**Pension Fund Committee**

Meeting to be held on 6 September 2013

|  |
| --- |
| Electoral Division affected:  'All' |

**Fund Shareholder Voting and Engagement Report**

(Appendices 'A' and 'B' refer)

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| --- |
| Executive Summary In accordance with its policies on promoting corporate social responsibility in the businesses in which it invest the Fund works through Pensions and Investment Research Consultants Ltd (PIRC) as its Governance Adviser and the Local Authority Pension Fund Forum (LAPFF) to both ensure that shares are voted in accordance with sound governance principles and influence companies' behaviour.  This report provides the latest quarterly update for the Committee on the work undertaken on the Fund's behalf by PIRC and the engagement activity undertaken by LAPFF.  The attached report from PIRC (Appendix 'A') covers the period 1 April to 30 June 2013. The Fund has voted on 2,866 occasions and has opposed or abstained in 29% of votes. PIRC recommends not supporting resolutions where it does not believe best governance practice is being applied. PIRC’s focus has been on promoting independent representation on company boards, separating the roles of CEO and Chairman and ensuring remuneration proposals are aligned with shareholders’ interests.  The attached engagement report from LAPFF (Appendix 'B') also covers the period 1 April to 30 June 2013.  Details of live class actions in relation to companies in which Lancashire County Pension Fund has, or had, owned shares is also set out in the report. Recommendation The Committee is asked to note the report. |

**Background and Advice**

# Shareholder Voting and Governance

# PIRC, acts as the Fund's proxy and casts the Fund's votes on its investments at shareholder meetings. PIRC are instructed to vote in accordance with their guidelines unless the Fund

# instructs an exception. PIRC analyses investee companies and produces publically available voting recommendations to encourage companies to adhere to high standards of governance and social responsibility. The analysis includes a review of the adequacy of environmental and employment policies and the disclosure of quantifiable environmental reporting. PIRC is also an active supporter of the Stewardship Code, a code of practice published by the Financial Reporting Council with the aim of enhancing the quality of engagement between institutional investors and companies.

# There may be occasions when the Fund wishes to cast a vote at a shareholder meeting in a way which does not accord with PIRC's recommendations. For example, an investment manager might request the Fund to vote in a particular way to support or oppose a corporate action. Such requests would be considered by the Fund on a case by case basis and PIRC instructed to cast the Fund's vote accordingly.

PIRC also lobbies actively on behalf of its investing clients as well as providing them with detailed support. It works closely with NAPF (the National Association of Pension Funds) and LAPFF (the forum of Local Authority Pension Funds).

# PIRC's quarterly report to 30 June 2013 is presented at Appendix A. This report not only provides details of the votes cast on behalf of the Fund but also provides a commentary on events during the period relevant to environmental and social governance issues.

# In addition PIRC produces a detailed document which is reviewed by the Fund's officers, which sets out the circumstances and reasoning for every resolution opposed, abstained or withheld. This document is available on request.

# The Fund's voting record using PIRC as its proxy for the three months ended 30 June 2013 is summarised below:

**TABLE 1: GEOGRAPHIC VOTING OVERVIEW**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Geographic Region | Meeting | Resolutions | For | Oppose | Abstain | Withheld | Non-Voting |
| UK | 17 | 354 | 279 | 32 | 43 | 0 | 0 |
| EU | 42 | 584 | 376 | 109 | 30 | 0 | 67 |
| JAPAN | 25 | 315 | 274 | 40 | 1 | 0 | 0 |
| NORTH AMERICA | 118 | 1404 | 749 | 418 | 61 | 173 | 1 |
| SOUTH AND CENTRAL AMERICA | 8 | 42 | 14 | 22 | 0 | 6 | 0 |
| ASIA | 16 | 144 | 84 | 51 | 9 | 0 | 0 |
| REST OF THE WORLD | 4 | 23 | 12 | 6 | 3 | 0 | 2 |

**TABLE 2: ANALYSIS OF UK ALLSHARE VOTING RECOMMENDATIONS**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Resolution Type | For | Percentage % | Abstain | Percentage % | Oppose | Percentage % | Total |
| Annual Reports | 10 | 58.82 | 3 | 17.65 | 4 | 23.53 | 17 |
| Remuneration Reports | 1 | 5.88 | 5 | 29.41 | 11 | 64.71 | 17 |
| Articles of Association | 1 | 100.0 | 0 | 0.0 | 0 | 0.0 | 1 |
| Auditors Appointment | 8 | 47.06 | 8 | 47.06 | 1 | 5.88 | 17 |
| Directors | 156 | 84.78 | 19 | 10.33 | 9 | 4.89 | 184 |
| Dividend | 14 | 100.0 | 0 | 0.0 | 0 | 0.0 | 14 |
| Executive Pay Scheme | 1 | 16.67 | 0 | 0.0 | 5 | 83.33 | 6 |

The Fund was party to 2,866 resolutions during this period, of which 62% resulted in positive votes for shareholder resolutions and 29% were opposed or an abstention given. Voting abstention is regularly used by institutional investors as a way of signalling a negative view on a proposal without active opposition. In addition, within certain foreign jurisdictions, shareholders either vote for a resolution or not at all, opposition to these votes is described as vote withheld. These totalled 179 within the period, just over 6%. The remaining agenda items required no vote.

In relation to the **UK**, this quarter's report focuses upon remuneration issues at Aggreko plc, issues with external audit fees at Rolls Royce Holdings plc, and regulatory criticisms at Prudential plc. In addition, the corporate governance of Halifax Bank of Scotland (HBOS) was noted as “a model of self-delusion, of the

triumph of process over purpose”, according to the Parliamentary Commission on Banking Standards (PCBS).

Within **European** markets, Swiss shareholder groups taking action over executive pay was noted, as well as the difficulties faced by the Spanish banking sector in maintaining acceptable levels of corporate governance. The biggest German bank, Deutsche Bank, witnessed significant opposition to its supervisory board and some other resolutions put to vote at its AGM. In addition, Deutsche Post DHL faced accusations at its AGM that it abuses workplace rights in some countries in which it operates. Regarding employee directors and diversity, the proportion of females at board level is significantly higher amongst companies that have employee representation than those that don’t, PIRC has found.

Within the **United States**, the quarterly report references several shareholder-relevant events involving several major US listed companies including Hewlett-Packard, News Corp, JP Morgan, and Walmart. In addition, two leading governance practitioners called for directors of US companies to be more open to engagement with shareholders.

# Shareholder Engagement through LAPFF

Lancashire County Pension Fund is also a member of the Local Authority Pension Fund Forum (LAPFF), which 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.

Members of the Committee may be interested to note the attached engagement report from LAPFF (Appendix B) which covers the period 1 April to 30 June 2013.

It sets out details of their activities in influencing governance, employment standards, reputational risk, climate change, finance and accounting, and Board composition, and provides a slightly different and wider perspective than the PIRC report.

# Class Actions

**United States**

The Fund has appointed Barrack, Rodos and Bacine (BR&B) to provide a US class actions monitoring service with the aim of ensuring that the Lancashire County Pension Fund receives allmonies due to the Fund by filing its proof of claim from these cases. This service is at no cost to the Fund.

BRB will identify class actions where the Fund has a potential loss arising from an alleged fraud or a securities law violation. This is achieved by the BR&B 'BEAMS' monitoring system which follows each securities case from the beginning to the end by ensuring its filing of the proof of claim so that the Fund may receive its payment.

Occasionally the Fund may be asked to participate in a class action, and/ or to apply to become the lead or co-lead plaintiff, but under US law any shareholder subject to such a loss will be automatically entered into and benefit from a class action without having to file an individual claim.

Details of current US live cases to 30 June 2013 are set out below:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Company Name** | **Ticker** | **Effective Class Period Begin** | **Effective Class Period End** | **Case Status** | **Estimated Loss--FIFO** | **Estimated Loss--LIFO** |
| Medtronic, Inc. | MDT | 08/12/10 | 03/08/11 | NEW | ($27,712.00) | ($27,712.00) |
| CenturyLink, Inc. | CTL | 08/08/12 | 14/02/13 | ACTIVE | ($521,629.00) | ($521,629.00) |
| Barrick Gold Corp. | ABX | 07/05/09 | 23/05/13 | ACTIVE | ($364,669.00) | ($411,360.00) |
| Intuitive Surgical, Inc. | ISRG | 19/10/11 | 18/04/13 | ACTIVE | ($251,535.00) | ($251,535.00) |
| ITT Educational Services, Inc. | ESI | 24/04/08 | 25/02/13 | ACTIVE | ($760,060.00) | ($678,368.00) |
| Verisign, Inc. | VRSN | 25/06/12 | 25/10/12 | ACTIVE | ($246,205.00) | ($246,205.00) |

(Losses are typically valued either on FIFO (First In First Out) or LIFO (Last In First Out) accounting methodologies.)

**United Kingdom**

Unlike class actions within the US jurisdiction, where all relevant recipients benefit from a class action when filed, class actions within the UK require investors to file their actions individually in order to potentially benefit from a successful class action.

The Fund previously held significant share holdings in Royal Bank of Scotland during which time it is alleged that the company materially misled investors with respect to its sub-prime-related credit market exposure, and in addition allegedly misreported other asset values and goodwill. These alleged actions, it is argued, caused investors to suffer losses relating to a subsequent Rights Issue on 30 April 2008. A class action against RBS on behalf of investors has been in development over the last two years and is now at the point where individual investors need to decide whether or not to participate. Lancashire County Pension Fund's potential losses arising out of the Rights Issue is estimated at $3.2million, although there is no guarantee that all or any of these losses can be recovered.

Whilst insurance to the value of £15m has now been secured by the lead legal firm, there is still a risk of cost exposure dependent upon relative holdings and number of participants should the insurance in place be insufficient in the event of a lost case. The amount of recoverable losses is also subject to debate, particularly given the legal fees that will be 'top-sliced' prior to any recovered amounts being distributed. Consequently, and in keeping with the majority of other affected LGPS, the Fund is keeping a watching brief over developments. The deadline for filing a claim, after which the case would be statute-barred, is April 2014.

In order to facilitate transparent and effective decision-making, a class action protocol is currently being developed to enable the relevant criteria to be assessed in advance of participating in a non-US class action or where a request is made by BR&B for the Fund to consider applying for lead plaintiff. Since Lancashire County Pension Fund has not previously applied for lead plaintiff status, advice is currently being taken from other Funds with such experience in order to benefit from it.

**Ethical Investment**

Following discussion of ethical investment issues at the March meeting of the Committee, a number of LGPS funds have also considered their position and an update will be provided at the Committee's next meeting.

# Consultations

N/A

**Implications**:

It is a key component of good governance that the Fund is an engaged and responsible investor complying with the Stewardship Code.

Well run responsible companies are more likely to be successful and less likely to suffer from unexpected scandals.

**Risk management**

The promotion of good responsible corporate governance in the companies the Fund is invested in reduces the risk of unexpected losses arising as a result of poor over-sight and lack of independence.

Involvement in a non-US class action may result in losses incurred being recovered for the Fund, but should a case be lost then the Fund may incur related costs which may not be known with certainty at the time of filing. Applying for lead plaintiff status in the US may incur significant officer time and resources in bring a potential case to fruition.

##### Local Government (Access to Information) Act 1985

##### List of Background Papers

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| N/a |  |  |
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