



**Presentation to the LGPS Advisory Board
Investment & Engagement Sub-Committee**

Local Authority Pension Funds and Active Stewardship

Report by the Local Authority Pension Fund Forum

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1. Introduction to how LAPFF operates in bringing together local authority funds to engage collectively

- 1.1 LAPFF represents the interests of 63 local authority pension funds and their members, which have combined assets of approximately £150 billion. Its mission is to protect the long-term investment interests of their beneficiaries, by promoting the highest standards of corporate governance and corporate responsibility amongst the companies in which they invest.
- 1.2 The Forum provides a unique opportunity for Britain's local authority pension funds to discuss investment issues and shareholder engagement on the basis of active stewardship.
- 1.3 LAPFF as an organisation was created by LGPS funds in 1991 and has grown into a body recognised and respected by companies, asset managers and other organisations undertaking active stewardship. It enables pension funds to exercise active stewardship for assets they hold directly and indirectly; facilitates holding asset managers to account and provides guidance on how to effectively ensure stewardship is undertaken by asset managers used by pension funds.
- 1.4 The Forum has an annually agreed research and engagement workplan. Proposals are requested prior to the Forum's annual meeting in January each year, although member funds can make suggestions at each Quarterly Business Meeting. During the year the

LAPFF executive committee meets quarterly and makes recommendations on engagement activities to the general membership.

- 1.5 LAPFF's activity is driven by its members. At Quarterly Business meetings, members discuss and approve future company and policy engagement. Members also receive detailed updates on current initiatives.
- 1.6 LAPFF is supported in its work by PIRC, the Forum's research and engagement partner and by a part time Forum Officer (a former local authority chief financial officer) who provides day-to-day liaison with its members, and promotes the benefits of LAPFF membership amongst non-member LGPS funds.
- 1.7 LAPFF is a membership organisation, with funds paying an annual fee.

2. How does LAPFF represent the engagement interests of its Member Funds?

- 2.1 One of LAPFF's strengths is in the relationships it builds with the directors of major companies. The Forum's shareholder resolutions to the AGMs of Marks & Spencer and News Corp which received high vote turnouts were based on long-term engagements with directors at these companies.
- 2.2 The Forum's influence is not restricted to companies. It can also point to numerous examples where it has successfully lobbied on policy issues on behalf of its members. Its investor criticism of accounting standards that misrepresented the capital position of financial institutions has prompted serious review by the FRC and other institutional bodies.
- 2.3 LAPFF has strength in numbers. The format of LAPFF lets funds both big and small play a part in making a difference by pooling resources and increasing their influence. Any one LAPFF member holds only small proportion of shares at FTSE companies, but together local authority funds will, on average, hold 1-2% of outstanding shares in most large-cap UK companies. They therefore have an important shareholder voice.
- 2.4 Without LAPFF, smaller funds that do not have the internal capacity to undertake engagement in their own right would not be able to exercise this aspect of their Stewardship responsibilities. LAPFF is an essential organisation to ensure that local authority pension funds' views are heard by company directors, regulators and policy makers.
- 2.5 LAPFF collaborates with other investors who bring expertise and experience to the issue, and with wider groupings through its membership of the UN supported Principles for Responsible Investment (PRI) clearing house. Collaboration works well when there is a clear agenda for engagement that has been agreed in advance by the shareholders.

Where investor views differ on certain issues, the difference of opinion needs to be made sufficiently clear in the meeting and in follow up correspondence. In LAPFF's experience, targeted collaboration on very specific issues for a set period of time is far more successful than agreements to collaborate in principle on many different issues with no set agenda or timeframe.

- 2.6 Some limitations of collaborative engagement have been experienced when the Forum has participated in engagement in partnership with other investors. These are primarily about differing agendas, objectives and approaches of the investor participants. Care must be taken to present a consistent message to the companies or regulatory bodies with whom engagement is being undertaken.
- 2.7 LAPFF has benefitted from being free of conflicts of interest that have undermined investor collaboration elsewhere. It represents asset owners with only one purpose, unlike asset managers which have a varied client base as well as their own financial and operational interests, such as pay and performance.

3. How does LAPFF create its engagement agenda?

- 3.1 Forum members can suggest new matters to be reviewed at any time during the year, with sufficient time allocated in the workplan budget for such reviews and potential consequent engagement. The monthly bulletin for members is one conduit to flag up issues of interest for members. The Forum operates a broadly similar approach to most issues: PIRC, the research and engagement partner to LAPFF, undertakes an initial investigation of the concern raised. A review is conducted by identifying the investment impact of the issue; whether it is susceptible to shareholder engagement; what comparative data may be available; and whether corporate best practice can be identified. Where the matter is primarily policy-related then PIRC will provide a scoping report for the Executive to consider, including possible responses, engagement objectives and outcomes. Subject to any suggested changes, if the report is approved by the Executive committee, it is then proposed to the next Quarterly Business meeting for adoption. The final adopted report will have benefited from collective scrutiny from the Executive and Member Funds at the Business meeting. Depending on the timing of the proposal and the urgency of the matter, action can then be taken or alternatively scheduled to be taken in the following year's annual workplan.
- 3.2 For company engagement two principal screens (on corporate governance and shareholder rights) are undertaken on relevant companies, with an analysis of LAPFF member holdings in them. A recommendation is made on future engagement programmes to the Executive.
- 3.3 Each year, LAPFF undertakes focussed face to face engagement meetings with over 30 companies on environmental, social and governance issues. This is in addition to over 30

direct letters or co-signatory initiatives. LAPFF does not represent an 'ethical' perspective, but is interested in talking to companies about reputational risks and long-term sustainable value creation.

- 3.4 What is unique about LAPFF is the fact that it acts on behalf of the LGPS funds as asset owners, and can bring a unique perspective to the engagement. Sometimes engagement undertaken through asset managers can dilute the message to companies, as asset managers will have various clients with differing interests and so investment concerns may not always be compatible. Asset managers are also under significant pressure to demonstrate financial outperformance within the relatively short investment timeframe required by their investment mandates. John Kay, in his 2012 review of short-termism in UK capital markets discusses this issue in detail.
- 3.4 In addition LAPFF's engagement has another unique feature: individual members of the LAPFF Executive, both Councillors and officers of the fund membership, actually lead the engagement meetings with companies. This does not happen in any other market engagement strategies in the UK.
- 3.5 LAPFF on the other hand represents a strong voice on issues of concern to pension fund members. Because it is the view of the underlying asset owners, it is not beholden to a short-term perspective that some investment managers may take, whether out of choice or out of necessity. In some respects LAPFF can provide a level of 'sober second thought' that takes into consideration some of the larger, more systemic and longer-term issues that may not be high on the agenda of investment managers in operating their three or five year mandates.
- 3.6 In response to LAPFF's engagement efforts, some companies query why LAPFF wants to speak to the directors and they often want to know how much stock LAPFF members hold. It is LAPFF's experience that companies are often unaware that it is the pension funds (and not the asset managers) that are the underlying beneficiaries of the investment. Although LAPFF's members, on average, collectively own 1-2% of the outstanding stock of most large British companies, this fact is not well understood by companies because the assets themselves are held through investment managers in collective investment vehicles or brokers, and therefore our members' names do not always appear on a company's share register.
- 3.7 In engagement meetings, LAPFF will often hear companies say "we have consulted with our top ten shareholders," which may mean they have consulted with the ten largest asset managers. Asset managers will take their own informed view of a company's governance. At times this view will complement the views of the underlying asset owners, but at times those views may differ. Therefore, the unique role that LAPFF can play is to provide an alternative view to the mainstream investment industry, considering issues of systemic and long-term importance to their beneficiaries.

- 3.8 LAPFF provides a vehicle that takes advantage of economies of scale to ensure engagement is conducted in a way that is cost effective for the members and does not place any undue administrative costs or burdens on the pension funds. Members are supported in this engagement by a training programme tailored to provide mentoring and coaching and to develop knowledge and expertise in particular sectors.

4. Stewardship

- 4.1 Good stewardship involves analysis of individual listed company governance arrangements, evaluation of their strengths and weaknesses measured against defined and established best practice; and establishing priorities for engagement to improve the governance weaknesses or concerns leading to engagement. Engagement involves identifying companies where there are concerns, setting out clear agendas, goals and timelines, and participating in a dialogue to move companies towards best practice. Frequently this is informed by prior engagement with companies demonstrating such best practice. LAPFF's approach is to seek to understand the company's viewpoint first, and then to provide LAPFF's informed perspective.
- 4.2 The Forum will agree meeting notes with the company to ensure a common understanding of the issues discussed and any commitments made. Verbal accounts of the meetings are provided to members at the Business meetings and a concise summary is provided in publicly available engagement reports.

5. Issues

- 5.1 There are 60 LGPS member funds in LAPFF. Irrespective of its size, each fund pays a fee of £8,350 (this is the average of the full charge of £8460 and discounted 3 year rate of £8,250) and has one vote (although, apart from the annual election of its Chair and Executive, most decisions are taken by consensus). This enables them to effectively undertake collective stewardship of over £120bn of assets with a budget of c£450,000 and is a very cost-effective opportunity for funds to receive the collective benefits of LAPFF engagement.

- 5.2 The issues addressed by LAPFF in its engagement in 2012/13 have included:

Governance (General)
Board Composition
Incentivising Executives
Reliable Accounts (Finance & Accounting)
Remuneration
Shareholder Rights
Climate Change

Employment Standards
Environmental Risk
Human Rights
Reputational Risks
Social Risk
Supply Chain Management

- 5.3 Nearly one-third of all engagement undertaken by LAPFF in 2012/13 had a positive outcome and one fifth resulted in LAPFF establishing an ongoing dialogue with the company. Where possible, LAPFF seeks to influence at the highest level of governance, meeting with Chairman and non-executive directors to exchange views.
- 5.4 When LAPFF meets with companies, the meetings are almost always led by the LAPFF chair or a member of the LAPFF executive committee, directly representing the Forum and its constituent pension fund members. In this way, the message is not diluted or influenced by being delivered by third parties or by asset managers, who may have conflicting agendas. Appendix 1 lists meetings held in the 2013 calendar year and company and LAPFF participants.
- 5.5 While LAPFF prefers undertaking 'quiet diplomacy', we are open to using the various tools at our disposal to advocate for change. In addition to meeting in private with companies, LAPFF will issue proxy voting alerts where it feels there is a particular concern to be addressed or where LAPFF believes praise is warranted. Attendance at annual meetings is another method of signalling support and providing encouragement for company boards, or to raise questions in a public forum. LAPFF has also been known to use press releases or file shareholder proposals in cases where progress has been slow or private engagement has not been effective. The primary concern at all times is what is in the best long-term interests of our members' beneficiaries and of the company.

An essential element of stewardship is transparency on engagement. LAPFF provides a Quarterly Engagement Report which is approved by members and then published externally. This provides a progress report on Forum engagement undertaken during the three month period, including the companies and issues engaged on, any engagement with regulators as well as events attended and media coverage. The Forum also provides an Annual Report of the whole spectrum of its activities on behalf of member funds. Examples of the most recent of these publications are attached and are also available on the [LAPFF website \(www.lapfforum.org\)](http://www.lapfforum.org).

Appendix 1

Company	Topics	Positions Engaged
Afren	Remuneration, Board Composition	Non-Exec Director
Associated British Foods	Employment Standards, Social Risk	Chairperson
Bellway	Board Composition, Governance (General)	Non-Exec Director
BP	Climate Change	Specialist Staff
British American Tobacco	Social Risk, Reputational Risk	Chairperson
Burberry	Remuneration, Board Composition	Specialist Staff
Centrica	Remuneration	Specialist Staff
Centrica	Environmental Risk, Social Risk	Specialist Staff
Comcast Corp	Board Composition, Shareholder Rights	Specialist Staff
Deutsche Post	Employment Standards	Specialist Staff
Freeport McMoran	Board Composition, Social Risk	Executive Director
Hewlett Packard	Audit Practices	Non-Exec Director
Imagination Technologies	Board Composition, Remuneration	Specialist Staff
Imperial Tobacco	Social Risk, Reputational Risk	Executive Director
J Sainsbury	Employment Standards, Social Risk	Specialist Staff
Legal & General	Remuneration	Non-Exec Director
Lonmin	Employment Standards, Social Risk	Chairperson
Marks & Spencer	Remuneration	Non-Exec Director
N Brown Group	Employment Standards, Reputational Risk	Specialist Staff
National Grid	Climate Change, Climate Change	Chairperson
Next plc	Employment Standards, Social Risk	Ex- Exec Director
Rio Tinto	Environmental Risk	Specialist Staff
Royal Dutch Shell	Climate Change	Specialist Staff
Societe Generale	Board Composition	Specialist Staff
Societe Generale	Remuneration	Non-Exec Director
Standard Chartered	Board Composition, Remuneration	Chairperson
Standard Chartered	Remuneration	Chairperson
Tesco	Employment Standards	Specialist Staff
Trinity Mirror	Reputational Risk, Social Risk	Chairperson
Twenty-First Century Fox	Board Composition, Reputational Risk	Non-Exec Director
WM Morrison Supermarkets	Remuneration	Chairperson