

QUARTERLY ENGAGEMENT REPORT

JULY TO SEPTEMBER 2014



Voting machines at National Grid AGM

Local Authority Pension Fund Forum (LAPFF)

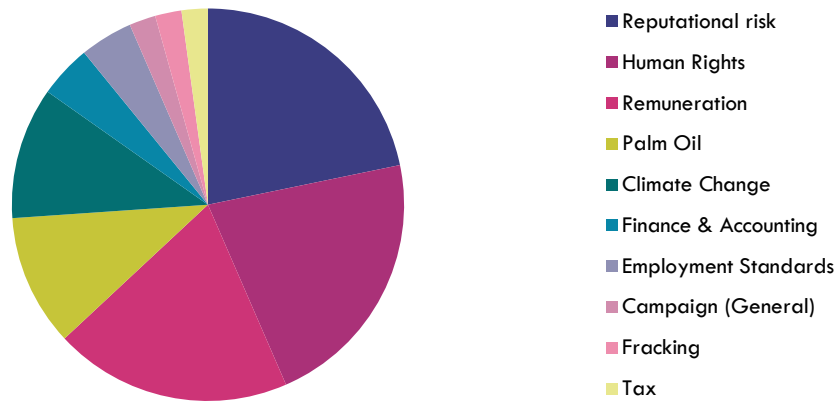
LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting social responsibility and corporate governance at the companies in which they invest. Formed in 1990, LAPFF brings together a diverse range of local authority pension funds in the UK with combined assets of over £150 billion, www.lapfforum.org.

ENGAGEMENT SUMMARY

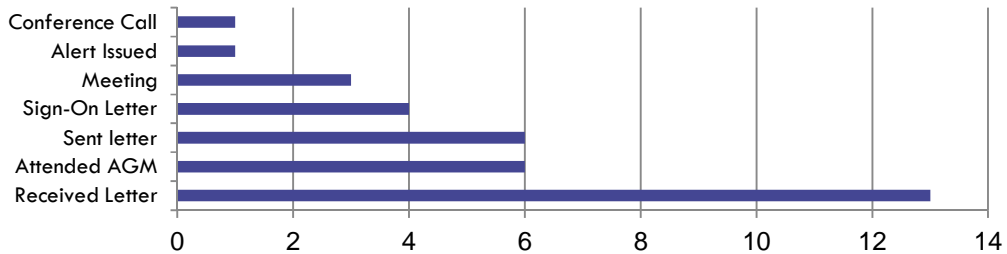
JULY TO SEPTEMBER 2014

The Forum engaged with **30 companies** over the period

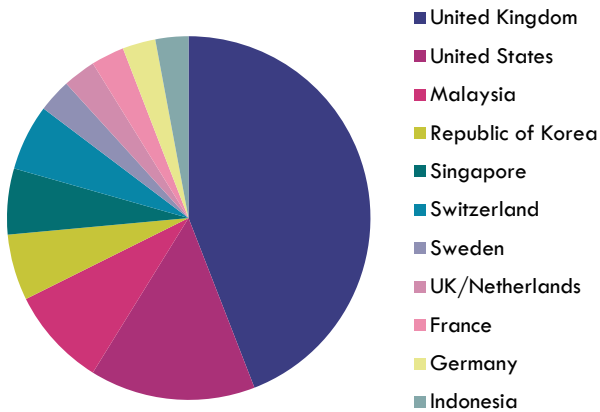
Topics



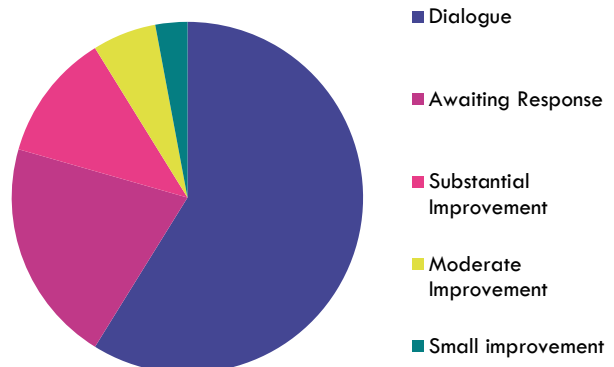
Activities



Company Domicile



Outcome



ACHIEVEMENTS

During the Quarter, LAPFF has maintained a consistent profile, engaging on governance and corporate responsibility concerns and publicly raising significant shareholder issues by direct questioning at company AGMs as part of the engagement process.

- Cllr Greening questioned the board on the links between executive pay and longer term climate risks and mitigation strategies at the **British Land** AGM.
- Asked the chair of **Vodafone** at the AGM about excessive executive pay, given the Company's performance has not been very strong over the past year. Received response to Cllr Greening's question that bonuses rarely result in a 100% payout and that the long term incentive metric outperformed the market.
- Cllr Greening also questioned **Betfair** at its AGM over illegal dividends and share buybacks after LAPFF issued a voting alert on this topic.
- Cllr Cameron Rose attended the **BT Group** AGM to ask how the Company ensures that its customer service performance is adequately reflected in pay incentives when the importance of this area has been downgraded in the performance metrics.
- Raised concerns over remuneration at the **Burberry** AGM in light of the increase in salary and other arrangements for the newly appointed CEO Christopher Bailey.
- Attended the **National Grid** AGM to continue engagement around progress towards achieving a top level within the Carbon Disclosure Project's Climate Performance Leadership Index. Were told that LAPFF was the first investor group to raise the issue of progress on reporting Scope 3 emissions.
- After collaborative engagement on sustainable palm oil practices, **Sime Darby, Kuala Lumpur Berhad, Asian Agri Resources** and **IOI Group** have announced an immediate moratorium on clearance of high carbon stock forests.
- Met with **G4S**'s senior independent director to discuss changes at the head of the company and the effect on operational and reputational risk management including challenges from complex, international contracts, diversity and succession planning.
- Met with **Glencore** for a second time on carbon management within the Aiming for A investor initiative, as well as raising other social and governance risk management concerns.
- Pursued previous engagement with **BAE** by meeting with the chair, Sir Roger Carr. Topics covered anti-corruption processes, executive pay and gender diversity at board level as well as throughout the company.



British Land AGM



National Grid AGM

THE FORUM IN THE NEWS

Director Remuneration
[Lexology](#)

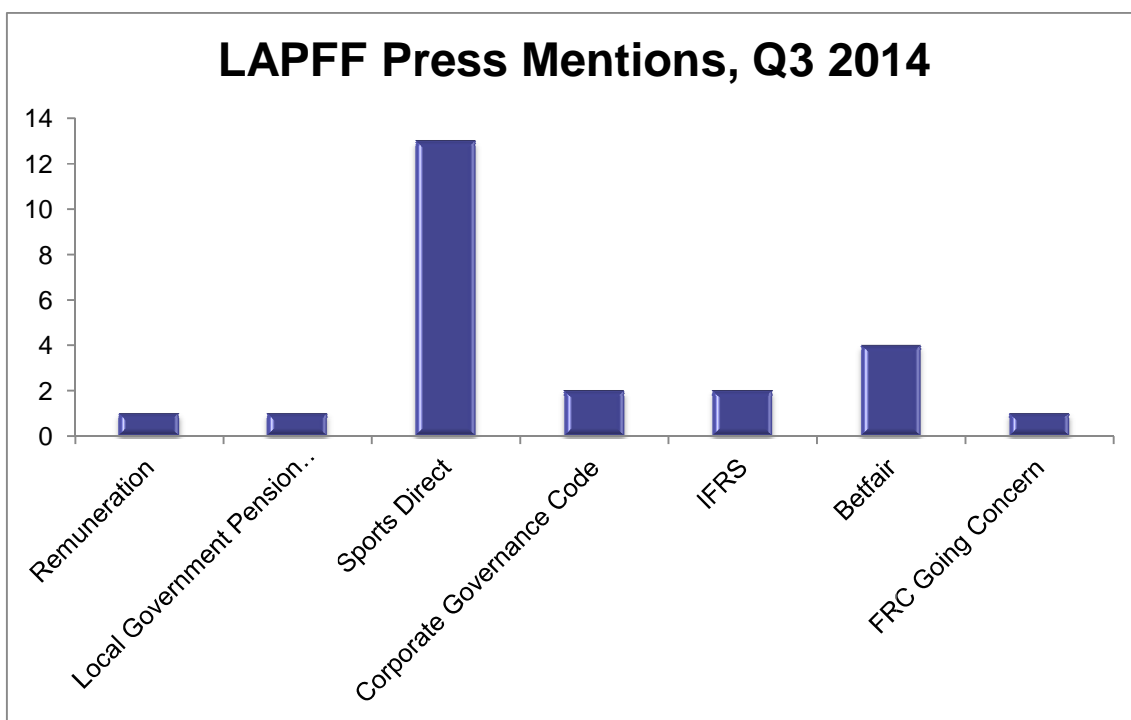
Local Government Pension Schemes
[Local Government Chronicle](#), [Investment and Pensions Europe](#)

LAPFF targets SportsDirect over Mike Ashley's pay package
[City A.M.](#), [Reuters](#), [Investment & Pensions Europe](#), [The Guardian](#), [BBC](#), [Evening Standard](#), [The Journal](#), [Express and Star](#)

Corporate Governance Code
[Financial Times](#), [Accountancy Age](#)

IFRS Failings
[Professional Pensions](#), [Investment and Pensions Europe](#), [Financial Director](#)

Betfair
[Sunday Telegraph](#), [SBC News](#), [economia](#), [Financial News](#), [Shares Magazine](#)
[Chinese press](#).



COMPANY ENGAGEMENT

LEADERSHIP ON KEY CAMPAIGNS

The issue of the production and sale of cluster munitions was raised at the June executive meetings and LAPFF agreed to engage with nine aerospace and defence companies over the production and sale of cluster munitions. The concern is that these weapons kill people indiscriminately and that they continue to be dangerous after conflicts have ended. Of the companies contacted – **Textron, ATK, L-3, General Dynamics, Lockheed Martin, Doosan, Hanwha** and **Singapore Technologies** – four have responded to letters requesting confirmation that these companies do not produce or sell cluster munitions.

By and large, the responses received so far state that the companies do not produce or sell cluster munitions within the definition of the Oslo Convention. However, neither the U.S. nor South Korea – both of which are major clients of these firms – have ratified or acceded to the Oslo Convention. This lack of state commitment to the law makes it more difficult to discern the extent of companies' involvement.

A meeting was held with the chair of **BAE**, Sir Roger Carr, to discuss cluster munitions and to follow up from previous meetings with the company. Sir Roger provided assurances that BAE is completely compliant with the terms of the Oslo Convention, which is the international law that bans cluster munitions. The meeting gave the opportunity to assess progress on anti-corruption processes, looked at simplification of pay arrangements and assessed the measures BAE was putting in place to ensure not only board diversity, but gender diversity throughout the company.

PROMOTING GOOD GOVERNANCE

Executive Pay

LAPFF continues to push companies on their executive pay arrangements, especially in relation to rewards for sub-par performance and on complexity. At the **Vodafone** AGM, Cllr Greening asked Chairman Gerard Kleisterlee how the Company could have rewarded its executives with variable pay when the financials for the year were not good. Mr Kleisterlee responded that bonus payments rarely reach a 100% payout and that metrics informing the long term incentive plan outperformed the market. However, he did not address the lack of a link between pay and performance.



A second meeting with the senior independent director of **G4S**, aimed to ascertain whether changes at the head of the Company have led to better operational management on the

ground and have lessened reputational risk. The new chief executive, Mr Almanza, appears to be making significant changes, and post-Olympics, the company believes there is improved contract assurance and greater scrutiny of contracts with newly established risk committees at the executive and board levels to deal with complex contracts. LAPFF again raised the issue of pay complexity. The company has engaged extensively with its major shareholders, but has come up against opposing investor opinion on metrics. A follow-up phone call established that some elements of the EPS adjustments were confusing and would be removed.

Complex pay arrangements are also of concern at **Hays**. Hays' scheme is problematic in that it has too many components, six in total, thus making it difficult for investors to track payments and whether the payments were deserved. LAPFF has written to the company seeking a meeting. At the **BT** AGM, Cllr Rose asked how pay incentives helped improve customer service given that the relative importance of customer service has dropped in the Company's performance metrics for executives.

Reliable Accounts

Betfair has stated in its Annual Report that it paid illegal dividends and share buyback distributions for the years 2011, 2012 and 2013. LAPFF issued a voting alert ahead of the September AGM aiming to hold relevant Board members responsible for the distribution payments. The alert includes a recommendation to abstain on the resolution approving the payment of dividends for the year under review as it is not clear that the accounting problems have been remedied. It appears that the illegal dividends were paid in part because the Company's accounts were not audited in line with the 'true and fair view' standard set at law.

MANAGING ENVIRONMENTAL RISK

Palm oil

LAPFF's engagement with companies to encourage sustainable palm oil production and supplies has met some success. A group of palm oil growers, including **Sime Darby, Kuala Lumpur Berhad, Asian Agri Resources** and **IOI Group**, released a 'Sustainable Palm Oil Manifesto' directed at ensuring future palm oil developments are subject to high standards of environmental protection and limit deforestation. While the Manifesto might be regarded as a step forward, LAPFF shared concerns that it does not set the same strong standards as those followed by major industry leaders whom the Forum has supported such as Wilmar and Golden-Agri.



The Manifesto does not adequately extend to the companies' third party suppliers or protect peatlands and allowed the companies to continue deforestation while definitional issues are resolved. LAPFF again co-signed letters with Green Century Capital Management to raise these concerns with these companies, seeking an immediate moratorium on deforestation and

requested the companies adopt a time-bound plan for fully traceable palm oil. By mid-September members of the Palm Oil Manifesto Group announced that they would be adopting an immediate moratorium on clearance of high carbon stock forests.

LAPFF is continuing to work with the **PRI Investor Group** and is participating in collective engagement with the largest buyer of palm oil from an Indonesian supplier on working to find a way to engage with that supplier over concerns with its practices for palm oil production.

Energy and Environmental Risk



LAPFF has continued to engage on climate risks at AGMs during the 2014 season. At the **British Land** AGM, Cllr Greening focussed on the extent to which the Company has considered future climate impacts in land purchase and developments, particularly flood and inundation risk. The board was also asked about the Company's influence with local authorities to

improve sustainability and resilience factors in housing and commercial developments. The concern is that if climate impacts have not been considered adequately, both in location and design, British Land developments could face longer term risks from extreme weather or other environmental impacts. If these risks materialise, they could affect shareholder value.

This extended notion of climate risks was reflected in the question asked to Sir Peter Gershon, the **National Grid** chairman, at the company's AGM regarding measurement and reporting of Scope 3 emissions. To date, most companies have focused reporting on Scope 1 and 2 emissions. However, it is important to recognise that company emission profiles encompass their supply chains and major contractors, or Scope 3 emissions. This AGM attendance continues LAPFF's participation in the 'Aiming for A' engagement which encourages company progress within the Carbon Disclosure Project's Climate Performance Leadership Index. The Chair, Sir Peter Gershon, noted that LAPFF was the first investor group to raise the issue of progress on monitoring Scope 3 emissions. Identifying the emissions profiles generated throughout complex supply chains also helps to begin to address the deeper issues of climate risk management and the development of adaptation and resilience measures critical to energy supply companies operating vital infrastructure networks.



LAPFF continued its engagement with **Glencore** on carbon management within a discussion on the overall environmental, social and governance risk management processes. Questions were posed both at a sustainability presentation and a separate meeting with the head of the board environment and safety committee. On its carbon management, the company was encouraged to establish emissions reduction initiatives and set associated targets in order to

and to clearly identify links between the initiatives and reductions made. Closer questioning on performance against health and safety metrics indicated a more effective monitoring system being implemented. On board governance, succession planning and gender and other aspects of diversity were addressed.

TARGETING SOCIAL ISSUES

Employment Standards

The issue of modern day slavery is beginning to rise on companies' radars. Recent reports on Asian slave labour helping to produce prawns destined for US and UK supermarkets and the UK Government's Modern Slavery Bill, introduced in June has given a greater focus on transparency in supply chains. For extractive companies such as Glencore, concerns include child labour, artisanal mining and exposure to social risks particularly in countries such as Mauritania.

"It is difficult to accept that modern Britain is home to slavery, but this appalling crime is taking place here - often out of sight - in shops, fields, building sites and behind the curtains of houses on ordinary streets" (Home Secretary Theresa May, BBC, 31 July 2014)

Social and Reputational Risks

LAPFF continues to engage with a range of stakeholders in order to inform better campaign and engagement approaches. Western Sahara Resource Watch (WSRW) requested a meeting to explain its position on company engagement in Western Sahara. Citing a UN legal decision on Western Sahara's right to exploit its natural resources as a Non-Self-Governing Territory, the organisation takes the stance that Morocco is illegally occupying Western Sahara and that therefore foreign companies, particularly phosphate and oil companies, should not be signing contracts with Morocco in relation to projects in Western Sahara. WSRW would like to see the political situation between Morocco and Western Sahara resolved before foreign companies undertake projects in Western Sahara. It believes this resolution would allow companies to engage with Saharawis to ensure that projects are mutually beneficial.

CONSULTATIONS & PUBLIC POLICY

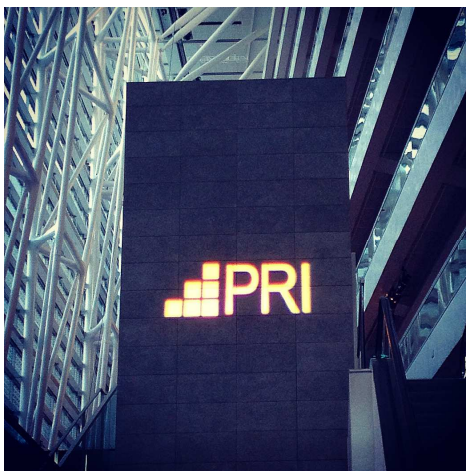
ENGAGING WITH POLICY-MAKERS

LAPFF has co-signed a letter to the International Organisation of Securities Commissions (**IOSCO**) to support working more closely with regulators, stock exchanges and other related parties to improve the disclosure of material and high-quality corporate Environmental, Social and Governance information in the global marketplace.

LAPFF hosted fringe meetings at the **Labour Party Conference** and the **Conservative Party Conference** on 'The Future of the Local Government Pension Scheme.' Speakers included the LAPFF chair, Cllr Kieran Quinn, Henry Boucher of Sarasin and Partners and Cllr Denise Le Gal, Chair, Surrey Pension Fund.

NETWORKS & EVENTS

- **30% Club Investor Group** – 'Next steps for accelerating change' with CEO of Women on Boards
- **Glencore Sustainability Presentation** by Tony Hayward (Chairman), Ivan Glasenberg (CEO) and Peter Coates (Chair of HSEC Committee)
- **CCLA** – event highlighting the importance of collective action on climate change, hosted by St Paul's/CCLA.
- **Threadneedle/UKSIF** event on UK preparations for fracking
- **Clifford Chance** – seminar on whether an arbitration tribunal similar to investment tribunals would be feasible for human rights
- **PRI in Person, Montreal** – included debates on fossil fuel divestment, investor tax responsibility, green bonds, fracking, human rights in extractives and executive remuneration



COMPANY PROGRESS REPORT

| Company | Topics | Outcome |
|-------------------------------|------------------------------------|-------------------------|
| Glencore | Carbon management, board diversity | Small Improvement |
| Textron | Reputational risk, human rights | Dialogue |
| Alliant Techsystems | Reputational risk, human rights | Awaiting Response |
| L-3 Communications | Reputational risk, human rights | Dialogue |
| General Dynamics | Reputational risk, human rights | Awaiting Response |
| Lockheed Martin | Reputational risk, human rights | Dialogue |
| Doosan | Reputational risk, human rights | Awaiting Response |
| Hanwha Corporation | Reputational risk, human rights | Awaiting Response |
| Singapore Technologies | Reputational risk, human rights | Dialogue |
| Hays | Remuneration | Dialogue |
| Astrazeneca | Mergers and acquisitions | Dialogue |
| BAE Systems | Remuneration, board composition | Moderate Improvement |
| Burberry Group | Remuneration | Dialogue |
| BT Group | Remuneration | Dialogue |
| British Land | Remuneration, climate change | Dialogue |
| G4S | Remuneration, human rights | Moderate Improvement |
| National Grid | Carbon management | Dialogue |
| Svenska Handelsbanken | Remuneration | Dialogue |
| National Express | Employment standards | Dialogue |
| Vodafone | Remuneration, tax | Dialogue |
| Betfair | Finance & accounting | Dialogue |
| Sime Darby | Sustainable palm oil | Substantial Improvement |
| Kuala Lumpur Berhad | Sustainable palm oil | Substantial Improvement |
| Asian Agri Resources | Sustainable palm oil | Substantial Improvement |
| IOI Group | Sustainable palm oil | Substantial Improvement |
| Novartis | Holdings Based Engagement | Dialogue |
| Total | Carbon management, fracking | Dialogue |
| Deutsche Telekom | Employment Standards | Dialogue |
| Severn Trent | Remuneration | Dialogue |
| Olam | Sustainable palm oil | Dialogue |

Companies LAPFF has not previously engaged with individually are indicated in bold.

Local Authority Pension Fund Forum Members

Avon Pension Fund
Barking and Dagenham LB
Bedfordshire Pension Fund
Camden LB
Cheshire Pension Fund
City of London Corporation
Clwyd Pension Fund
Croydon LB
Cumbria Pension Scheme
Derbyshire CC
Devon CC
Dorset County Pension Fund
Dyfed Pension Fund
Ealing LB
East Riding of Yorkshire Council
East Sussex Pension Fund
Enfield LB
Falkirk Council
Greater Gwent Fund
Greater Manchester Pension Fund
Greenwich Pension Fund RB
Gwynedd Pension Fund
Hackney LB
Hampshire Pension Fund
Haringey LB
Harrow LB
Hounslow LB
Islington LB
Lancashire County Pension Fund
Lambeth LB
Lewisham LB

Lincolnshire CC
London Pension Fund Authority
Lothian Pension Fund
Merseyside Pension Fund
Newham LB
Norfolk Pension Fund
North East Scotland Pension Fund
North Yorkshire CC Pension Fund
Northamptonshire CC
NILGOSC
Nottinghamshire CC
Rhondda Cynon Taf
Sheffield City Region Combined
Authority
Shropshire Council
Somerset CC
South Yorkshire Pensions Authority
Southwark LB
Staffordshire Pension Fund
Surrey CC
Teesside Pension Fund
Tower Hamlets LB
Tyne and Wear Pension Fund
Waltham Forest LB
Wandsworth LB
Warwickshire Pension Fund
West Midlands PTA Pension Fund
West Midlands Pension Fund
West Yorkshire Pension Fund
Wiltshire CC
Worcestershire CC

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

