

QUARTERLY ENGAGEMENT REPORT

JANUARY TO MARCH 2014



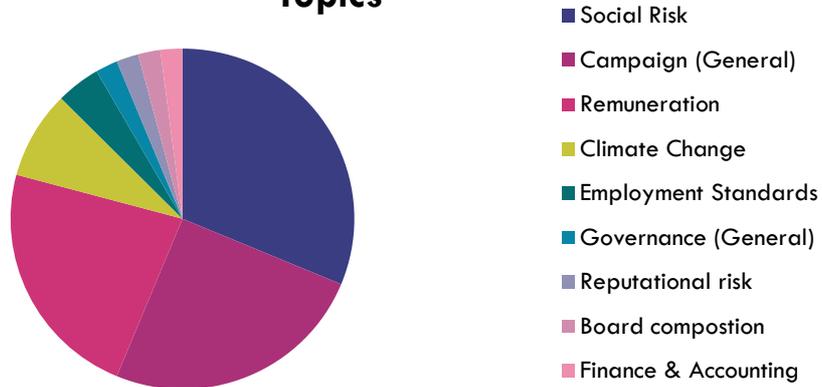
Local Authority Pension Fund Forum

LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest. Formed in 1990, the Forum brings together a diverse range of local authority pension funds in the UK with combined assets of over £125 billion.

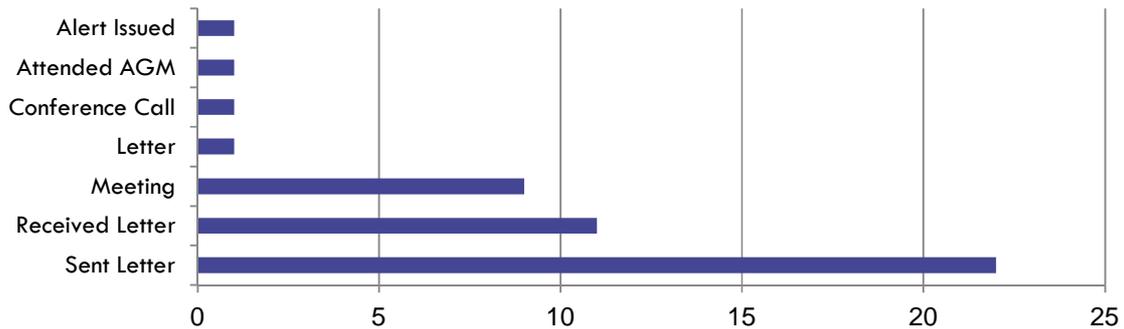
ENGAGEMENT SUMMARY

JANUARY TO MARCH 2014

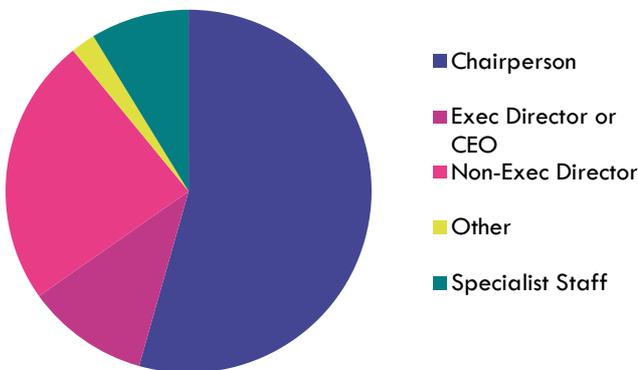
Topics



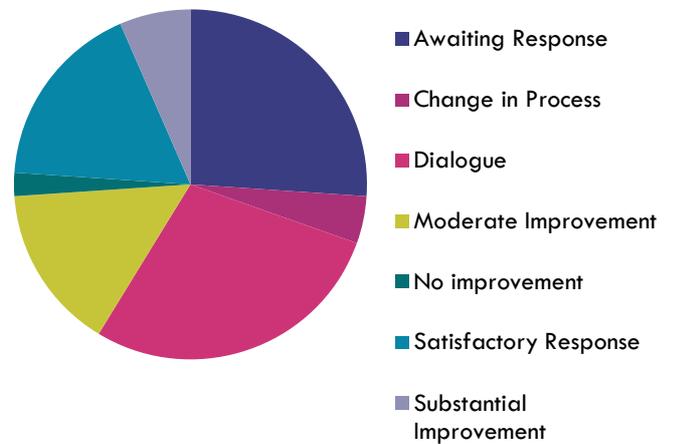
Activities



Company Contact



Outcomes



ACHIEVEMENTS

- **UK Listing Authority** amends listing rules for independent directors in majority controlled companies to only be elected by non-majority members, in line with LAPFF position set out in its response to the 2012 consultation on the issue.
- Attended **Lonmin** AGM as part of ongoing engagement around labour relations, and pressed board members for more detail on the company's 'five-point plan'.
- Held meetings with **easyJet**, **G4S** and **Afren** remuneration committee chairs regarding pay complexity and overall pay awards. Met with **BT** to discuss the company's approach to remuneration.
- Following collaborative engagement on board diversity, **London Stock Exchange** appointed two women to the board.
- Met with the **Nestlé SA** chair, with **Roche Holding** and **Jardine Matheson**, prompted by the Forum's holdings-based approach. Pay was a central focus of these meetings.
- Supported **Wilmar** in its commitment to sustainable palm oil sourcing subsequent to collaborative letters to US companies on the sustainability of their supplies. **Kelloggs** also announced a policy for sourcing sustainable palm oil following engagement.
- Responded with the investor coalition to the second **FRC** consultation on Sharman and Going Concern, to support the original Sharman proposals, not the FRC amendments. Given the opposition the FRC is now going to have to consult for the third time.
- Provided a response to the **Law Commision** fiduciary duty consultation presenting a LGPS perspective on key issues of stewardship, short termism and beneficiaries' interests.

THE FORUM IN THE NEWS

LAPFF leads high profile demands to return to
'prudent' accounting regulations.

[The Telegraph](#) and again [The Telegraph](#)

UK pension funds weigh in on board re-election threat over female director targets

[Responsible Investor](#)

LAPFF challenges bus operator over human rights

[Investment and Pensions Europe](#), [Professional Pensions](#), [Market Watch](#)

Investors demand scalp of Barclays Bonus-setting chief

[The Times](#), [Bloomberg](#)

Early blow for 'say on pay' guidelines

[Financial Times](#)

COMPANY ENGAGEMENT

LEADERSHIP ON KEY CAMPAIGNS

The Forum has progressed its engagement on 'blacklisting' by writing to a further six construction companies supporting the development and implementation of a compensation scheme for any individuals affected by blacklisting. LAPFF requested that the companies work constructively with relevant trades unions and others representing the victims of blacklisting in order to ensure that the scheme is implemented quickly and in a way that is acceptable to those affected. Of the companies contacted, **Carillion**, **Amec** and **Costain** responded, giving further company specific information. Two companies expressed support for a code of conduct aimed at preventing any repetition of similar practices in future.



Together with some members of the Investor Group of the 30% club, LAPFF had written to a number of companies on board gender diversity in late 2013. A meeting had been set up with the chairman of the **London Stock Exchange** as it had no women on its board. However, shortly prior to the meeting, the company announced the appointment of Sherry Coutu and Joanna Shields

to the board. This leaves Glencore Xstrata as the sole FTSE 100 company with no female board directors.

PROMOTING GOOD GOVERNANCE

Holdings Based Engagement

In line with an increasing focus on holdings based engagement, analysis was undertaken on governance and corporate responsibility concerns at those European and Asian companies most widely held by member funds. Letters were sent to six companies and meetings held with Roche Holding and Jardine Mattheson, and LAPFF attended a roundtable with the Nestle chairman.

All three meetings sought to establish a positive, ongoing dialogue and understand each company's approach to managing shareholder concerns over governance and company specific issues. Nestlé and Roche Holding are both Swiss companies, for whom the mandatory pay vote was a key concern and thus was a core component of discussion.

The conversation with **Roche Holding** was a first and explored the possibility of strengthening minority shareholder rights as descendants of the founding families own 45% of issued share cap and another Swiss pharma company owns a further one third of shares. On remuneration,

further clarity was sought on clawback and introductory payments. LAPFF also sought a better understanding of the company's approach to patents and their application in developing countries.

The Forum previously met with **Nestlé** in 2011, to discuss a range of governance issues including compensation and succession planning. The meeting this quarter was in the form of a chairman's round-table. The chairman set the agenda around the new requirement for a binding vote on pay in Switzerland, the 'Minder' initiative. One concern raised was that the framework for informing variable pay is opaque and makes it difficult for investors to assess whether amounts paid were in line with performance expectations.

The meeting with **Jardine Mattheson** was a first for LAPFF. The Keswick family is a controlling shareholder of this Hong-Kong based conglomerate, with three family members holding board positions as chair, managing director and deputy managing director. LAPFF explored the importance of independent directors and the company's recent decision to withdraw from a premium listing in London.

Executive Pay

Meetings continued with companies to solicit feedback to LAPFF's [Expectations for Executive Pay](#) document. A meeting with Patricia Hewitt, the remuneration chair at **BT Group** was prompted by the LAPFF's positive viewing of the company's decision to reduce the short-term bonus opportunity for the Chief Executive of BT Retail. The company places greater emphasis on variable pay in relation to base pay than the Forum promotes. However, in doing so this does appear consistent with seeking to ensure widespread financial participation in the performance of the firm. The focus on variable pay also helps ensure that pay awards are felt to be fair throughout the Company.



Other company meetings aimed to focus on complexity in pay practices. In the Forum's view excessive complexity can confuse both executives and shareholders and obscure the relationship between executives' everyday actions and the expected outcome of better shareholder return.

easyJet had been identified as a company that had received significant dissent over its pay practices at its 2013 AGM and had been making its long-term incentive plan (LTIP) metric more complicated over time. The company regularly consulted with institutional shareholders and moved from a return on equity to a return on capital employed metric. After further consultation with shareholders, leases were then included in this measure. On further consultation a measure of relative total shareholder return was added. It was clear that the company had been proactively consulting with its institutional investors to ensure pay practices

were in line with their expectations. Prior to the 2014 AGM, the Forum issued a voting alert recommending members approve the remuneration report.

The Forum also had discussions over remuneration disclosure with **G4S** in particular for the 2012 period. The company clarified that the only long-term award that accrued for that period was under the TSR metric and that disclosure could be clearer as regarded adjustments to incentive scheme metrics in future. G4S recognises the down-side of complexity in remuneration scheme metrics but they have to balance this against the benefits of aligning the scheme with the company's strategic objectives.

As a company that only listed in 2005, **Afren** has grown rapidly and entered the FTSE 250 in 2010. LAPFF has met with company representatives several times since 2011 to discuss its remuneration practices. The company has had high oppose votes in four of the last five years including its pay vote being defeated at the 2013 AGM. A major issue previously had been the ability to award special bonuses and this provision has been removed. At a follow-up meeting, the chair of the remuneration committee was pressed on further measures to ensure that shareholders will view remuneration arrangements as appropriate in the binding vote on pay at the 2014 AGM.

Reliable Accounts

LAPFF had, under the former LAPFF Chair, met with Baroness Hogg Chair of the Financial Reporting Council (FRC) regarding problems with International Financial Reporting Standards (IFRS) and the implications for the accounts (and the audits of banks). The FRC public position remained positive towards IFRS despite strong criticism in the UK and EU Parliaments.

LAPFF also engaged with Sir Win Bischoff (outgoing chair of Lloyds Banking Group) who had been publicly critical of IFRS. Sir Win is now the incoming chair of the FRC from 1 May 2014 which LAPFF supports. (LAPFF with the investor coalition had written to Vince Cable with the view that the new FRC Chair should not be from one of the Big 4 accounting firms).



An Evening Standard article dated 28 February 2014 is an interview with the outgoing Baroness Hogg. The headline is "the numbers must add up next time, warns the Footsie's first lady". In it she also expresses concern about the effectiveness of bank auditors and the delay in the FRC investigating accounting/audit failures.

MANAGING ENVIRONMENTAL RISK

Palm oil

Following its engagement with a number of US companies on sustainable palm oil, LAPFF signed an investor statement of support for **Wilmar's** recently announced commitment to eliminate deforestation, peatland development and human rights violations from its palm oil supply chain. Wilmar is the world's largest palm oil trader, controlling 45% of the global palm oil trade and the aim of the statement was to ensure that the company was appropriately recognised for their groundbreaking commitment.

Wilmar and Kelloggs commit to eliminate deforestation from their palm oil supply chains

The Forum had already written to **Kelloggs** on this same concern, in collaboration with other investors in late 2013. In February, Kellogg's announced a policy to only purchase sustainable palm oil with a target of end 2015 for compliance.

Energy and Environmental Risk

Continuing its engagement with listed companies on 'fracking' activities, LAPFF is participating in a collaborative initiative coordinated through the PRI with a number of asset managers and asset owners. The Forum has co-signed letters to six companies in the oil and gas sector requesting meetings aimed at ensuring a proper understanding of the risks involved and to encourage best practice to minimise these risks.

TARGETING SOCIAL ISSUES

Employment Standards

Following correspondence in late 2013 with **Lonmin** regarding media coverage of actions during the 2012 Marikana mine incident, LAPFF attended the company's AGM for the second year running in January. Over the year, there have been a number of board changes, including the appointment of the new chief executive, Ben Megara.

The Chair and Chief executive gave useful updates on progress on the company's 'five-point plan' and wider initiatives. The company has recovered well from the impact of the previous wildcat strike, but is now being badly hit by the recently started protected strike by the Association of Mineworkers and Construction Union (AMCU). Cllr Brayshaw pressed for as much detail as possible on plan projects, timescales and metrics, in particular on reforming shift patterns, housing provision, on the



local/migrant labour balance and on other points in the plan. He indicated LAPFF would continue positive dialogue with on overall progress at its various South African operations.

Further changes have emerged at **Deutsche Post** following engagement by LAPFF, unions and other investors. These have been negotiated through a settlement mediated by the German National Contact Point for the OECD Guidelines for Multinational Enterprises and include assessments of industrial relations with affiliate unions in India and Columbia.

CONSULTATIONS & PUBLIC POLICY

ENGAGING WITH POLICY-MAKERS

LAPFF remains closely involved in shaping the debate around the proposed restructuring of the Local Government Pension Scheme. The LAPFF chair and vice-chair are active members of the **LGPS Advisory Board Investment and Engagement Subcommittee**. The Forum submitted a report to the Subcommittee on 'Local Authority Pension Funds and Active Stewardship' setting out how LAPFF operates to bring together funds to engage collectively and effectively.



LAPFF has been concerned about the governance of both the process of setting accounting standards and of the Financial Reporting Council. One aspect of concern is the dominant representation of the Big 4 Accounting firms, their immediate alumni, investment banking interest and sell-side analysts. LAPFF and the investor coalition have not engaged directly with the IASB because of these governance concerns, instead have engaged with accountable parties aiming to make the IASB accountable.

During January and February, the Economic Affairs Committee of the EU Parliament followed up on Daily Telegraph reports of serious compliance issues with the IASB being up to seven years in arrears with Companies House filings. The matter has been pursued by a cross party coalition of MEPs including UK Lib Dem Sharon Bowles MEP and UK Conservative leader Syed Kamall MEP, plus the Greens and Socialists. The IASB issued a public rebuttal which was then proven wrong.

CONSULTATION RESPONSES

In response to a request from the Department for Business, Innovation & Skills (BIS) and the Department for Work and Pensions (DWP) the **Law Commission** issued a consultation on how fiduciary duties currently apply to those working in financial markets. This asked questions to flesh out views on how far pension duties require trustees to maximise financial return over a short time scale, and how far trustees can consider other factors, such as environmental and social impact. [LAPFF's response](#) presented a LGPS perspective on key issues of stewardship, short termism and beneficiaries' interests.

A response was also provided to the **Financial Reporting Council's (FRC)** second consultation on Risk management, Internal Control and the Going Concern Basis of Accounting. In its [response](#), LAPFF strongly supported the original Sharman proposals not the amendments proposed by the FRC, pointing out that recent FRC statements on the quality of audits at UK banks would suggest that directors and auditors should be undertaking their basic task properly as opposed to reviewing a list of generalised risks. The FRC is now in a position of having to re-consult, i.e. for a third time.

All LAPFF consultation responses can be viewed at: <http://www.lapfforum.org/consultations>.

NETWORKS & EVENTS

Representatives of LAPFF regularly attend conferences and events on behalf of members. A list of recent events attended is as follows:

- **ICGN - PRI meeting** – board composition and director elections
- **PRI Fixed Income Event** – hosted by AXA Investment Managers
- **Centre for the Study of Financial Innovation** – round table on carbon bonds

COMPANY PROGRESS REPORT

Company	Topics	Outcome
Afren	Remuneration	Moderate Improvement
AIA Group	Holdings Based Engagement	Awaiting Response
Amec	Blacklisting	Satisfactory Response
Balfour Beatty	Blacklisting	Awaiting Response
BT Group	Remuneration	Satisfactory Response
Carillion	Blacklisting	Dialogue
Costain	Blacklisting	Satisfactory Response
Deutsche Post	Social Risk	Substantial Improvement
easyJet	Remuneration	Moderate Improvement
Essar Energy	Governance (delisting)	Awaiting Response
ExxonMobil	Climate Change	Change in Process
G4S	Remuneration	Dialogue
Golden Agri	Sustainable Palm Oil	Dialogue
Hormel Foods	Sustainable Palm Oil	Satisfactory Response
Jardine Matheson	Holdings Based Engagement	Dialogue
London Stock Exchange	Board composition	Substantial Improvement
Lonmin	Employment Standards, Social	Change in Process
N Brown	Social Risk	Satisfactory Response
Nestle	Holdings Based Engagement	Dialogue
Novartis	Holdings Based Engagement	Dialogue
Roche Holding AG	Holdings Based Engagement	Dialogue
RSA	Finance & Accounting	Awaiting Response
Samsung	Holdings Based Engagement	Awaiting Response
Skanska AB	Blacklisting	Awaiting Response
Svenska Handelsbank	Remuneration	Awaiting Response
Trinity Mirror	Reputational risk, Social Risk	Dialogue
Vinci	Social Risk	Dialogue

Companies LAPFF has not previously engaged with individually are indicated in bold. 'Awaiting response' indicates a letter was sent during the period but a written response was not received.



The Local Authority Pension Fund Forum was established in 1991 and is a voluntary association of local authority pension funds based in the UK. 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 its members invest. The Forum's members currently have combined assets of over £125 billion.

Report prepared by PIRC Ltd. for the
Local Authority Pension Fund Forum

PIRC

www.lapfforum.org

Aberdeen City Council
Avon Pension Fund
Barking and Dagenham LB
Bedfordshire Pension Fund
Camden LB
Cheshire Pension Fund
City of London Corporation
Clwyd Pension Fund
Croydon LB
Cumbria Pension Scheme
Derbyshire CC
Devon CC
Dorset County Pension Fund
Dyfed Pension Fund
Ealing LB
East Riding of Yorkshire Council
East Sussex Pension Fund
Enfield
Falkirk Council
Greater Gwent Fund
Greater Manchester Pension Fund
Greenwich Pension Fund
Gwynedd Pension Fund
Hackney LB
Hampshire Pension Fund
Haringey LB
Harrow LB
Hounslow LB
Islington LB
Lancashire County Pension Fund
Lambeth LB
Lewisham LB
Lincolnshire CC
London Pension Fund Authority
Lothian Pension Fund
Merseyside Pension Fund
Newham LB
Norfolk Pension Fund
North East Scotland Pension Fund
North Yorkshire CC Pension Fund
Northamptonshire CC
NILGOSC
Nottinghamshire CC
Rhondda Cynon Taf
Shropshire Council
Somerset CC
South Yorkshire Integrated Transport Authority
South Yorkshire Pensions Authority
Southwark LB
Staffordshire Pension Fund
Surrey CC
Teesside Pension Fund
Tower Hamlets LB
Tyne and Wear Pension Fund
Waltham Forest LB
Warwickshire Pension Fund
West Midlands ITA Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund
Wiltshire CC
Worcestershire CC