

ANNUAL REPORT **2017**





4 CHAIR'S STATEMENT

6 LAPFF EXECUTIVE COMMITTEE

7 LAPFF POLICY ENGAGEMENT – SPOTLIGHT ON POOLING

7 LAPFF POLICY ENGAGEMENT SUMMARY

- 8 CORPORATE GOVERNANCE BEIS CONSULTATION RESPONSE
- 9 RELIABLE ACCOUNTS
- 10 SECTION 172 COMPANIES ACT 2006 ('ENLIGHTENED DIRECTOR DUTIES')
- 10 EXECUTIVE PAY POLICY VOTING

11 LAPFF COMPANY ENGAGEMENT

11 ENGAGEMENT OVERVIEW FOCUS ON INTERPLAY OF ESG ISSUES

15 GOVERNANCE RISK - SPOTLIGHT ON BOARD MEMBERS WITH SUSTAINABILITY EXPERTISE

- 15 GOVERNANCE RISK SUMMARY
- 15 Cyber Security
- 16 Diversity
- 16 Executive Pay
- 16 Mergers & Acquisitions

17 ENVIRONMENTAL RISK – SPOTLIGHT ON THE DIVESTMENT v ENGAGEMENT DEBATE

- 17 ENVIRONMENTAL RISK SUMMARY
- 17 Shareholder Resolution Support
- 18 Carbon Disclosure and Scenario Planning
- 18 Low Carbon Transition

19 SOCIAL RISK – SPOTLIGHT ON STAKEHOLDER ENGAGEMENT

- 19 SOCIAL RISK SUMMARY
- 19 Human Rights
- 20 Employment Standards
- 20 Public Health

21 MEDIA COVERAGE

22 LIST OF COMPANIES ENGAGED

24 LIST OF MEMBERS

25 MEMBER SUPPORT

CHAIR'S STATEMENT



COUNCILLOR KIERAN QUINN
CHAIR OF THE LOCAL AUTHORITY
PENSION FUND FORUM

To say that no one could have predicted the political shifts of the last year and a half is a gross understatement. The UK's shock vote on Brexit was followed by an equally unexpected vote in the US Presidential election last November.

The only predictable outcome of this political turmoil has been uncertainty. Although markets have generally performed well in the last year, it is still unclear how major developments such as Brexit will play out. On the environmental front, we don't yet know what impact Mr Trump's decision to pull the US out of the Paris Accord will have on both countries and companies, and the green energy market. Socially, we have seen a rise in populism globally that is affecting migration flows, and in turn local labour markets and economies. The long-term effects of this trend remain to be seen.

Amid all of these developments at the international and national levels, local government pension scheme pooling has taken root with many pools both up and running or just about to be. Apart from their struggle to take off as new, experimental entities, pool companies are having to work out ways to operate in the new political and economic environment. This means not just establishing their own governance structures and their relationships with administering authorities but also negotiating the responsible investment terrain. As pooling progresses Councillors and Officers at administering authorities are gradually adapting to the new conditions.

A cross-pool responsible investment group has developed to address this need, and both pools and administering authorities – which retain legal responsibility for responsible investment under the pooling regulations – are looking to LAPFF for support. As a result, LAPFF is having to think hard about its own structure and governance in order to grow and meet the needs of its current and future membership.

However, these changes and developments also highlight why LAPFF is such an important organisation for its members. The Forum's work at the policy level, through its continuing efforts on accounting standards, responses to government consultations including on corporate governance and listings and the All-Party Parliamentary Group on Local Authority Pension Funds (APPG) started last year, enable LAPFF members to influence the policy environment they are trying to navigate. The Forum's engagement with UK and global companies also provides members with an understanding of how companies are reacting to this uncertain political and economic environment and allows members to make better decisions for their own portfolios.

CHAIR'S STATEMENT

Therefore, if there is one thing I take away from my experience as Chair of LAPFF over the last year, it is that we have to understand the linkages in everything we do. We need to understand how at the international and national level politics affects us at the local authority level. We need to understand how the Forum's policy and engagement work inform each other. And we need to understand how environmental, social and governance risks that companies face work together to affect company performance and consequently their impact on Member funds' portfolios. LAPFF is uniquely placed in this role.



THANK YOU

The LAPFF Executive has seen a number of changes over the last year. I would like to extend huge thanks to Cllr Cameron Rose, who stepped down as Vice-Chair of LAPFF this year. His input to LAPFF over the years has been extensive and has helped to make LAPFF a stronger organisation. We have welcomed his colleague from Lothian Pension Fund, Cllr Alasdair Rankin, who has already proven himself an asset to the LAPFF Executive. A big welcome also to Cllr Yvonne Johnson, who was elected to the LAPFF Executive at the LAPFF AGM. Denise Le Gal has been elected to the position of LAPFF Vice-Chair alongside Ian Greenwood, and I am grateful to both Denise and Ian for their invaluable input and support over the year.

Long-standing LAPFF Executive member, Cllr Richard Greening, also stepped down and we are immensely grateful to Richard for his committed and varied contribution to LAPFF over the years. Cllr Mary Barnett stepped down to pursue other, very worthy, challenges. We will miss her strong, helpful and witty views. And last but not least, our long-standing Honourable Treasurer, Geik Drever, has retired. Geik played a significant role in helping LAPFF to reach its current strong financial position, and I would like to thank her for her consistent and fastidious attention to LAPFF's finances. LAPFF membership has risen to 72 funds in the past year, reflecting the role that LAPFF has been playing in helping members to make sense of the current environment. Many thanks again to Forum Officer, Keith Bray, for his continued efforts and success in recruiting new funds.

Once again our research and engagement work is made possible by our R&E Partner, PIRC Ltd. Their successful contract renewal through the recent LAPFF tender process last November, enabled continuation of their outstanding role over the recent period. I look forward to our work with PIRC for the next period of LAPFF's development and growth.

In closing, I would like to extend a heartfelt thank you to all of my LAPFF colleagues on the Executive and to the membership at large who have contributed ideas this year that have helped LAPFF to grow and develop as an organisation, as well as providing input to LAPFF's engagement and policy development. Without your interest and support, LAPFF would not continue to be the voice of responsible investment for local authority pension schemes in the United Kingdom.

I look forward to continued input and feedback from the LAPFF membership as we work through the big challenges and uncertainties we face, both as investors and administering authorities.

LAPFF EXECUTIVE COMMITTEE



**Chair –
Councillor Kieran Quinn**
Greater Manchester
Pension Fund



**Deputy Chair –
Ian Greenwood**
West Yorkshire Pension Fund



**Deputy Chair –
Councillor Denise Le Gal**
Surrey Pension Fund



**Executive –
Councillor Barney Crockett**
North East Scotland
Pension Fund



**Executive –
Councillor Paul Doughty**
Merseyside Pension Fund



**Executive –
Councillor Yvonne Johnson**
Ealing Pension Fund



**Executive –
Councillor Mukesh Malhotra**
London Borough of Hounslow



**Executive –
Councillor Doug McMurdo**
Bedfordshire Pension Fund



**Executive –
Councillor Alasdair Rankin**
Lothian Pension Fund



**Executive –
Councillor Toby Simon**
London Borough of Enfield



**Executive –
Rodney Barton**
West Yorkshire Pension Fund



**Executive –
Jane Firth**
South Yorkshire Pension Fund



**Executive –
Faith Ward**
Environment Agency
Pension Fund

LAPFF POLICY ENGAGEMENT – SPOTLIGHT ON POOLING

Whilst the agenda for asset pooling has made uneven progress, administering authority staff and members made best efforts to meet government deadlines and objectives. The Forum continued to provide regular updates through its Business meeting agendas and seminars. Reports were also provided at each LAPFF Executive meeting through the chair, vice chairs and those particular individuals who in effect ‘represented’ their own pools, some in their capacity of membership of the Scheme Advisory Board or from work through cross-border pool meetings.

The Forum Executive also met late August to review pool company participation in the Forum as individual membership organisations and a decision was made by the Executive to recommend membership and a current year fee. Details of the constitutional position of pool companies remains to be determined.

LAPFF POLICY ENGAGEMENT SUMMARY

As set out by the LAPFF chair in the introduction, the focus of this year’s annual report is on linkages. This section draws out some of the overlap between LAPFF’s policy and engagement initiatives and outcomes. These connections have arisen especially in relation to accounting, regulation and climate change, and with the government’s consultation on corporate governance, and include looking at the role of employee engagement and input at board level.



ALL-PARTY PARLIAMENTARY GROUP, FRINGE MEETINGS, CONFERENCE AND SEMINARS

ALL-PARTY PARLIAMENTARY GROUP (APPG)

Not surprisingly, the APPG topics over the last year focused on pooling. There were general concerns about cost transparency related to pooling, an issue raised by Cllr Roger Phillips, Chair of the LGPS Scheme Advisory Board (SAB). New regulations on LGPS investment also factored into the discussion, as did MiFID II. Specifically, participants raised concerns that local authority pension funds might be classified as retail, rather than professional investors under the Directive, thus compromising their mandate to invest in infrastructure within pools. Paul Spedding of Carbon Tracker also addressed the APPG, advocating for a managed decline of investment for oil investments to protect investor portfolios from the impacts of climate change.

Fringe Meetings

LAPFF continued to engage politicians and stakeholders by hosting fringe meetings at the Labour, Conservative and SNP annual party conferences. This year’s theme for discussion was the pros and cons of workers on the board, following the corporate governance green paper and the Prime Minister’s proposal to have employees represented in the boardroom. The meetings were well attended and speakers included: Chris Philp MP (PPS to HM Treasury); Jack Dromey MP (Shadow Minister, Business, Energy and Industrial Strategy); Clare Haughey MSP; Maree Todd MSP; Stefan Stern (Director, High Pay Centre); Grahame Smith (General Secretary, STUC) alongside LAPFF executive members Kieran Quinn, Denise Le Gal and Alasdair Rankin.

Conference

The 2016 LAPFF Annual Conference, which takes place each December at the Marriott in Bournemouth, was one of the most impactful yet. Audience members were left speechless by Bill Browder's harrowing account of running a hedge fund in Moscow and trying to challenge Vladimir Putin on corruption. Glencore Chair, Tony Hayward, told the last session of the conference that oil and gas companies would still see demand for fossil fuels for the foreseeable future, while his challenger, Jeremy Leggett, proposed an alternative vision of the energy future focused on renewables and alternative fuel sources. A number of LAPFF members also comprised a panel on pooling, providing a view of how the pools were starting to take shape. A few conference members even braved the cold water for the traditional last day 'dip' in the sea.



Climate Change Investment Policy Framework Seminar

LAPFF often holds seminars on topical issues of interest to members. This past year, as requested by members, the Forum held a hugely successful seminar on member fund responses to the investment implications of climate change in the context of the LAPFF draft climate change investment policy framework. A number of LAPFF fund representatives explained how their funds had factored climate risk into their investment strategy. This presentation was followed by a range of speakers, from investment managers to actuaries from the insurance industry who presented their views on the challenges and opportunities presented by the current state of play in the financial industry on climate change.

CORPORATE GOVERNANCE BEIS CONSULTATION RESPONSE

The Department for Business, Energy & Industrial Strategy (BEIS) issued its Green Paper on Corporate Governance Reform in November 2016.

The LAPFF response focused on ensuring that executive pay is properly aligned to long-term performance, giving a greater voice to employees and consumers in the boardroom, and raising the bar for governance standards in the largest privately-held companies.

Although the Forum remains concerned that the current executive remuneration system is fundamentally broken and needs to be overhauled, the Green Paper contained a number of suggestions regarding the existing framework. Binding upper thresholds for total annual pay and mandatory disclosure of fund manager voting records were recommended. Furthermore, increased stakeholder engagement on executive remuneration, including employee representation on remuneration committees and incorporating employee views into pay policy, were also recommended.

In responding to the consultation, in respect of stakeholder engagement, LAPFF called for more legal requirements to ensure that stakeholder voices of all types, not just those of employees and consumers, to be considered in order to build business resilience to non-traditional financial factors. LAPFF also set out where there are major problems with the regulator of governance, accounts and financial reporting; the Financial Reporting Council (FRC).

The government then issued a White Paper in August 2017. This included a proposal to compare CEO pay to UK average employee pay and to deal with aspect of Long Term Incentive Plans (LTIPs). The White Paper also sets out several different routes to dealing with employee representation on boards.

In addition, the White Paper said the following on share buybacks *'the Government will take forward its manifesto commitment to commission an examination of the use of share buybacks to ensure that they cannot be used artificially to hit performance targets and inflate executive pay. The review will also consider concerns that share buybacks may be crowding out the allocation of surplus capital to productive investment. The Government will announce more details shortly.'* LAPFF first discussed concerns over share buybacks with members in 2015, and these concerns echo just some worries that LAPFF explored in the discussion paper 'Buybacks – Solutions or Illusions'. LAPFF considers the government's approach a positive step in an area that has received relatively little attention from other investors or investor bodies.

RELIABLE ACCOUNTS

The FRC - Matters Relevant to Banks' Accounts, Audits and Their Solvency

LAPFF has a particular interest in the accounts of banks which failed and had identified inconsistencies between the law and FRC standards and guidance. The Forum obtained a legal opinion on this issue from George Bompas, a QC who is also a Deputy Judge of the High Court. This area is called statutory capital maintenance (Companies Act 2006) and it precedes anything else that banking regulation may or may not do. These provisions exist to protect creditors and shareholders of limited liability companies and audited accounts have a central role in that. Mr Bompas identified several areas where the FRC is wrong in its interpretation and application of this law.

The statutory capital maintenance regime establishes a test for robustness of the numbers in the accounts for solvency and distributions (the profits and net assets). This test is unlikely to have been met where a bank collapses shortly after an audit that has uncovered, or should have uncovered, problems (essentially over-valuation) with the pre-existing loan book, as occurred with HBOS, RBS and some other banks.

On being questioned by the House of Lords Economic Affairs Committee on this issue in 2014, the FRC told Parliament that the governments' lawyers disagreed with the LAPFF position and agreed with the FRC's counsel. A Freedom of Information (FOI) request on BEIS showed that not to be the case. The FOI instead revealed the government had explicitly stated that it had never said that LAPFF was wrong.

This revelation is prima facie evidence that the accounts of banks failed to meet their statutory objectives. As a result of that experience, LAPFF undertook a fuller comparison of the legislative text and requirement and FRC materials. This

comparison uncovered a problem: the FRC was using the short title, rather than the full text, a practice that repeats itself regarding quotes from s393 Companies Act 2006 (True and Fair view). That error can be seen in the FRC's 2011 and 2014 papers on 'True and Fair View'. The correct wording of the statute 'true and fair view of the *assets, liabilities, financial position and profit or loss*' does not actually appear anywhere in those papers. Those papers contain shortened and misleading forms of words instead. Given that s393 is the overarching statutory requirement, the shorter construction is a major weakness.



There are other problems with the transcription of other part of legislation, including FRC guidance on qualified audit reports, section 837(4). The FRC guidance on the legislation states that an auditor statement in lieu of an unqualified audit opinion targets the dividend cover of a proposed distribution¹.

That is incorrect, and s874(5) could not be clearer that the statutory requirement relates to the distribution capacity that the accounts show, and not dividend cover of any proposed dividend/distribution². Also, the same guidance is defective by omission. The FRC guidance states, correctly, that the test of lawfulness is set out in Part 23 of the Companies Act. It then cites the profits test (s830 CA 2006). However, it misses the net assets test (s831 CA2006) altogether. These problems with framing the distribution requirements and the profits test are both very material defects.

The impact of the FRC's erroneous guidance is that it fails to highlight that net assets as well as profits are relevant to distributions for a public company, and hence relevant to whether an auditor report is qualified or not.

Given the gearing of banks, and the sensitivity of banks' net assets to inadequate bad debt provisioning, the FRC's

¹Miscellaneous Reports by Auditors Required by the United Kingdom Companies Act 2006, para 11 and 12 and the model report contain the error.

²The FRC guidance correctly cites the text in footnote.

problems in this area are clearly relevant to the audits of banks which failed within months of receiving clean audit opinions. HBOS, Co-op Bank, RBS and others are examples. But there is also relevance to thinly capitalised companies with large pension funds which pay dividends (such as BHS).



SECTION 172 COMPANIES ACT 2006 (‘ENLIGHTENED DIRECTOR DUTIES’)

LAPFF has been concerned about the FRC’s approach to director duties and the strategic report. These concerns emerged from discussions with FRC executives that LAPFF had, together with some NGOs, on the subject of climate change. Matters were also raised by the BEIS Select Committee in the wake of issues with BHS and Sports Direct. The FRC claimed that there were issues with the legislation rather than its guidance.

However, LAPFF believed that the problem was not the requirements of the legislation for director duties, s172, or the strategic report, s414C, but the way in which the FRC guidance (for companies and auditors) on the legislation had left out parts of the text of s172. As with s393, the FRC guidance chose to cite the short-title of the section rather than the content of that section of the statute itself. It was quite clear there was an error³ by the FRC merely by reading the government’s correct description of the legislation in its Corporate Governance Green Paper of November 2016.

As a result of a vocal campaign – which included pointing out that FRC evidence to the BEIS Select Committee repeated the error – the FRC did, in August 2017, issue draft revised guidance which adds back the text omitted. LAPFF does not find the FRC’s explanation that an EU Directive has altered things to be compelling, as that Directive does not touch on the parts of s172 for which the FRC has now correctly transposed the existing 2006 Act text.

That said, it is positive that the wording is now correct in the FRC’s revised guidance. On the basis that the FRC inspects accounting firms and accounts according to its guidance, any misinterpretation of the law will have a systemic effect.

EXECUTIVE PAY POLICY VOTING

During 2017, a majority of UK companies faced binding votes on their executive remuneration policies, in line with 2014 legislation calling for such votes at least every three years. Overall, remuneration levels were down for executives, in part because prior to setting their policies, many companies engaged with investors critical of existing pay arrangements.

LAPFF decided this context provided a good opportunity to issue voting alerts on executive remuneration. The companies with the highest opposition to their pay policies in 2016 and with votes on their remuneration policies during 2017 were identified. They were then cross-referenced with companies in which LAPFF collectively has a high level of holdings. Members received voting alerts either critiquing or commending the companies, as appropriate, for their proposed remuneration policies.

For a number of these companies, LAPFF had engaged directly on their remuneration arrangements and expressed concerns in relation to some aspects. Voting recommendations for members balanced areas of concern with recognition of positive changes made during the year, resulting in the following recommendations.

The companies for which LAPFF issued voting alerts to members during 2017 were:

Company	LAPFF Recommendation
BP	For
Shell	For
WPP	Oppose
Sports Direct	For
Smith & Nephew	Oppose
Carillion	Oppose
GlaxoSmithKline	Oppose
Babcock International	Oppose

³Or not an error. A paper from Deloitte indicates that because the legislation had not turned out as the FRC had expected, it produced Guidance on the basis of the outcome it had wanted but not got.

LAPFF COMPANY ENGAGEMENT

ENGAGEMENT OVERVIEW

FOCUS ON INTERPLAY OF ESG ISSUES

This portion of the report highlights the linkages between the 'E', the 'S' and the 'G' elements of responsible investment in relation to LAPFF engagements. Failure to recognise these linkages can mean a failure to properly identify financial risks.

The three sections on pages 14 to 19 cover areas where LAPFF has identified the importance of such linkages: sustainability expertise on boards, the divestment versus engagement debate, and stakeholder engagement. The report covers policy engagement activity from the beginning of October 2016 to the end of September 2017.

COMPANIES

50

ENGAGEMENTS

108

TABLE 1: **ENGAGEMENTS BY TOPIC**

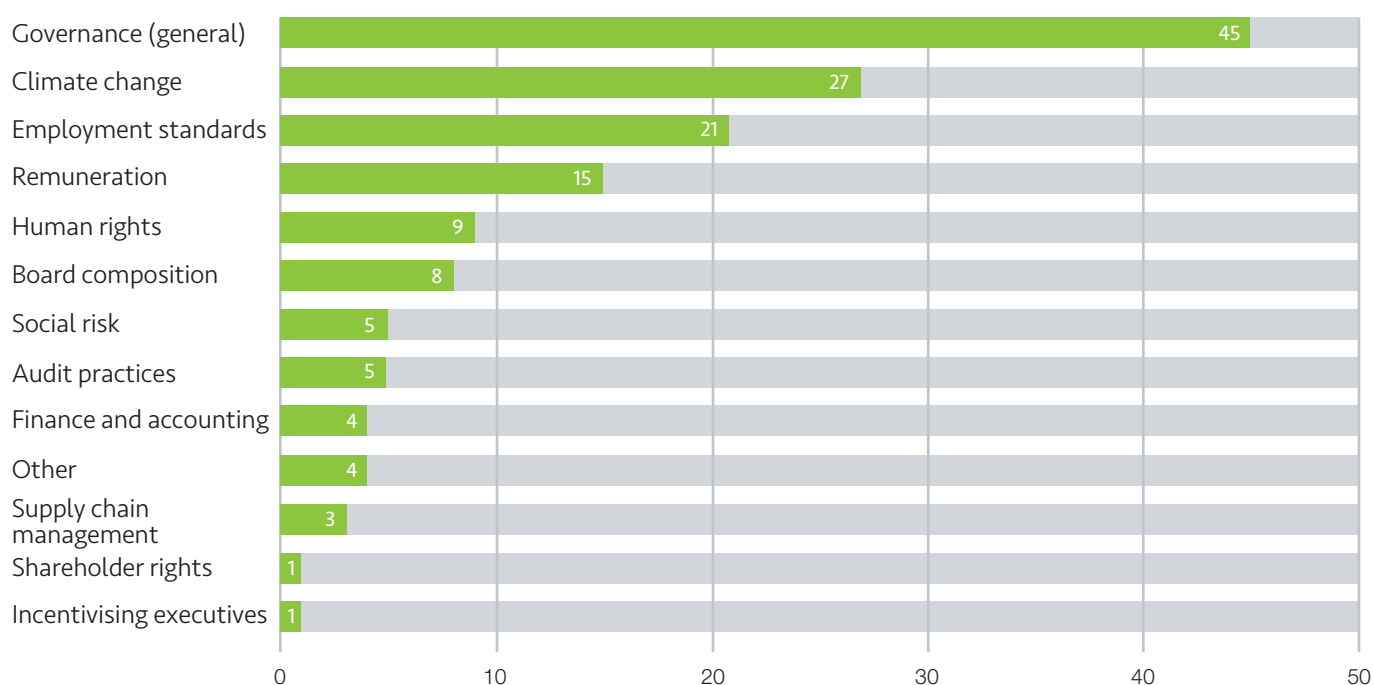


TABLE 2: **TYPES OF ENGAGEMENTS**

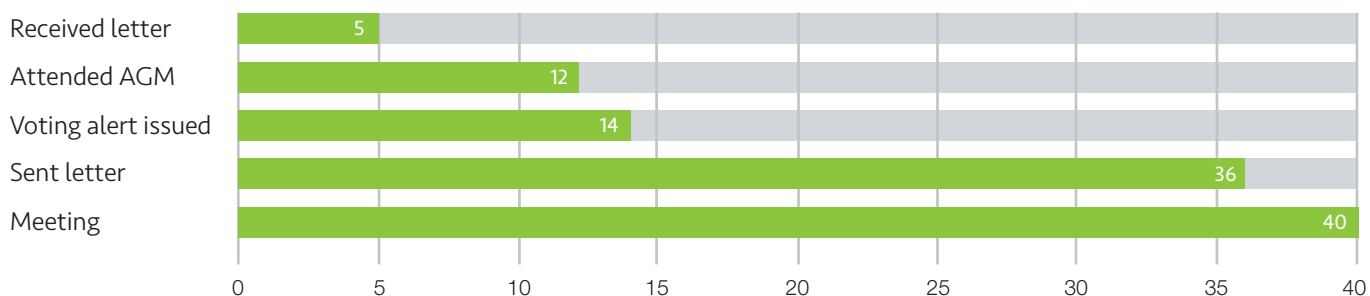


TABLE 3: **COMPANIES BY DOMICILE**

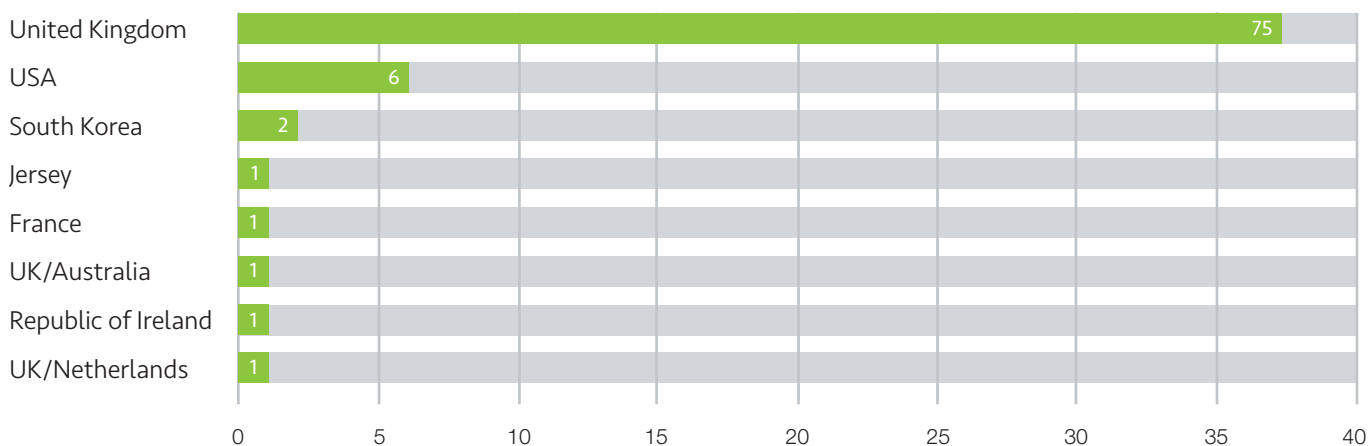


TABLE 4: **POSITION ENGAGED**

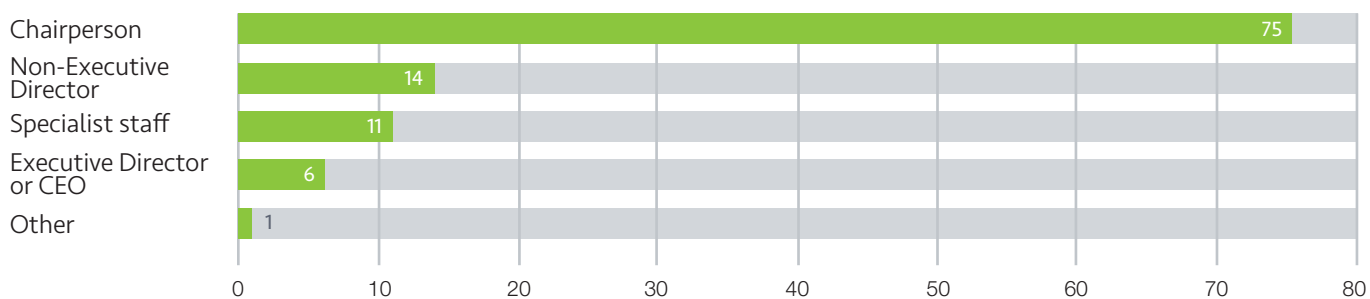


TABLE 5: **ENGAGEMENT PER INDUSTRY**

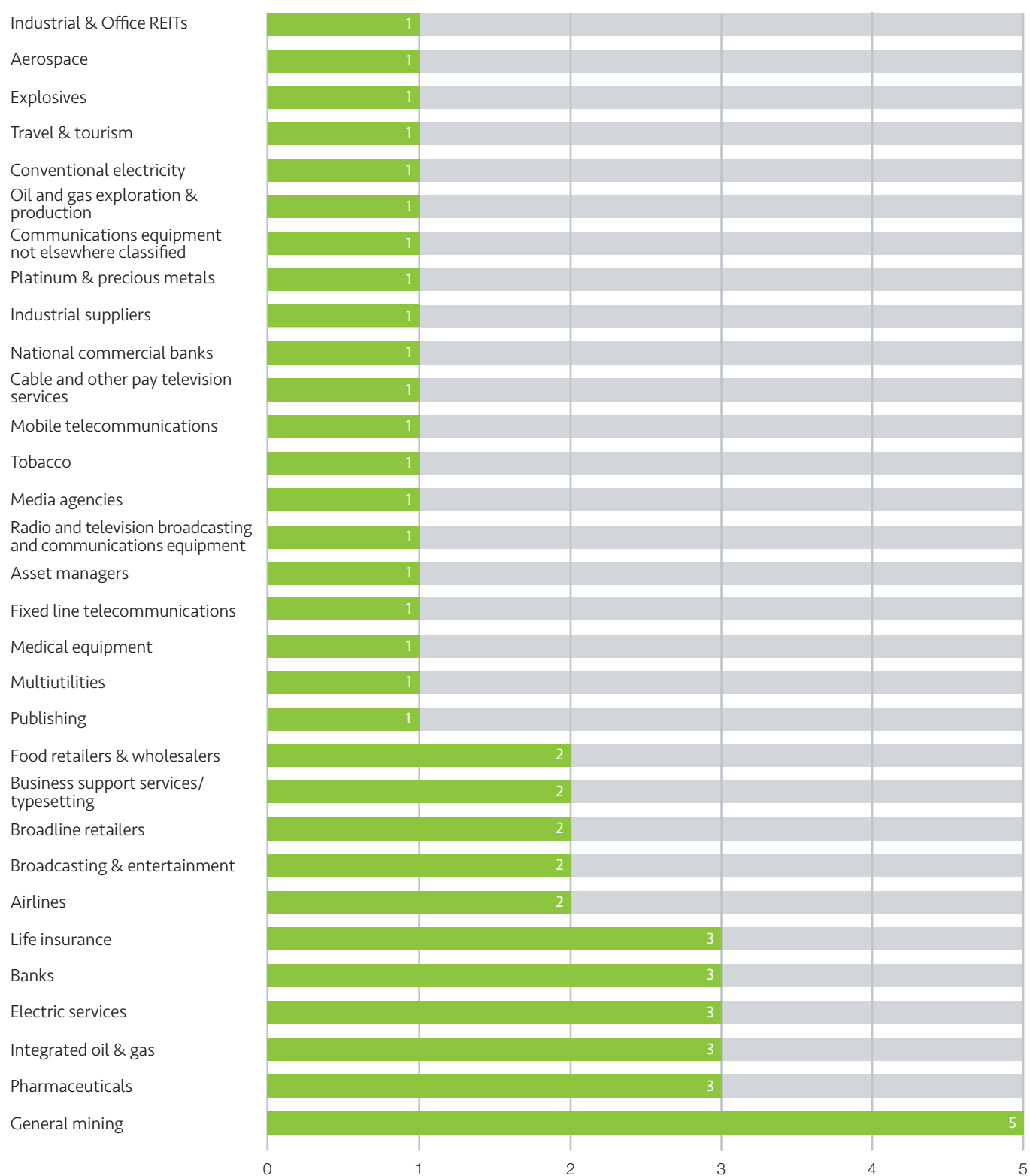
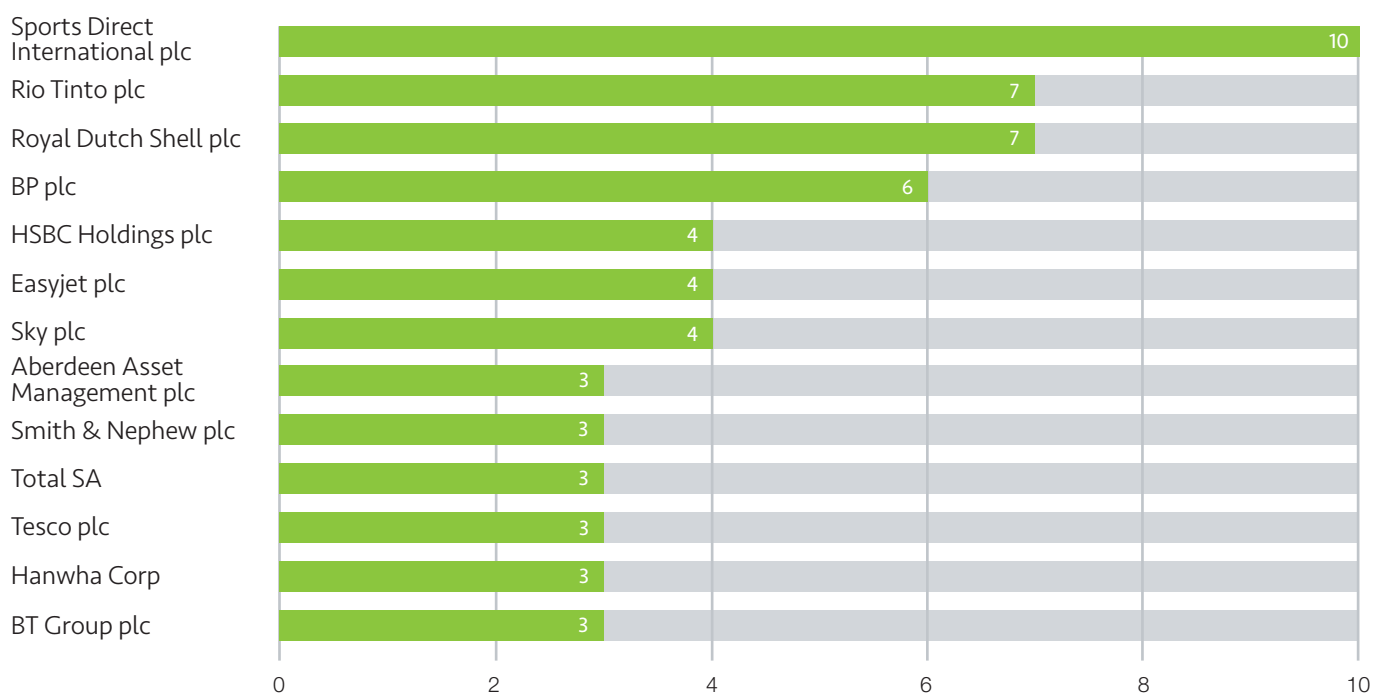


TABLE 6: **NUMBER OF ENGAGEMENTS PER COMPANY (WHERE THERE WERE MORE THAN TWO)**



GOVERNANCE RISK – LINKAGE 1: SPOTLIGHT ON BOARD MEMBERS WITH SUSTAINABILITY EXPERTISE

LAPFF often uses governance as a lens for social and environmental competence. Increasingly, this approach is used in relation to board composition. Over the course of the year, the Forum has conducted engagements to explore whether boards have sufficient sustainability competence. These engagements have taken place both through questions asked at AGMs and through discussions at meetings with companies.

To progress this approach, on environmental competence, LAPFF has partnered with US-based 50/50 to explore the possibility of advocating for board directors with climate change expertise. This is in part because there continue to be company boards that appear slow to recognise the pace of change required for the low carbon transition and not least, a number of company directors in the US that deny climate science. However, it is increasingly clear that climate change is a financially material issue. LAPFF's report issued with Carbon Tracker points to the need for a managed decline for oil assets if investors are to protect their investment portfolios from the impacts of climate change. In practice, when engaging with companies, LAPFF is seeing more and more evidence of boards and/or board members that refuse to acknowledge, and act on, this trajectory, particularly in the US, and is collaborating with other investors, to highlight the risks this poses for shareholder capital.

In relation to social risk, a LAPFF member asked about maintaining appropriate sustainability expertise on the Carillion board where the Director with greatest experience in this area was leaving the board. It was clear from the company's reporting that the remaining Board members did not have the necessary knowledge and understanding of the Company's social risk because only one aspect of social risk received due attention in the Annual Report and the AGM responses, whereas the company clearly should be considering a range of risks in this area. An engagement meeting with BAT covered the same issue. In general, feedback from companies has been that boards should have business experts with sustainability knowledge rather than sustainability specialists. While there is a good argument for the former case, many companies do not appear to consider even this approach in discussing board composition or succession planning.



Even if boards are open to improving their sustainability expertise, based on LAPFF engagement, there are questions about whether directors know what appropriate sustainability expertise looks like and how to roll out sustainability considerations through appropriate representation and structures within a company. Therefore, LAPFF sees sustainability competence on boards as an issue for continued consideration and engagement.

GOVERNANCE RISK SUMMARY

Cyber Security

Cyber security currently ranks as one of the biggest concerns for investors and company boards alike. Recent high-profile cyberattacks have highlighted the operational and reputational costs at stake. To safeguard against these threats, LAPFF has sought further detail and assurances from companies about how they are mitigating the risks posed.

The Forum had meetings with the Chairmen at BT and Vodafone to discuss cybersecurity as both companies are at the forefront of the threat given their role in the exchange of information. At this year's Tesco AGM, LAPFF asked the chairman, in light of the cyberattack on Tesco Bank the previous year, whether the board had the right competencies to mitigate future attacks and gained a better understanding of how cyber risk is managed within the company and the training the board had received. LAPFF also asked about cyber security at the SSE AGM. It appears that this issue will continue to increase in importance for investors in the coming years.

Diversity

Board diversity is important for many reasons, not least to avoid group think and provide effective challenge in the boardroom. Over the year LAPFF continued to both engage companies on board diversity and be an active member of the 30% Club investor coalition, which works to achieve a minimum of 30% women on FTSE-350 boards and 30% women at senior management level in FTSE100 companies. Glencore was the last FTSE 100 Company not to have an all-male board and the Forum attended its AGM to ask about further progress. Despite all FTSE 100 companies now having at least one woman on the board, this is not the case for all FTSE 350 companies. To push for board diversity across the whole of the FTSE, the Forum issued voting alerts on gender diversity on the boards of Euromoney and EnQuest, both of which have all-male boards. In both cases whilst the boards had stated their commitment to gender diversity the Forum felt it was not being addressed with sufficient urgency. This complacency is a particular concern given the reputational repercussions tech companies such as Google have faced over gender diversity during the course of the year.

However, the Forum considers diversity incorporates many more aspects than gender alone and in discussions with Antofagasta the challenges of achieving board and workforce diversity in terms of gender, skills and international experience and perspectives were explored. The Forum also submitted a response to the Parker review of ethnic diversity of UK Boards. The Forum's response set out how it engages on such issues and recommended that the final report could be strengthened by stressing the role that investors can and should play.

Executive Pay

LAPFF has long engaged on executive remuneration and has developed its 'Expectations on Executive Pay' since they were first issued in 2013, by engaging with boards on this topic. In addition to issuing a number of voting alerts on pay policies, Forum members met with a number of companies to discuss their structure for and approaches to executive pay. Over the last year, LAPFF raised remuneration issues at the Smith & Nephew and Ashted Group AGMs and held several meetings to discuss pay policies and schemes, most notably with EasyJet, Shell, Smith & Nephew, BP and Vodafone.

Mergers and Acquisitions

The past year has been an interesting time for corporate mergers and acquisitions (M&A). We have seen continued jostling for market position by global pharmaceutical giants, and Tesco has taken a big leap by announcing a planned merger with Booker. This announcement followed on from Sainsbury's acquisition of Argos last year, perhaps pointing to a merged concept of food and non-food consumer products more generally. A large merger in the financial services sector also took place between Aberdeen Asset Management and Standard Life.

LAPFF took the opportunity to meet with a number of companies about their approaches to M&A. These companies included Shire, Tesco, Aberdeen and Standard Life (now Aberdeen Standard). All of the directors, including chairs and CEOs, who met with LAPFF to discuss this issue provided helpful stories describing their approaches to M&A, and their insights have helped to substantiate the findings in LAPFF's trustee guide, *The Case for Engaging on M&A: Raising Standards of Corporate Governance by Asking the Right Question*.



ENVIRONMENTAL RISK – LINKAGE 2: SPOTLIGHT ON THE DIVESTMENT v ENGAGEMENT DEBATE

Recently, a number of member funds have been on the receiving end of calls for divestment related to ‘carbon heavy’ companies’ climate impacts. However, this campaigning approach has also been used to tackle social problems. One current area of focus for divestment campaigners is companies associated with the manufacture or distribution of cluster munitions. Divestment from companies invested in apartheid South Africa is another historical example.

LAPFF has always espoused the position that engagement is preferable to divestment. The Forum takes this stance for several reasons. First, LAPFF does not hold shares in companies; its member funds do. Therefore, while member funds are free to divest as they see fit within their individual investment strategies and mandates, LAPFF can provide an opportunity to press companies on an issue of concern through engagement, effectively ‘sandwiching’ a company with both divestment and engagement. We have seen this approach in relation to climate change, where a couple of LAPFF funds have divested from fossil fuel investments but the Forum has continued to engage with, for example, Shell and BP.

Second, the Forum believes that divestment can be a blunt tool that deprives investors of leverage to influence companies. Over the past year, we have seen this concern materialise through the vote for Sports Direct Chairman, Keith Hellawell, who had said he’d step down if he received less than half the independent vote. He ended up receiving 53% of votes in support from independent investors. Some commentators believe this is in large part because of the Standard Life and Aviva divestments. LAPFF saw the power of voting and engagement through its members’ co-filing and supporting the strategic resilience resolutions to BP and Shell in 2015 and the UK-listed integrated mining companies in 2016. This trend has been evident again this past year in the US where an unprecedented number of investors supported climate-related resolutions with companies such as Chevron, Exxon and PPL. Boards that had been intransigent on addressing the strategic business implications of climate change have had to devote attention and resources to it as a result of shareholder pressure. There is a long way to go, but engagement on climate change has yielded a number of positive results in the last few years and appears to be snowballing.



ENVIRONMENTAL RISK SUMMARY

Shareholder Resolution Support

In what turned out to be landmark victories for shareholders on climate change disclosure, LAPFF issued voting alerts recommending members support shareholder resolutions at PPL, Chevron and Exxon Mobil. The resolutions sought to require the companies to undertake analysis and produce publicly-available reports on the impact that a two-degree scenario, as outlined in the Paris Agreement, would have on their business and shareholder value. The resolutions at Exxon, the world’s largest oil and gas company, and PPL both received majority backing of shareholders.

Following a similar shareholder resolution at Southern Company, LAPFF met the company’s legal counsel along with other US investors. The conversation covered climate change and carbon risk, and explored how the company is best positioning itself to report its strategy for a two-degree scenario in the context of the shareholder resolution to the company, which received 46% of support from shareholders. The meeting was co-ordinated via the Forum’s partnership with the 50/50 Climate Project.

Carbon Disclosure and Scenario Planning

Carbon disclosure also featured in a number of engagement meetings and questions at AGMs. At the Rio Tinto AGM, LAPFF welcomed the company's disclosure in response to the strategic resilience resolution but pushed the company to provide greater detail. Two meetings were held with Rio Tinto's CEO which explored the company's experience of internal carbon pricing, the impact of the Taskforce on Climate-Related Financial Disclosure (TCFD) and progress on scenario planning. Similar issues were raised with Sir Peter Gershon, the chair of National Grid at the AGM.

LAPFF continued to engage with BP and Total and explored the implications of scenario planning for a faster transition, including how this related to their businesses. At the Total AGM, LAPFF also asked whether Total would be willing to report its oil and gas resources in resource-neutral gigajoules in order to compare better the value of these reserves with the value of renewables for the company. At a follow-up meeting Total confirmed that they did report in a resource-neutral way using a carbon intensity measure and also set out how their strategy was consistent with a two-degree scenario.

Low Carbon Transition

During the year LAPFF engaged with several energy and mining companies on how their remuneration policies could create incentives for an accelerated low carbon transition. LAPFF engaged with BP, Shell and Anglo American on their remuneration policies that were being put to vote at their 2017 AGMs. As result of some measures taken to link executive pay with the required low carbon transition, LAPFF issued voting alerts recommending that Members support the remuneration policy vote at BP and Shell, recognising direction of travel, despite other concerns. LAPFF's focus on creating incentives for companies to align their strategies with a two degree scenario were also raised at a number of other meetings. During a meeting with the chair of Lonmin, the Forum gained better understanding of the company's position on carbon pricing and the governmental level discussions on the issue in South Africa.



SOCIAL RISK – LINKAGE 3: SPOTLIGHT ON STAKEHOLDER ENGAGEMENT

Stakeholder engagement figures prominently in LAPFF's approach to responsible investment. From engaging with other investors and corporate boards on shareholder resolutions to meeting with unions and non-governmental organisations (NGOs) for input on social and environmental issues, LAPFF seeks to understand business issues and concerns from all sides. LAPFF undertakes this rounded engagement approach to ensure that companies' business models and business strategies are fit for purpose based on all financial and ESG risks.

Progress in engaging with companies on climate change would not have been possible without engaging with other institutional investors and NGOs. Unions have been important engagement partners on shareholder resolutions with Sports Direct and National Express. LAPFF also regularly engages with regulators on a range of issues, from reliable accounts to climate change to corporate governance reform.

The Forum looks for similar engagement and openness in investee companies. For example, in relation to National Express, LAPFF has been speaking with the Company for a number of years regarding allegations that its employment standards in its US operations are inadequate. Many of these allegations have come from employees via trade unions. Therefore, LAPFF has consistently pressed National Express to engage more openly with unions.

The situation seemed to be intransigent, but LAPFF continued to engage with both National Express and the unions, using both voting alerts and engagement meetings to encourage both parties to talk. At last year's National Express AGM, there appeared to be a breakthrough. The Company finally agreed to meet with the Teamsters union, and although it took until this year for a meeting between the two parties to take place, early indications are that this engagement has been positive. LAPFF has every confidence that, as with its FirstGroup engagement, the two parties will reach an agreement that will strengthen the company and benefit workers.

LAPFF has also observed the importance of engaging with both social and environmental stakeholders in mining projects. Often, environmental impacts lead to significant social problems that then cause operational and reputational risk for companies. Appropriate governance of and accountability for these risks and relationships is crucial for cost-effective projects that meet stated timelines and allow companies to create shareholder value.



SOCIAL RISK SUMMARY

Human Rights

Historically, much of LAPFF's engagement around human rights has been through the lens of employment standards. This approach continues to the case to a large extent with companies such as Sports Direct and Ryanair.

This year, though, the range of human rights engagements seems to have increased. For example, LAPFF engaged again on the use of cluster munitions, as well as with companies operating in Israel and the settlements. LAPFF also engaged with extractives companies facing pressure from community groups over their mining practices. These engagements reflect human rights concerns on which LAPFF has engaged previously. However, LAPFF also engaged with 21st Century Fox over its sexual harassment scandal, which seems to be snowballing across the entertainment industry and has even played a role in its attempted acquisition of Sky. This development and the government's focus on worker access to corporate boards also drives home the link between corporate governance and employment rights, highlighting the need for good human capital management, or workforce management as it is increasingly known.

LAPFF supplemented these engagements with attendance at external events on the importance of gaining free prior and informed consent (FPIC) from communities affected by corporate mining projects, child labour and its implications for investors, and the launch of the Corporate Human Rights Benchmark. Input from this range of stakeholders, plus engagement meetings with companies, allows LAPFF to develop an understanding of where legal and policy gaps exist and where company practice can be strengthened to encourage companies to develop more resilient business models and better business strategies.

Employment Standards

Employment standards continue to figure prominently in LAPFF's work on social risk. Of LAPFF's 38 engagements on social risk during the year, 21 such engagements covered employment standards. Companies engaged on this topic include Lonmin, 21st Century Fox, and National Express. However, by far the largest focus of engagement was Sports Direct, a company with which LAPFF has attempted to engage over a number of years. This past year, LAPFF issued a voting alert, attended an investor question and answer session held by Mike Ashley and attended the Company's AGM to ask again for an independent review of corporate governance and workplace conditions. LAPFF has been pleased with some developments at the Company, including the appointment of a worker representative to liaise with the Board. However, the selection process for this representative has not been made sufficiently clear in LAPFF's view to ensure that he is an appropriate representative. Furthermore, the continued corporate governance problems at Sports Direct make it unlikely that any kind of effective employee voice will make it through to Company policy or practice.

Investors have exhibited a renewed interest in the role that company work forces can play in the creation of shareholder value. Organisations such as the Pensions and Lifetime Savings Association (PLSA) and ShareAction are developing tools for investors to use in assessing how well companies account for their work forces in setting the conditions for shareholder value creation. LAPFF provided PLSA with feedback on its work force reporting tool at a Roundtable this year and submitted a number of comments and suggestions to ShareAction as it develops the Workforce Disclosure Initiative (WDI). Both tools are important developments on the path to enabling investors to understand more clearly the link between work forces and the creation of shareholder value at investee companies.

Public Health

Public health is a growing topic of interest for the Forum. During the year, LAPFF attended sessions to update investors on the Access to Nutrition Index, and in particular the India and US Spotlight Indices.

Deputy Chair Ian Greenwood also met with representatives of British American Tobacco to discuss next generation products and their impact on the overall effort to reduce health implications of smoking, as well as the effects of plain packaging and health warning signs on packages. The Forum plans to further engage on public health issues and assess the related investment risks.



MEDIA COVERAGE



Accounting Standards

There was extensive press coverage of LAPFF's position on IFRS accounting standards throughout the year. As well as pressing for proper adherence to the law on capital maintenance related matters, the Forum has also demanded that the European Commission demonstrate that it has followed a lawful procedure in endorsing IFRS 9. The Forum was also cited several times in the press after it called on the Government to give serious consideration to winding up the FRC.

LAPFF's stance on these issues was reported in the Financial Times, Investment & Pensions Europe and CityAM, among other sources.

Climate Risk and 50/50 Climate Change Project

The Forum has partnered with the 50/50 Climate Project, to support effective long-term climate change strategies amongst the public companies with the 50 largest carbon footprints. The partnership and the Forum's increased pressure over climate change risk has received good coverage in the news, including pieces in Pensions & Investments, LocalGov and Portfolio Institutional.

LAPFF Response to the Government's Corporate Governance Green Paper

The BEIS Green Paper on Corporate Governance Reform and the government's subsequent response in its White Paper have prompted much debate in 2017; LAPFF advocated in particular for alignment of executive pay with long-term performance and that a greater voice to be given to employees and consumers in the boardroom. The Forum's response was reported in IPE and has been posted on ThomsonReuter's Practical Law site.



Executive Pay

LAPFF's concerns over poor executive pay practices are long-standing and represent an ongoing governance risk. The Forum therefore frequently comments on this topic. In 2017, the Forum's views on excessive CEO remuneration packages of Martin Sorrell (WPP), Thomas Fanning (Southern Co.) and Bob Dudley (BP), were reported by Reuters, Bloomberg, Financial Time and the Guardian, to name a few.

Sports Direct

After issuing a voting alert and attending Sport Direct's AGM, LAPFF featured in the media after LAPFF member, Cllr Richard Greening, requested changes within the Company. Executive member, Jane Firth, and the LAPFF Chair, Cllr Quinn were also quoted setting out LAPFF's dissatisfaction with progress in various outlets.

Sky

Following 21st Century Fox's bid for Sky in December 2016, LAPFF was concerned that the offer undervalues the Company and called for an appropriate premium and a safeguard for future probity. The Forum's recommendation to put the bid to a shareholder vote, along with Cllr Quinn's concerns on the matter was covered by Guardian, The Street, Investment & Pensions Europe and Belfast Telegraph, among others.

LIST OF COMPANIES ENGAGED

Company	Topic	Activity	Outcome
Aberdeen Asset Management plc	Governance (General)/Employment Standards/Social Risk	Meeting/Letter	Change in process
Anglo American plc	Climate Change/Human Rights	Meeting	Change in process
Antofagasta plc	Governance	Meeting	Dialogue
Ashtead Group plc	Remuneration	AGM	Satisfactory response
AstraZeneca plc	Governance (General)	Letter	Dialogue
Aviva plc	Governance (Cybersecurity)	Letter/Letter received	Dialogue
Babcock International Group plc	Remuneration	Alert issued	Dialogue
BP Plc	Remuneration/Climate Change	AGM/Alert issued/ Meeting/Letter	Substantial improvement
British American Tobacco plc	Public Health/Supply Chain Management/ Board Composition	Letter/Meeting	Small improvement
BT Group plc	Audit Practices/Governance (Accounting Practices)	Meeting	Change in progress
Carillion plc	Board Composition/Supply Chain Management/Remuneration	AGM/Alert issued	Dialogue
EasyJet plc	Remuneration/Employment Standards/Governance	Meeting/Letter/AGM	Dialogue
EnQuest plc	Board Composition (Diversity)	Alert Issued	Dialogue
Euromoney Institutional Investor plc	Board Composition (Diversity)	Alert Issued	No improvement
GlaxoSmithKline plc	Remuneration	Alert Issued	Dialogue
Glencore plc	Board Composition/Climate Change	AGM	Small improvement
Hanwha Corp	Human Rights (Cluster Munitions)	Letter/Letter received	No improvement
HSBC Holdings plc	Governance (Cybersecurity)/ Employment Standards/Finance and Accounting	Letter /Letter received/ Meetings	Change in progress
International Consolidated Airline Group SA	Governance (Cybersecurity)	Letter	Dialogue
ITV plc	Governance (Cybersecurity)	Letter	Awaiting response
Lloyds Banking Group plc	Finance and Accounting	Letter	Dialogue
Lonmin plc	Employment Standards/Climate Change/Finance and Accounting	Letter/Meeting	Substantial improvement
Marks & Spencer Group plc	Governance (Cybersecurity)	Letter	Awaiting response
Motorola Solutions Inc.	Human Rights	Letter	Dialogue
National Express Group plc	Employment Standards	AGM	Dialogue
National Grid plc	Climate Change	Meeting/AGM	Small improvement
NRG Energy Inc	Climate Change	Alert issued	Dialogue
PPL Corporation	Climate Change	Alert issued	Substantial improvement
Prudential plc	Governance (Cybersecurity)	Letter/Letter received	Dialogue

LIST OF COMPANIES ENGAGED

Company	Topic	Activity	Outcome
Rio Tinto plc	Climate Change	Meetings	Substantial improvement
Rolls-Royce Holdings plc	Environment/Corruption	Meeting	Small improvement
Royal Dutch Shell plc	Social Risk/Human Rights Climate Change/Remuneration	Meeting/Alert issued/ AGM	Dialogue
Sainsbury plc	Governance (Cybersecurity)	Letter	Awaiting response
Samsung Electronics Co Limited	Governance/Supply Chain Management	Sent letter	Awaiting response
Segro plc	Board Composition	Letter	Awaiting response
Shire plc	Governance (General)	Letter/Meeting	Small improvement
Sky plc	Governance	Meeting	Dialogue
Smith & Nephew plc	Remuneration/Governance	Meeting	Moderate improvement
Southern Company	Climate Change	Meeting	Moderate improvement
Sports Direct International plc	Employment Standards/Board Composition/Governance	Letter/AGM/EGM/ Alerts issued/Roundtable	No improvement
SSE plc	Employment Standards (Cybersecurity)	AGM	Change in process
Standard Chartered plc	Governance (General)	Letter	Awaiting response
Standard Life plc	Governance (General)/Employment Standards/Social Risk	Meeting/Letter	Change in process
Tesco plc	Mergers & Acquisitions/ Governance (General)	Meeting/AGM	Moderate improvement
Total SA	Environmental Risk	Meeting	Substantial improvement
Twenty-First Century Fox Inc	Employment Standards	Letter	Dialogue
Vedanta Resources plc	Human Rights/Climate Change	Meeting	Dialogue
Vodafone Group plc	Governance Cybersecurity/ Remuneration/Audit Practice	Meeting/Letter	Substantial improvement
Wells Fargo & Company	Governance (General)	Alert issued	Dialogue
WPP plc	Governance (Cybersecurity)/ Remuneration	Letter/Letter received/ Alert issued	Dialogue

LIST OF MEMBERS

- Avon Pension Fund
- Barking and Dagenham (London Borough of)
- Bedfordshire Pension Fund
- Cambridgeshire Pension Fund
- Camden (London Borough of)
- Cardiff and Vale of Glamorgan Pension Fund
- Cheshire Pension Fund
- City of London Corporation
- Clwyd Pension Fund
- Croydon (London Borough of)
- Cumbria Pension Scheme
- Derbyshire County Council
- Devon County Council
- Dorset County Pension Fund
- Durham Pension Fund
- Dyfed Pension Fund
- Ealing (London Borough of)
- East Riding of Yorkshire Council
- East Sussex Pension Fund
- Enfield (London Borough of)
- Falkirk Council
- Gloucestershire Pension Fund
- Greater Gwent Fund
- Greater Manchester Pension Fund
- Greenwich Pension Fund (Royal Borough of)
- Gwynedd Pension Fund
- Hackney (London Borough of)
- Haringey (London Borough of)
- Harrow (London Borough of)
- Hertfordshire County Council Pension Fund
- Hounslow (London Borough of)
- Islington (London Borough of)
- Lambeth (London Borough of)
- Lancashire County Pension Fund
- Lewisham (London Borough of)
- Lincolnshire County Council
- London Pension Fund Authority
- Lothian Pension Fund
- Merseyside Pension Fund
- Newham (London Borough of)
- Norfolk Pension Fund
- North East Scotland Pension Fund
- North Yorkshire County Council Pension Fund
- Northamptonshire County Council
- Northumberland County Council
- Nottinghamshire County Council
- Powys County Council Pension Fund
- Redbridge (London Borough of)
- Rhondda Cynon Taf
- Shropshire Council
- Somerset County Council
- Sheffield City Region Combined Authority
- South Yorkshire Pensions Authority
- Southwark (London Borough of)
- Staffordshire Pension Fund
- Strathclyde Pension Fund
- Suffolk County Council Pension Fund
- Surrey County Council
- Sutton (London Borough of)
- Teesside Pension Fund
- The City and County of Swansea Pension Fund
- The Environment Agency Pension Fund
- Tower Hamlets (London Borough of)
- Tyne and Wear Pension Fund
- Waltham Forest (London Borough of)
- Wandsworth (London Borough of)
- Warwickshire Pension Fund
- West Midlands ITA Pension Fund
- West Midlands Pension Fund
- West Yorkshire Pension Fund
- Wiltshire County Council
- Worcestershire County Council

MEMBER SUPPORT

Guidance for members has been produced throughout the year, including media training for members on how to respond to media requests; a climate change seminar LAPFF framework and climate risk investment strategies; and surveys requesting feedback to improve member support. E-bulletins are sent to members every month covering news on LAPFF engagement themes along with the Forum's engagement activities throughout the month. Several consultations have also been produced during the year on

topics ranging from ethnic diversity and gender imbalance to climate-related disclosure and financial reporting standards.

LAPFF representatives have also addressed various member funds' pension committees and member consultative meetings throughout the year, providing information on the Forum's activities and engagement outcomes. A full list of services for members is listed below:

Company engagement	Quarterly engagement report	Consultation responses
Voting alerts	AGM briefings and attendance	Website
Investor partnership	Business meeting and presentations	E-bulletin
Information on LGPS reform	Trustee guides	Media coverage
Member briefings	Working groups	PRI/AODP reporting
Investor seminars	Shareholder resolution filing support	Event attendance
Policy guidance	Twitter presence	Training
Mentoring scheme	Fund presentations	LGPS/Pooling research

For further information on any LAPFF services or publications, please contact Lara Blecher, Engagement Services Executive – lara.blecher@pirc.co.uk



For more information about LAPFF, visit our website at www.lapfforum.org

For further information on LAPFF and membership enquiries, contact Keith Bray, Forum Officer postmaster@keithbray.plus.com or 07811 800612 or 01633 255685



Engagement information and data supplied by LAPFF's Research and Engagement Partner, PIRC Ltd – www.pirc.co.uk

For more information about LAPFF's Engagement Programme, please contact Lara Blecher at lara.blecher@pirc.co.uk

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