

QUARTERLY ENGAGEMENT REPORT

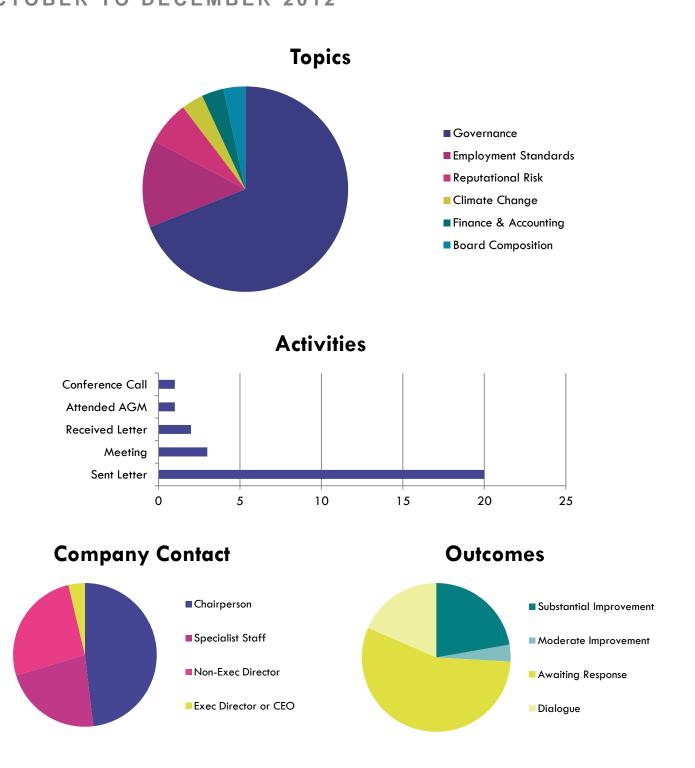
OCTOBER TO DECEMBER 2012



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 £115 billion.

ENGAGEMENT SUMMARY



ACHIEVEMENTS

- Attended the **News Corporation** AGM in Los Angeles to speak to the resolution filed by LAPFF members and Christian Brothers Investment Services asking for an independent chair. It received 67% support from independent shareholders.
- Responded to DEFRA consultation on greenhouse gas emission reporting regulations flagged up the Forum's long-term support for **mandatory carbon emission reporting** being brought into effect by the regulations. Met with **BP**, together with CCLA, to discuss their carbon emissions management and positioning for a low carbon economy.
- Launched the 'Smith Institute' report '**Investing for Growth**' at a parliamentary event in October, co-sponsored by LAPFF. The Forum's '**People and Investment**' report was launched at the Forum's annual conference.
- Continued to engage companies and policy-makers on the basis that international accounting standards can overvalue assets and supported an USS-led investor coalition promoting **IFRS reform**. This position is beginning to be vindicated by statements by the Financial Policy Committee of the Bank of England.
- Discussed labour relations, succession planning and board diversity with **National Express**. Held a follow-up conference call focussed on employee relations in the US.
- Met with the chairman and chair of the audit committee of **Royal Bank of Scotland** to discuss IFRS, 'true and fair view' accounting, as well as recent fines and reputational risk in the banking sector.

THE FORUM IN THE NEWS

Independent Chair at News Corporation - <u>Bloomberg TV</u>, CNN, CNBC, <u>Sydney</u> <u>Morning Herald, Independent, Guardian</u>, Telegraph

'Aiming for A' Improving carbon reporting at UK companies - Financial Times

'People and Investment' Report - <u>The Independent</u>, <u>Employee Benefits</u>, <u>Board</u> <u>Talk</u>, Global Proxy Watch

International Financial Reporting Standards - <u>Responsible-Investor.com</u>, <u>Financial</u> <u>News</u>, <u>IPE</u>, <u>Financial Times</u>

Infrastructure Investment: Public Finance, Guardian

View more press coverage: <u>http://lapfforum.org/TTx2/press/in-the-news</u>

COMPANY ENGAGEMENT

LEADERSHIP ON KEY CAMPAIGNS

The LAPFF chair, Ian Greenwood, attended the AGM of **News Corporation** in Los Angeles and spoke in support of the resolution for an independent Chairman as part of ongoing constructive dialogue with company directors. Two LAPFF funds were co-filers on the resolution. In the run-up to the AGM the Forum spoke with several large News Corp shareholders and proxy advisory services. Subsequently both big US advisers, ISS and Glass Lewis, recommended a vote in favour of the resolution, and major investors including CalPERS and CalSTRS also stated their public support.

The resolution for Independent Chair at **News Corp** received 30% of the shareholder vote. Excluding the Murdoch family stake, this represents 67% of the vote.

LAPFF's participation in the investor group of the **30% Club**, continued with the group issuing an update on its Best Practice Guidelines on board diversity, '<u>Diversity and Stewardship: the</u> <u>Next Steps</u>' at an event to mark the second anniversary of the Group at the London Stock Exchange. The update includes proposed voting policies to promote diverse boards.

PROMOTING GOOD GOVERNANCE

Global Focus List Engagement

LAPFF wrote to fifteen companies, listed in the UK, US, France, Spain, Switzerland and Sweden. These companies have been selected for engagement by evaluating company performance on key governance issues. Companies include **Flir Systems**, a former focus list constituent, **Société Générale** where a LAPFF fund co-filed a resolution in 2011 relating to combined roles at the head of the company, and **Carnival Corporation**, where there are ongoing health and safety concerns. The Forum also wrote to five companies that achieved the highest scores in our evaluation in each of the markets to commend them on their good governance practices.

People & Investment Value

The Forum launched a new publication at the annual LAPFF conference entitled the Forum's publication 'People and Investment Value: Appraising Employee Value Propositions to Distinguish Corporate Performance.' The report identifies how companies can create

"The science tells us committed, as opposed to motivated staff (at all levels), are driven by purpose, a desire to connect with like-minded colleagues, autonomy, mastery and a sense of achievement and progress."

-'People & Investment Value' Report

sustainable value using non-monetary mechanisms to attract, retain and motivate staff. Formulated as a guide for investors, it sets out questions investors can raise with companies or their investment managers.

The questions will enable investors to a) distinguish between companies with compelling employee value propositions and those with weak employee value propositions, b) engage with companies on this basis, and c) provide a platform to encourage companies to improve operating and stock price performance through better human capital management.

Financial Reporting & Audit

In December, the Financial Policy Committee of the Bank of England warned that banks have been over-optimistic in valuing their books and will have either to restructure their businesses or raise new capital, and to do that will require prudent accounting. LAPFF continues to call for change to international accounting standards and is working with an investor group including the Universities Superannuation Scheme, Royal London Asset Management and others. The group has set out a position paper arguing that International Financial Reporting Standards (IFRS) has failed UK companies and has not provided investors with sufficient assurance that accounting figures prepared under the IFRS provide an accurate picture of the financial health of companies.

A <u>second position paper</u> signed by LAPFF together with twenty-eight other investors expresses deep concern regarding the failure of **auditors** to provide investors with adequate warnings prior to the financial crisis. It highlights problems in the audit profession and calls for improvements to audit quality, mandatory rotation of audit firms at a minimum every fifteen years, mandatory re-tendering every five to seven years, and setting limits on non-audit work conducted by the auditors.



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LAPFF finished its round of meetings with UK banks, with a meeting with the chairman and audit committee chair of **Royal Bank of Scotland** this quarter. At the meeting, the Forum raised its concerns about accounting standards and the risks they pose to shareholder capital, and sought the company's perspective on the issue.

MANAGING ENVIRONMENTAL RISK

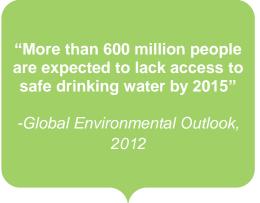
Climate Change

The Forum's ongoing involvement in influencing carbon management at corporations continued with the 'Aiming for A' engagement, in conjunction a group of UK charities and pension funds led by investment firm CCLA. The focus of the initiative is on engaging high emitting utilities and extractive companies that have been identified as slower than their peers in implementing carbon reduction measures. An initial meeting was held with representatives of **BP** where we discussed how companies can balance short-term demands against long-term regulatory requirements. Shareholder resolutions are planned for 2013/2014 for those companies that do not provide evidence of how they are improving.

The LAPFF Chair, Ian Greenwood, also met with the Chair of the Institutional Investor Group on Climate Change (IIGCC), Donald Macdonald, to explore where the Forum might align its policy work with that of the IIGCC. The IIGCC has recently announced an agreement to work with similar investor networks in the US and Australia to form the Global Investor Coalition on climate change (GIC).

Environmental Risk Management

In collaboration with other investors, LAPFF helped increase corporate responses to the CDP Water **Disclosure Project**. Overall, investors wrote to 41 companies in 2012 that had not yet committed to improve disclosure of water-related risks. Five of the companies later agreed to respond to the annual water questionnaire. Both Marathon Oil and McDonalds agreed to improve water disclosure after receiving letters co-signed by LAPFF. Despite these successes, overall engagement for the group was less effective than in 2011. Future engagement will focus on supply and/or operational risks in the food, beverage or textiles sector.



TARGETING SOCIAL ISSUES

Employment Standards

Engagement with **National Express** continued in October as LAPFF met with the company to discuss unionisation in the US and board diversity issues. Following meetings with union representatives in the US, LAPFF held a second conference call in November. LAPFF outlined its concerns regarding the company's approach to labour relations in the US and there was an agreement to meet again in the New Year.

The Forum also wrote to **Tesco** this quarter to discuss the future of the US business Fresh & Easy. LAPFF previously identified Tesco's Fresh & Easy subsidiary as presenting certain risks, as it faced significant commercial challenges. There have also been questions regarding human capital management, with reduced staffing levels affecting employee morale and customer service.

CONSULTATIONS & PUBLIC POLICY

ENGAGING POLICY MAKERS

LAPFF is a member of the Investor Network on Climate Risk, which now forms part of the new Global Investor Coalition on Climate Change (GIC). GIC, together with UNEP FI and PRI, <u>released a letter</u> to the governments of the world's largest economies calling for stronger climate and clean energy policies. The letter was announced ahead of international climate negotiations in Doha and coincided with the public launch of GIC.

The Forum met with Baroness Hogg, chair of the **FRC** and Roger Marshall an FRC Board Member to raise concerns regarding IFRS-audited accounts. LAPFF believes that the IFRS accounts of the UK's largest banks do not provide investors with a 'true and fair' view of companies' financial position. The discussion was productive, and extended to cover issues related to the ownership and stewardship responsibilities of investors more generally.

CONSULTATION RESPONSES

LAPFF responded to a consultation on **greenhouse gas emission reporting regulations** in October, by the Department for the Environment, Food and the Regions (DEFRA). Having long pushed for mandatory reporting, the Forum welcomed the new regulations for providing more consistent advice and support to businesses. The Forum noted that companies need to provide adequate information so investors can determine how carbon management is being factored into business strategy. The Forum further commended the principles-based approach of the Carbon Disclosure Standards Board which aims to align reporting with existing principles and objectives of financial reporting.

The Institute for Chartered Secretaries and Administrators, **ICSA**, issued a consultation this quarter on engagement between companies and investors. LAPFF welcomed the ICSA approach but suggested that an overly bureaucratic approach to engagement can dilute the investor message and lead to less productive outcomes in company meetings. The Forum does not see a need for any intermediary mediation service and prefers direct engagement with company representatives.

The Department for Communities and Local Government's consultation on **Investment in Partnerships** afforded the Forum an opportunity to set out its view on amendments that might appropriate to remove barriers that currently prevent scheme funds from investing in infrastructure projects. The Forum supported the proposal for an increased limit of 30% on investment in limited partnerships. The response also highlighted recent research by the <u>Smith</u> <u>Institute</u>, which was co-sponsored by LAPFF.

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

NETWORKS & EVENTS

The LAPFF conference met the usual high expectations with a sell-out event in Bournemouth, with the keynote speaker, **Robert Swannell** chair of M&S starting the event with high praise for the Forum in its previous engagement with the company. Sir Michael Darrington set out his vision for the future on a panel discussing the problem of ballooning executive pay. The panel on the banking crisis addressed concerns regarding IFRS and highlighted the growing chorus of investors voicing concerns. The conference ended with a fascinating keynote speech by Michael Woodford, the former CEO of Olympus, on his experience exposing widespread fraud and mismanagement by the company's directors. Next year's event is expected to take place in Bournemouth in late November or early December 2013.

- 'Investing for Growth' parliamentary report launch
- **Board Evaluation** seminars by Board Insight & Ffion Hague
- Institutional Investor Group on Climate Change AGM
- Church Investors Group observer during CDP session
- Plastic Disclosure Project webinar on plastic risks
- Focussed on the Future, Martin Currie conference on global investment

LAPFF co-sponsored a report, '**Investing for Growth**' which looks into opportunities and barriers to local authority pension fund investment in local projects that offer wider socioeconomic benefits. The report was launched at a parliamentary event in October chaired by Clive Betts MP, chair of the DCLG select committee, Paul Hackett of the Smith Institute, and Ian Greenwood.

LAPFF representatives also attended two events that explored current best practice and relevant success factors in revising the UK Corporate Governance Code. The Code introduced provisions on board evaluation almost ten years ago, and more recently has suggested that FTSE 350 companies should have their board evaluations externally facilitated at least every three years.

COMMUNICATIONS

Forum communications have had a 'revamp' with a redesigned website (<u>www.lapfforum.org</u>), the publication of LAPFF's 2012 <u>Annual Report</u>, and an update to the layout and format of the members' monthly email bulletin.

COMPANY PROGRESS REPORT

Company	Торіс	Progress
ASML Holding	Governance	Awaiting Response
Assurant Inc.	Governance	Awaiting Response
Bellway	Governance	Awaiting Response
BNP Paribas	Governance	Awaiting Response
BP plc	Climate Change	Dialogue
Burberry	Governance	Awaiting Response
Carnival Corp	Governance	Awaiting Response
Centrica	Governance	Awaiting Response
Coach Inc.	Governance	Awaiting Response
Cognizant Technology Solutions	Governance	Awaiting Response
Comcast Corp	Governance	Awaiting Response
CRH plc	Governance	Awaiting Response
Flir Systems	Governance	Awaiting Response
Freeport McMoran	Governance	Awaiting Response
Imagination Technologies	Governance	Awaiting Response
Inditex	Governance	Awaiting Response
Lindt & Sprungli	Governance	Awaiting Response
Marshalls	Governance	Awaiting Response
National Express	Employment Standards	Dialogue
News Corporation	Board Structure, Reputational Risk	Dialogue
Resolution Ltd	Governance	Awaiting Response
Royal Bank of Scotland	Finance & Accounting	Dialogue
Société Generale	Governance	Awaiting Response
Svenska Handelsbanken	Governance	Awaiting Response
Tesco	Employment Standards, Reputational Risk	Dialogue



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 £115 billion.

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



Aberdeen City Council Avon Pension Fund Cheshire Pension Fund Derbyshire CC Dorset County Pension Fund Falkirk CC Greater Gwent Fund Gwynedd Pension Fund Hackney LB Harrow LB Hounslow LB Lancashire County Pension Fund Lincolnshire CC London Pension Fund Authority Lothian Pension Fund Merseyside Pension Fund Newham LB North East Scotland Pension Fund North Yorkshire CC Pension Fund Northamptonshire CC Nottinghamshire CC Shropshire Council South Yorkshire Integrated Transport Surrey CC Teesside Pension Fund Tower Hamlets LB Tyne and Wear Pension Fund Warwickshire Pension Fund West Midlands Pension Fund West Yorkshire Pension Fund Worcestershire CC