Response to ICSA consultation on improving engagement practices
November 2012

Local Authority Pension Fund Forum

LAPFF response to ICSA consultation on improving engagement practices between companies and institutional investors

The Local Authority Pension Fund Forum (the Forum) was set up in 1991 and is a voluntary association of 55 local authority pension funds based in the UK with combined assets of approximately £115 billion. It 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. The Forum has taken the opportunity below to provide our view on those issues which we consider relevant to our activities.

The Institute of Chartered Secretaries and Administrators' (ICSA) steering group aims to implement recommendations by an investor working party to

- create a simple guide to good engagement practice, jointly developed by companies and institutional investors, with the particular aim of encouraging more productive meetings; and
- to help companies and institutional investors find more ways to seek feedback on the quality of meetings and, over time, use this feedback to identify good stewardship and make improvements to practices.

The steering group considered improvements were needed to the process of holding engagement meetings, but that these should be accompanied by a 'new conversation' between companies and their owners and is consulting on associated guidance to be released in March 2013.

1 Do respondents agree that guidance in this area will help strengthen engagement practices? If they do not agree that guidance will have that effect, what else do they believe can be introduced to strengthen engagement practices?

The steering group has noted that investors wish to encourage dialogue which builds and encourages a long-term relationship with, and commitment to, the company. LAPFF has been engaging with listed companies for over twenty years and considers it currently follows or is aware of best practice as indicated by Appendix E. A best practice framework for engagement meetings is useful and should lead to more productive and beneficial conversations for both investors and companies.

However the Forum's experience is also that an overly bureaucratic approach can lead to confusion and dilution of clear investor messages to companies particularly through joint engagement initiatives.

An area that seems to be missing from those identified, is communication of investor voting strategy where it relates to the meeting objective. It has become apparent that investors may often engage privately on an issue, for example to push for the removal of a particular director, but that their associated voting on the director's election at a subsequent AGM will indicate support of their re-election. This serves to devalue voting as a real method of investor engagement, especially as many institutional investors hold such large portfolios, that voting is the primary method of 'engagement'. Investors should be prepared to explain to directors if any engagement meeting is likely to influence their voting strategy at the company AGM.

In addition the Forum has noted that the failure by some asset managers to enable client voting in pooled funds has led to further devaluation of the shareholder vote and subsequent confusion by companies in understanding the full extent of shareholder concern about issues. The Forum recommends that the ICSA steering group press for asset managers holding client assets in pooled vehicles to be required to facilitate voting.

Another area not addressed, is reporting back to beneficiaries on engagement. Directors recognise that reputational risk is one reason that may induce shareholders to engage more directly with boards. Investors should be clear on the boundaries of confidentiality in meetings, and how they report outcomes of meetings to the underlying asset-owners.

2 Do respondents agree with the need to develop a new conversation? Are there any other considerations that should be included in this new conversation?

In the Forum's view as a long-term investor, the conversation is not a 'new' one, but is based on a commitment to a long-term relationship with the company. LAPFF policy has been to analyse issues for a particular sector and identify the leaders and laggards in this context. Engagement meetings prioritise companies with better practices in order to inform subsequent meetings with those companies where areas for improvement have been identified.

Dependent on resources, the engagement process can take time, or actually be quite distinct albeit it is done in the context of an understanding that investment is made on a long-term basis. For some companies, if the issue is resolved after one or two meetings, termination of direct engagement on this issue is an appropriate outcome. Other engagements may progress over a number of years until mutual agreement is reached. In its work programme, the Forum plans for engagement with some companies, initially only for one year. Some of these engagements continue to subsequent years, and in one instance the Forum engaged for over seven years with a FTSE company until a positive outcome was achieved.

Finally the Forum's engagement strategy is very much geared to outcomes. The forum's engagement strategy is based on the identification of risk or concern, which is then comparatively analysed to try to establish if there is company best practice that can be used to benchmark the concern with the target company. This is used to prepare a positive case for why engaging with the Forum over the issue(s) can be of value for the target company. Thus the engagement dialogue is about resolving concerns face to face. Too often the Forum has noted engagements by other asset owners and asset managers fail to have clear outcomes due to insufficient preparation and clarity over objectives. We have noticed this is published reports of engagement by certain asset managers.

3 Do respondents agree that the measures outlined in Appendix E would significantly improve the quality of engagement meetings, and are there any other steps which could be taken?

The issues laid out for both investors and companies are relevant to improving the quality of meetings, particularly those related to outcomes and *participants.* The other categories; *preparation, agenda minutes and follow-up, and frequency and length* are useful practical guides and indications of best practice.

Purpose: In the Forum's experience, meetings called by investors and those called by companies are markedly different. The former typically focus on a narrower range of particular concerns, which may relate to board effectiveness and composition, company culture, risk and reputation, but could equally have a wider strategic remit. The latter appear to have broader initial agendas, and will often combine provisions of information on business model and strategy with these other issues.

Participants: the collective approach to engagement is always a factor considered in approaching company engagement, but the 'plusses' must be balanced with the 'minuses'. Collaborative engagements can benefit from a unified investor approach to what may be perceived as an issue of concern. Equally, although different investors may be concerned about an issue, they may have different views on how it should be resolved. Collaborative 'engagement' in the form of joint letters to board directors is a clear example of the former, where agreement on wording and approach is reached in drafting the letter. This is more difficult to orchestrate in meetings. Additionally, when there is a face-to-face meeting, there must be some exercise of caution as to numbers, not least in terms of encouraging positive dynamics in interactions.

The Forum thinks that companies should experiment more in terms of organising regular briefings of investors and their representatives to minimise costs and duplication of effort, as well as providing a level playing field for information and presentation dissemination. Of course one of the reasons that more companies do not do this is because they are fearful that having all investor reps in the room does not give them the opportunity to play different investors off against each other. This unfortunately seems to be a characteristic of some company-organised engagement.

4 Should companies and institutional investors seek feedback on the quality of meetings as an integral part of the engagement experience?

It was a clear recommendation from the initial working party on investor stewardship, that directors considered that feedback would identify areas for improvements in the quality of meetings. However the Forum seeks to create a real feedback loop through drafting a sets of minutes of the engagement meeting and asking the company to sign-off on the minutes. This process acts as an accountability mechanism, both for the company and the Forum; it clarifies what was agreed between the company and the Forum for future monitoring purposes; and it helps frame the management of future engagement between the Forum and the company. We recommend that this becomes standard engagement practice.

LAPFF considers that a request for feedback could be solicited when agreeing the meeting note with the company and in subsequent correspondence, particularly if the engagement is an ongoing one.

The Forum sees no merit in any third-party mediation/collation of feedback 'service'. Surely mature engagement will provide its own feedback mechanisms. Any proposal to create a monetised service for feedback monitoring is a mistake.

The real test of whether particular engagement meetings between companies and investors have been successful can be partially gauged through disclosure formats by both participants. In the case of investors such disclosure of engagement practices should be a required reporting for the investors to their clients. In the Forum's view this forms part of the fiduciary duty.

5 Do respondents consider that receiving feedback on meetings directly from investors might lead to more effective engagement compared to receiving the feedback from the company's brokers or advisers?

LAPFF considers that both forms provide a useful function, and any discrepancies or differences in focus between the two can in themselves provide additional information to directors.

6 Do respondents consider the questionnaire format, and the content, outlined in Appendix F would constitute an acceptable basis for providing feedback on investor meetings? Might any other mechanism be used? If using the questionnaire format, should any content be added (or removed)?

The format provides a starting point to address key issues in how engagement meetings are conducted. We recommend more emphasis on outcomes as set out in our answers above. The format would benefit from the inclusion of an 'open question' regarding any particular issues that arose at the meeting that would not fall into any of the categories provided.

7 Do respondents consider that addressing these key issues will help strengthen good practice engagement?

Directors will frequently say they are not asked questions by investors on sustainability issues at investor meetings, however if none of the corporate presentations have referred to any of these issues, this is unsurprising. If meetings are organised to focus on particular issues such as remuneration or corporate responsibility, they should explicitly include discussion of company strategy.

8 Do respondents have views on what other mechanisms can be used to encourage good practice engagement?

The Forum is currently reviewing the recommendations of the Kay Review.