsible investment practices or increase the current level of dedicated resources.

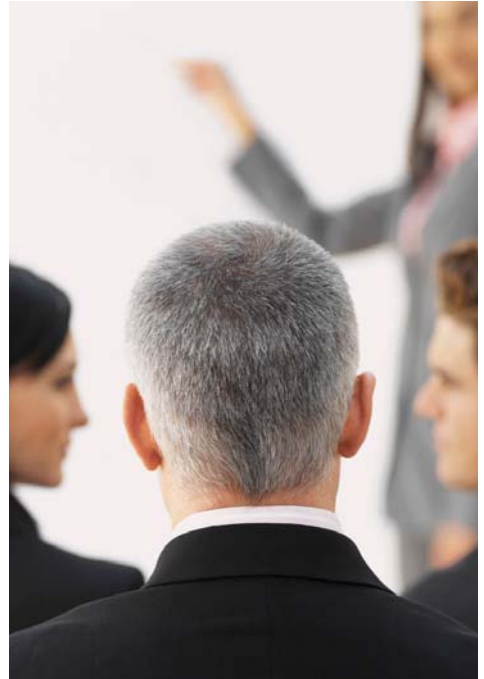
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- All managers consistently voted proxies in the UK and US (only the larger US holdings in the case of LGIM). SSgA and UBS consistently vote proxies in Japan. Elsewhere, the pattern is more mixed.
- Managers tend to be most active in engagement terms either where their staff are based or where they hold the bulk of their assets.
- Small cap stocks are rarely engaged. Managers tend to focus their engagement activities on their largest holdings.
- Holdings in emerging markets are typically never engaged. There was no evidence €17 billion of assets held in upwards of 1,000 companies are engaged despite probable higher level ESG risk.



In addition, it is notable that none of the three managers is a signatory of UNPRI, an issue that the Forum has already agreed should be pursued with fund managers.



Conclusions

The Rimetrics analysis demonstrates both that there is variation between managers and that there are obvious areas for improvement. The Forum will engage with all managers over the failure to support UNPRI, and consider manager-specific engagement over other issues (ie, failure to vote in all markets, lack of responsible investment policy and activity, etc).

Climate change - Forum to issue a trustee guide

Many commentators consider that the fallout for businesses from the recent financial crisis is dwarfed by the potential impact of climate change and that the global impact of climate change will in due course put all businesses at risk.

Despite pressure from the market downturn, investors must not ignore the impending risks, as well as the opportunities surrounding climate change. However, it has to be recognised that trustees and their officers are only able to devote limited resources and



time to any particular issue. The LAPFF trustee guide will be designed to cater specifically to the needs of its members, providing a guide that will prove useful in practical terms.

LGPS cost-sharing proposals and review of LGPS investment management regulations

The Forum has submitted views to Communities and Local Government on the cost-sharing proposals focussing on:

- Affordability
- Methodology
- Underlying assumptions
- Impact on the 2010 valuation
- Timetable issues

We have also submitted views on the need to amend the investment management regulations relating to:

- The definition of investment management
- Limits on limited partnerships
- Insurance contracts
- Single holdings
- Counterparty risks

Chief Operating Officer is appointed



The Forum has appointed, David Sellors, formerly of Capital International, as Chief Operating Officer.

Councillor Ian Greenwood, Chair of the Forum, said: "We are really delighted to have secured David's services. Following a period of remarkable growth in membership – we now have 49 member funds representing 50% of the LGPS by number and more than 75% when measured by assets under management – the Forum is now entering a new and exciting phase of its development. David's experience will be invaluable to us in ensuring that we continue to improve our effectiveness in dealing with the many challenges confronting us – particularly in the light of recent developments on capital markets and in the world of investment management generally."

Dave said: "I am really pleased to have been given this opportunity to work with LAPFF. They are entering a very exciting phase of their growth at a time when responsible investing is on everyone's mind."

Surrey joins the Forum

The Surrey County Pension Fund is the latest fund to join the Forum. Tracey Milner, Pension Fund and Treasury Manager at Surrey said: "The decision to join the LAPFF demonstrates the Surrey fund's commitment to socially responsible investment and the promotion of high standards of corporate social responsibility, thus re-enforcing the aim of maximising shareholder value. This will be of interest and benefit to the Surrey fund's stakeholders, whether they be employers, fund members or taxpayers."

In welcoming the Surrey decision, Forum Officer, Keith Bray, said: "Each new fund that joins us brings with it its own perspective of institutional shareholder activism and that must enhance our effectiveness. Keith also acknowledged the contribution made to the briefing given to Surrey regarding the significance of the UNPRI by Tessa Younger, Engagement Services Manager at PIRC (the Forum's research and engagement partner).

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