

## Appendix 'A'

### Lancashire County Pension Fund

#### Responsible Investment Report

<b>Title of Paper</b>	Quarterly Report on Responsible Investment
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<b>Appendices</b>	<b>Appendix 1: Q1 2016 Litigation Monitoring Report CR&amp;B</b> <b>Appendix 2: ESG Made Simple Guide - PLSA</b>

#### Executive Summary

This report provides members of the Pension Fund Committee of Lancashire County Pension Fund (LCPF) with a quarterly update on Responsible Investment (RI) matters.

This is the first RI report presented since the launch of the Local Pensions Partnership (LPP) and slight alterations in style and appearance reflect the change of context associated with LCPF receiving investment management services as a client of LPP.

#### Introduction

The matters covered within this report reflect the commitment and approach to RI set out within LCPF's Statement of Investment Principles (SIP). The SIP confirms that the objective of RI activity is to decrease investor risk, improve risk-adjusted returns and help the Fund adhere to the UK Stewardship Code through;

- incorporating material extra-financial factors (Environmental, Social and Governance considerations) within investment decisions;
- utilising ownership rights to protect and enhance shareholder value over the long term, primarily through voting and engagement.

The practical implementation of the Fund's commitment to RI involves four areas of activity which are each covered in turn within the report.

1. Voting Globally
2. Engagement through Partnerships
3. Shareholder Litigation
4. Active Investing

## 1. Voting Globally

LCPF owns shares in listed companies across the globe. To ensure consistent and effective use of the voting rights attached to these assets LCPF employs Pensions and Investment Research Consultants Ltd (PIRC) as an external provider of proxy voting and governance services. PIRC analyse and apply voting guidelines to the resolutions at shareholder meetings the Fund is entitled to attend and manage the process of vote execution.

PIRC provide quarterly reports providing a retrospective summary of votes cast and the outcome of voting (where known). A copy of the most recent report covering the period from 1<sup>st</sup> January to 31<sup>st</sup> March 2016 has been placed within the Members Retiring Room for reference. In summary, during the first quarter of 2016 (1<sup>st</sup> Jan to 31 March 2016) the Fund voted at 36 shareholder meetings (19 AGM, 7 EGM) and on 474 separate resolutions. The tables below summarise the geographical spread and the direction of voting in Q1:

Location	Meetings Voted		Vote Categories	No. of Resolutions	%
UK & BRITISH OVERSEAS	2	6%	For	268	57%
EUROPE & GLOBAL EU	7	19%	Abstain	38	8%
USA & CANADA	17	47%	Oppose	104	22%
ASIA	5	14%	Non-Voting (No ballot)	18	4%
JAPAN	1	3%	Withhold	46	10%
AUSTRALIA & NEW ZEALAND	2	6%	TOTAL	474	100%
REST OF THE WORLD	2	6%			
TOTAL	36	100%			

More than half of all resolutions (57%) were supported by the Fund.

Voting against or withholding support for resolutions primarily focussed on

- questions of executive remuneration
- the re-appointment of auditors due to relationships of long standing
- a perceived lack of independence in nominated Non-Executive Directors (NEDs) most often due to their length of tenure.

The Fund also opposed the nomination of NEDs where individuals were known to be simultaneously fulfilling multiple other directorships and were unlikely to be able to give matters sufficient undiluted time and attention.

At the WH Smith Plc AGM the Fund opposed the Remuneration Report due to significant concerns over the excessiveness of CEO remuneration. Whilst the level of fixed pay did not raise major concerns, variable pay for the year under review amounted to 690% of salary which is considered highly excessive. Changes in CEO pay over the last five years do not align with the Company's financial performance over the same period and the ratio of CEO pay compared to the average employee pay is highly excessive at 106:1. The Fund also opposed the Remuneration Policy reflecting that maximum potential awards under all incentive schemes are considered highly excessive, there are no schemes available to enable employees to benefit from business success unless they

purchase shares and the Long-Term Incentive Plan (LTIP) contains no non-financial performance conditions.

The Pensions and Lifetime Savings Association currently has an initiative focussed on executive remuneration. Research underway will result in guidance designed to assist and encourage asset owners to use their voting rights to influence companies to adopt Long Term Incentive Plans which better align with the interests of shareholders by producing financial incentives for strong performance measured against financial and non-financial indicators of both company and individual performance, assessed over a sufficient time period. LPP I will review the guidance once produced with a view to incorporating best practice into its voting approach.

## 2. Engagement through Partnerships

The Fund's engagement activities principally operate through direct relationships between Fund Managers/Investment Managers and investee companies with ongoing efforts focused on supporting companies to be well run, resilient and incorporating high standards of corporate governance.

Wider engagement efforts feature membership of partnerships and collaborations which offer greater reach and wider impact than acting alone. The Fund's principal collaboration within the RI work stream is its membership of the Local Authority Pension Fund Forum (LAPFF) which exists to promote the investment interests of local authority pension funds as asset owners. 70 of the 89 LGPS funds are now members.

LAPFF is LCPF's primary engagement partner and LCPF's interests are routinely represented by the Responsible Investment Officer (LPP I Ltd) who attends quarterly LAPFF Business Meetings, seeks to influence the development of the LAPFF work plan and identifies opportunities for direct participation in key initiatives.

A copy of LAPFF's Q1 2016 engagement report has been placed within the Members Retiring Room for reference and recaps on activities in the period from 1 January to 31 March 2016. Highlights in this first quarter include:

- Strategic Resilience Resolutions co-filed by LAPFF funds  
Building on the success of last year's results at the Shell and BP AGMs, three strategic resilience resolutions have been co-filed for the 2016 AGMs of Glencore, Anglo American, and Rio Tinto. Extra efforts were required by LAPFF and its coalition partners to rally Anglo American shareholders and push the resolution over the co-filing threshold.
- Trends Emerging from Tax Engagement  
LAPFF has received further responses and held meetings with three more companies as part of its ongoing Corporate Tax Transparency Initiative. Engagements reveal a continued reluctance to increase the disclosure of tax practices, even by companies already doing relatively well in this area.

LAPFF's most recent quarterly Business Meeting took place on 19<sup>th</sup> April 2016 and headlines from the meeting included the following matters:

- The LGPS Scheme Advisory Board (SAB) has met under the chairmanship of Cllr Roger Philips. John Richards of UNISON has been appointed Vice Chair. The LAPFF Executive

consider these to be good appointments which will provide the scheme with strong leadership.

- The Executive has received a report on the LAPFF membership structure including early proposals for accommodating the change in landscape arising from pooling. The working party on the LAPFF constitution will continue to take this issue forward.
- Member suggestions which have been added to the LAPFF work plan in 2016 include
  1. a guide to co-filing shareholder resolutions
  2. the collation of information on pooling arrangements under development
  3. engagement on cyber security
  4. engagement on COP21 (climate change)
- Scoping papers will be produced on two larger projects proposed by members. One is a request that LAPFF provides focus/coordination for a collaboration on the disclosure of RI activities undertaken by Fund Managers on behalf of their clients. This request was submitted on behalf of LCPF and LPFA by the LPP I RI Officer and reflects that LGPS schemes share managers and have a common need to hold them effectively to account for their RI efforts.
- Paul Spedding from Climate Tracker Initiative presented a paper commissioned by LAPFF on engagement with the Oil Coal and Gas sector. Very useful insights were given into the risks faced by the sector and the questions investors should be asking in relation to the sensitivity of business planning models and company valuations to oil prices and levels of demand.

### 3. Shareholder Litigation

LCPF is committed to maintaining an up to date understanding of any shareholder litigation it potentially has an interest in. Litigation offers a route for recovering financial losses where asset values have been diminished as a result of financial misconduct and also fulfils the commitment made by signatories to the PRI to engage with investee companies to improve standards of corporate governance.

The Fund receives securities litigation monitoring services at no cost from two US law firms - Barrack, Rodos and Bacine (BR&B) and Robbins Geller Rudman and Dowd (RGRD) who ensure prospective actions are known about, the fund's interest (level of loss) is quantified and information is available as a basis for making decisions on an appropriate course of action given the risks, costs, benefits and deadlines involved in each case. These arrangements continue on the Fund's behalf, managed by LPP I.

The document at Appendix 1 provides a brief summary from BR&B of litigation monitoring during Q1 2016. Reference is made to LCPF having received a distribution from a settlement fund. This relates to an action against Bain Capital Partners LLC/Aramark Corp. as part of a large antitrust class action that contended private equity firms had suppressed competition in certain leveraged buyouts ("LBOs") from 2003-2007 which resulted in shareholders being paid a reduced amount per share for their stock holdings. The recovery received by LCPF in January 2016 was \$146.83. Appendix 1 also makes reference to a claim filed by the Fund's custodian which relates to a case against ITT Educational Services Inc. involving alleged material misrepresentations and omissions concerning the company's liabilities and its failure to disclose that financial statements contained errors reflecting a lack of adequate internal controls over financial reporting. The committee will be informed about any recovery from this action in due course.

The pooling of assets will ultimately mean a change in ownership arrangements for the listed equities managed on behalf of LCPF and LPFA by LPP Investments Ltd. The Fund's

beneficial ownership rights will continue to be well protected once the new arrangements are introduced and LPP I will carefully monitor litigation to ensure the Fund is aware of cases where it has sustained losses and appraised about opt-in, opt-out or independent legal action where this might offer a premium recovery compared with the default approach of participating in class actions.

#### *Royal Bank of Scotland*

As previously reported, the Fund is part of a large group of institutional investors in a group action against Royal Bank of Scotland Group Plc (RBS) under which it is argued that investors suffered losses in connection with a Rights Issue in 2008. The law firm representing our investor group (SL Group Claimants) provides a monthly update on pre-trial progress with the case. However, a requirement for confidentiality around details of the ongoing legal process mean only limited aspects can be reported publicly. Progress is being monitored and LCPF interests (as a claimant) are being reviewed by the County Council's Director of Legal and Democratic Services on an ongoing basis.

Since the last quarterly report to the Pension Fund Committee there have been no further Case Management Conferences (CMC) though a 10<sup>th</sup> CMC is scheduled for 13-15 June 2016.

The SL Group's potential liability for adverse costs remains unchanged, there is no material change to Stewarts Law's and Leading Counsel's estimate of the prospects of success in the litigation and there are currently no new matters or issues Stewarts Law are aware of that might have a material impact on the prospects of success/recovery.

The estimated length of trial remains unchanged at 25 weeks (6 months) beginning in March 2017. However, this period will be interrupted by a two month break for Court vacation during August and September 2017.

#### 4. Active Investing

LCPF's commitment to active investing involves considering the wider characteristics of investment opportunities by identifying positive social characteristics and potentially negative impacts and allowing these to be taken into account as part of decision-making. The commitment is fulfilled in practice by incorporating the consideration of relevant Environmental, Social and Governance (ESG) factors into investment due diligence.

The Pensions and Lifetime Savings Association has recently added to its "Made Simple" guides with the publication of a volume focussed upon ESG. A copy of the guide is provided at Appendix 2 and it offers Committee members helpful insight and an up to date summary of the benefits and challenges associated with ESG as a complementary way of viewing investment risk. The guide may help to enrich the Committee's further thinking about RI and fiduciary duty including the way in which this translates into actions undertaken by LPP as its provider of investment services.

Within the last 12 months LCPF has invested additional time and resources to increase its focus on RI matters. This has coincided with growing emphasis on ESG within the media and explicit reference by the DCLG within its consultation on asset pooling and the revision of LGPS investment regulations. The DCLG is yet to publish its response to the consultation (which prompted a strong reaction to a proposed embargo on politically driven screening and received more than 23,000 submissions). Nevertheless, the



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agreement to prioritise an RI sub group to the LGPS Cross Pool Collaboration Group has demonstrated a recognition of the importance of RI/ESG as part of future arrangements for pooled investment stewardship. Each developing pool has nominated a representative to attend the RI sub-group.

The new group will act as practical forum for sharing ideas and best practice and tackling the issues which arise from pooling including the harmonisation of existing policies and approaches and ensuring each fund's interests as an asset owner are represented. The group will also aim to align and place the collective strength of the LGPS behind initiatives which support the long term interests of Local Authority pension funds as asset owners on behalf of fund beneficiaries, reflecting that pooling is set to increase the scale of joint investments and with it the potential influence of the LGPS an institutional asset owner.

The RI sub-group is chaired by the Chief Pensions Officer of the Environment Agency Pension Fund and has already held its first meeting. The interests of LCPF, LPFA and other clients of LPP will be represented by the RI Officer who will participate in the development of a work plan focussed on priorities and support the success of collaborations and wider cross pool initiatives which develop from this.